Revising European Safeguards and Antidumping Provisions in Light of the Chinese WTO Accession

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Dedication

I would like to dedicate this thesis to my loving parents, without whose support I would never have finished this thesis. I am grateful to their many encouragements. I also dedicate this work to all my international friends, who greatly encouraged my academic curiosity.

Abstract*

In November 2001, the WTO members allowed the People's Republic of China, a formerly planned economy that is going through different stages of domestic economic and related legal restructuring, to accede to the WTO. This accession is believed to be necessary for the WTO to become a truly international organisation in the post-Cold War era, along side of the IMF and the World Bank, and for China to become an integrated member of the international economic community. Although the end of the Cold War has changed European trade policy profoundly, the European Community (EC)** has maintained a traditionally bifurcated trade policy, in which planned economies, also referred to as "non-market economies", are given treatment different from market economies in trade policy instruments, such as the EC emergency safeguards provisions and EC anti-dumping regulation.

The EC perceives the Chinese domestic legal and economic reforms as unfinished; and, although the treatment of Chinese products under the EC import and anti-dumping regulations has been liberalised in recent years, China is still generally considered to be a non-market economy. It is questionable whether in light of China's WTO accession such a non-market approach *vis-à-vis* China, as approved in the Chinese Protocol of Accession, is justified. This thesis argues that the non-market approach for China, as it stands today, should be adjusted for two basic reasons. First, this approach does not allow China to benefit fully from its WTO accession for a number of years to come. Second, as long as the period allowing non-market economy treatment continues, the danger exists that the non-market economy trade policy, especially as far as anti-dumping is concerned, may tend to be abused for protectionist purposes by the EC.

Protectionist abuse would be harmful for China because its export-oriented growth is necessary to advance the country's domestic legal and economic reforms. Protectionism, equally, would be harmful for the EC because it prevents the Community industry from adjusting itself to face the challenge of increased Chinese competition. Because there is no satisfactory methodological solution to deal with the new variant of non-market economies, and because it is impossible for China - despite all good intentions - to implement fully the WTO accession requirements by the time they must phase in, the suggested approach is for the EC to show restraint in employing these trade policy instruments against China. As far as emergency safeguards are concerned, this restraint is already a fact. Nonetheless, some holdovers from the Cold War should be put up for change. Such adjustments will also be required for the EC anti-dumping regulation.

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* This volume speaks as of 1 August 2002, unless otherwise expressly indicated; and, it composes 98.376 words in the text proper.

** As indicated hereafter, "EC" is the preferred term over "EU" for purposes of this volume.

Introduction

Since its creation in 1995, after the end of the Cold War, the WTO as one of the "Bretton Woods institutions", faces the challenge of admitting members, which under communist rule developed a different economic and legal system[1]. Although similar challenges occurred in the 1960s and 1970s during the then GATT era when countries like Poland, Hungary and Romania became contracting parties[2], it is noted that many traditionally planned economies, which nowadays seek WTO membership, have embarked on profound domestic economic and legal reforms. These countries find themselves in different stages of "transition" and are hence often referred to as "transition economies"[3]. After fifteen years of negotiations and more than two decades of domestic economic and legal reform the People's Republic of China (PRC or China) became a member of the WTO. This accession is definitely one of the most significant events in post-World War II history. The Chinese accession is unprecedented, because the Chinese market is massive and certain economic sectors, such as textiles, have reached high levels of sophistication; whereas, for other sectors of the economy, China should still be considered as a "developing country". The Chinese accession is also unique, because the country, due to its past, stands culturally remote from the Western legal and economic values that have traditionally underpinned the WTO and because its economic structure is perceived to be different from that of the majority of the WTO membership base[4].

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[1] HALE, D., "Global Economic Integration After the Cold War", in UZAN, M. (Ed.), *The Financial System Under Stress*, London, Routledge, 1996, p. 81-131. See also BELLO, J. and HOLMER, F., "After the Cold War: Whither International Economic Law?", 32 *Harvard Int'l L. J.*, Spring 1991, n° 2, p. 323-329.

[2] See generally KOSTECKI, M., East-West Trade and the GATT System, New York, St. Martin's Press, 1979; and KOSTECKI, M., State Trading in International Markets: Theory and Practice of Industrialised and Developing Countries, New York, St. Martin's Press, 1982.

[3] See, *e.g.*, MARER, P. and ZECCHINI, S. (Eds.), *The Transition to a Market Economy*, OECD, Paris, 1991, p. 184-201.

[4] On the Chinese WTO accession, see, *e.g.*, CHANG, G., *The Coming Collapse of China*, London, Random House, 2001; STUDWELL, J., *The China Dream – The Elusive Quest for the Greatest Untapped Market on Earth*, London, Profile Books, 2001; and CLIFFORD, M. and PANITCHPAKDI, S., *China and the WTO – Changing China, Changing World Trade*, Singapore, John Wiley & Sons, 2002.

It is a challenge for the WTO to find ways to reconcile the Chinese economy in transition with the economies of its predominantly capitalist membership base, such as the European Union[5] (EU) and its member countries. In this regard it is important to build an "economic interface", to use a term coined by John Jackson[6], which can alleviate the possible trade friction that arises between nations when their economic systems have not sufficiently converged. Trade policy instruments such as emergency safeguards, antidumping and countervailing duty laws are among the more traditional remedies that can help to interface the structural differences that exist between economies. The Chinese Protocol of Accession[7] and the Working Party Report[8] on China's WTO accession acknowledge the structural differences that exist between the Chinese economy and that of other WTO members. To this end, the sections in these documents dealing with emergency safeguards, antidumping and countervailing duties are a strong reminder of China's special economic status. These sections allow WTO members to continue to regard China as a non-market economy (NME) or state-trading economy after its accession for a certain number of years to come. A purpose of this thesis is to examine further the treatment of China under the trade policy instruments of the European Community (EC)[9], in particular as far as emergency safeguards and antidumping is concerned and to question in particular whether the special treatment of China as a NME or state-trading economy is justified, especially given the fact that there are no clear economic or legal criteria to mark China's graduation from such treatment; and, the fact that the decision to treat China as such is judicially non-reviewable. It seems that despite significant efforts made by China to gain

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[5] It should be noted that the European Union has a limited legal personality; and, in terms of trade policy instruments, it is more correct to speak about the European Community and the European Steel and Coal Community as far as coal and steel products are concerned. In this volume European Community or EC is therefore the preferred term when dealing with antidumping and safeguards, also because the trade policy instruments considered are those of the European Community unless mentioned otherwise.

[6] See JACKSON, J., "United States Policy Regarding Disruptive Imports from State Trading Countries or Government Owned Enterprises", in WALLACE, D., SPINA, G. *et al* (Eds.), *Interface One – Conference Proceedings on the Application of US Antidumping and Countervailing Duty Laws on Imports from State-Controlled Economies and State-owned Enterprises*, The Institute for International and Foreign Trade Law, Washington DC, 1980, p. 1.

[7] WTO, Working Party on the Accession of China, Report of the Working Party on the Accession of China, WT/ACC/CHN/49

[8] Idem.

[9] See *supra* note 5.

accession to the WTO, the EC still uses the ongoing, and thus unfinished, domestic reforms as an excuse to continue NME or state-trading features of its trade policies with regard to safeguards and antidumping which, especially in the case of antidumping, can be abused for protectionist aims.

If China wishes to avoid being labelled a NME or state-trading economy, one of the more pressing reforms the country needs is to disentangle government from business[10]. This disentanglement, to be successful, should be "rule-based" and is most probably only possible through acceptance of the "rule of law"[11]. Much to the disappointment of many authors the 'old' state economy has not withered away to create an entirely private economy in China[12]. The main reason for the survival of many state-owned enterprises (SOE) is that ridding the economy of these inefficient enterprises involves heavy social costs and would jeopardise the country's political stability. Reforms are therefore bound to be partial, notwithstanding the serious efforts by the Chinese government to rationalise and to revitalise the state economy. Numerous legal measures try to establish financially autonomous and competitive SOEs independent from bureaucratic overreaching, and try to force these enterprises to make commercial decisions in line with market considerations as required by Article XVII GATT. Although weaknesses remain inside the Chinese corporate governance system, it is most probable that, because of the decentralisation of the state economy there no longer exists a danger for concerted economic policy action by the government in the state sector to undermine GATT/WTO obligations in view of Article XVII. However, this does not mean that, on the micro-economic level, all bureaucratic meddling with day-to-day management of SOEs is completely rooted out.

For the divestiture of state assets and the disentanglement of the government bureaucracy from business, China will need to embrace a "rule-orientation" as to its economic law

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[10] This will be exemplified in the second chapter. It suffices to note here that industry and commerce in China is tied to various layers of the Chinese administration.
[11] See further below in the next paragraph.
[12] See, *e.g.*, WOO, W., PARKER, S. and SACHS, J. (Eds.), *Economies in Transition – Comparing Asia and Europe*, Cambridge, MIT Press, 1997.

infrastructure. As far as the implementation of the rule of law in China is concerned, many Western scholars preach vigilance[13]. Creating a legal system is more than to increase legislative activity; the legal system should also be able to permeate the legal consciousness of the people living in the region undergoing reform. Moreover, Western influence on this point raises the question of "transplantability" of Western social and political institutions and laws in state-building. The last twenty-five years, China has had to establish a legal system from scratch and it is impossible on such a short notice to cast the foundations of a legal system that is suitable to implement, to monitor and to enforce laws and implementing regulations that are formulated and accepted along WTO standards. In this regard it is important to look at what guidance can be expected from Article X GATT and related WTO provisions, because these set out the standards to which the Chinese legal system will have to live up.

At this point I would like to clarify to the reader my use of the terms "rule of law" and "market economy". I take a minimalist and restrictive approach to these terms, while recognising that there are a wide range of views as to what these principles comprise and that there is not full concurrence even among the major Western powers. My use of the term 'rule of law' is limited to the issues involving the infrastructure of economic laws, though these issues can be interconnected with wider constitutional and human rights issues. In writings about Chinese law the authors will draw the attention to the difference between Chinese 'rule by law' and Western 'rule of law' to explain the Chinese instrumental use of law[14]. This instrumental use of law can also be found in 'law and economics', for which the law is an instrument to facilitate the market[15]. The adoption by China of the rule of law as a Western legal-philosophical concept is not an issue discussed in this thesis. The compliance with the rule of law for the purpose of this thesis

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[13] See, *e.g.*, CHEN, A., "The Developing Theory of Law and Market Economy in Contemporary China", in WANG, G. and WEI, Z. (Eds.), *Legal Developments in China – Market Economy and Law*, Hong Kong, Sweet & Maxwell, 1996, p. 3; CLARKE, D., "Regulation and its Discontents: Understanding Economic Law in China", 28 *Stan. J. Int'l L.*, Spring 1992, p. 287; COHEN, J., "Is there Law in China?", in LEE, T. (Ed.), *Basic Concepts of Chinese Law*, New York, Garland, 1997, p. 1; and LUBMAN, S., "Dispute Resolution in China after Deng Xiaoping: 'Mao and Mediation' Revisited", 11 *Colum. J. Asian L.*, Fall 1997, p. 229.

[14] Idem.

[15] See, *e.g.*, COOTER, R. and ULEN, T., *Law and Economics*, New York, Addison-Wesley, 1996.

is rather the compliance with minimally acceptable economic law standards of the major Western countries to facilitate world trade. On free 'market economy' I take the textbook view that such an economy is primarily based on prices, which are the result from supply and demand, though I concede of course that most Western economies are mixed economies to varying degrees. For the purpose of this thesis I should add that in market economies enterprises should normally make commercial decisions in line with these price-based market considerations.

Although the economic and legal reform efforts should advance China's integration into the WTO, the rise of a large powerful economy in Asia may spark new trade tensions as well. The constant search for new export markets may pose a central problem in this regard[16]. The expansion of exports is often seen as the only factor in the long-run that determines the development prospects of any transition economy, and the low-cost structure of a country like China may threaten jobs in more mature economies, such as in the EC. These threats may eventually cause the European international cooperation to slow down. The Chinese export-oriented growth policy exacerbates the EC's trade balance, which shows a considerable trade deficit with China. However, the chances for a successful restructuring of the Chinese economy, improving efficiency and raising living standards will not be very encouraging if exports cannot be expanded. For this reason the protectionist abuse of trade policy instruments to prevent Chinese exports to reach the European market would harm the Chinese reform process. The solutions dealing with trade imbalances are fairly limited, but for the EC to unduly restrict imports from China is definitely not the correct one. It is therefore questionable whether emergency safeguards and antidumping actions really advance the situation of the Community industries involved.

The challenge the EC has to face up to rather lies in responding to the increased Chinese competitiveness in certain economic sectors by allowing or inducing resources to shift

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[16] See COOPER, R. and GACS, J., *Trade Growth in Transition Economies*, Cheltenham, Edward Elgar, 1997; and CRANE, K., "The Costs and Benefits of Transition", in *East-Central European Economies in Transition*, Joint Economic Committee Congress of the United States, Study Papers, Washington DC, 1994, p. 25.

where new opportunities for more efficient use are emerging. Increased protectionism as a trade policy response *vis-à-vis* China would run the risk for the EC of being frozen in existing inefficiencies, whereas it would be better to continue the search and to struggle for remaining competitive strength. The relevant Community industries should realise that there is no turf that can be preserved forever for any country or group of countries[17]. Only if the EC continues to respond to change, it need not fear of being converted into an industrial desert. To advance this aim, it is crucial to alter trade policies such as antidumping legislation in ways that would make them less conducive to seizure for protectionist purposes. The profile of a protectionist abuser is a petitioner which has lost its comparative advantage in manufacturing merchandise to a respondent which makes the same or similar merchandise, and which is unwilling to reduce its cost structure to meet global competitive pressures, fails to incorporate technological innovations in his manufacturing process and product design, or is insensitive to changes in consumer tastes[18]. It should be the EC's aim to circumscribe the trade laws so as to minimise the risk of giving protectionist abusers a chance.

Whereas the EC has shown great restraint in employing emergency safeguard measures under the Uruguay Round Agreements after the creation of the WTO, it has not done so as far as antidumping measures are concerned[19]. The EC is reluctant to use emergency safeguard measures and seems to share the same approach as the WTO Appellate Body in this regard, which reserves the use of emergency measures in cases where it is truly necessary[20]. What complicates matters is the multitude of safeguards clauses that exist in European trade law. First of all there are safeguards clauses in bilateral trade agreements between the EC and China. Secondly, there are the safeguards clauses in several of the EC's import regulations, of which some are a transposition of Article XIX GATT and the relevant provisions of the WTO Agreement on Safeguards or Article 6 of the Agreement

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[17] PATEL, I., "The Adjustment Problem", in Trade Policies for a Better Future – The 'Leutwiler Report', the GATT and the Uruguay Round, Dordrecht, Martinus Nijhoff, 1987, p. 87.
[18] See BHALA, R., "Rethinking Antidumping Law", 29 *Geo. Wash. J. Int'l & Econ*, 1995, p. 1.
[19] China is the country of origin most frequently subjected to European antidumping measures. See chapters three and four.
[20] Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products, WT/DS98/AB/R; and Argentina – Safeguard Measures on Imports of Footwear, WT/DS121/AB/R.

on Textiles and Clothing. Others appear to be holdovers from the Cold War and are only applicable to certain imports from state-trading countries or NME countries, such as China. It is especially the latter sort of safeguards clause that may not comply with WTO requirements in case it would still be invoked. Although section 16 of the Protocol of Accession allows for a safeguard mechanism to be invoked against China with a lesser injury standard, this section seems to mimic the language of section 406 of the 1974 US Trade Law, which deals with a market disruption clause. Because the EC has no such equivalent of a market disruption clause and because the safeguards clauses applicable to certain imports from state-trading countries such as China use a different language, they may not survive WTO dispute resolution, and may therefore have to be changed or abolished altogether[21].

As far as antidumping measures are concerned the EC has not shown reserve. Chinese imports have suffered much from antidumping measures and unfortunately the antidumping methodology as applied to NME countries such as China is rife with opportunities for protectionist abuse[22]. The WTO texts and in particular its Antidumping Agreement do not offer much guidance as to how to arrive at a proper price comparability in determining dumping from NME countries. Usually, as is also the case for EC antidumping legislation, the normal value in dumping investigations concerning a NME country is based on information from companies located in a third market economy country, referred to as the analogue country. Section 15 of the Chinese Protocol of Accession explicitly allows for this methodology to be used in the fifteen years after China's accession. However, since 1998, the European antidumping regulation gives, on a case-by-case basis, the right to individual Chinese companies to prove that they operate along market economy conditions in accordance with certain criteria contained in the regulation. Where they can prove this to be the case, dumping allocations for the company are based on their own domestic prices and costs, instead of making reference to information from an analogue country. Although this amendment did not grant full market economy status to China nor disallows the NME methodology, the position of the

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[21] See chapter three for the full argumentation.
[22] These opportunities will be identified in chapter four.

country's imports has improved somewhat. Similarly, the position of Chinese imports has improved because European antidumping authorities have agreed in certain cases to calculate individual antidumping margins for cooperating Chinese exporters. This is a departure from the general rule by which antidumping authorities would not establish individual antidumping margins, referred to as individual treatment. The general refusal to grant individual treatment has been justified on the grounds that companies from NME countries have a limited degree of independence in their relationship with importers as they are unable to establish export prices and any other conditions or terms of sales by themselves, which may lead to circumvention of antidumping duties by channelling them through the trading company or NME producer with the lowest antidumping duty rate. Notwithstanding these improvements there still is scope for better treatment of Chinese imports into the EC.

To expand the foregoing paragraphs this thesis is divided into five chapters. The first chapter deals with the challenge the WTO faces in integrating transition economies such as China. It also points out how remote China is from some of the cultural, economic and legal underpinnings of the WTO. It also argues that, although each accession is unique and that the initial conditions of Chinese membership are different from other transition economies, there also exists a "thin consensus" in how these countries should step up economic and legal reforms in order to integrate successfully. The second chapter focuses on some of the important geo-political stages of Chinese accession. It discusses at great length the more than two decades old Chinese domestic economic and legal related reforms in light of Articles X and XVII GATT. And, in so doing, it asserts that if China wants to shed its state-trading label to become accepted as a true market economy it needs to convince WTO members that by embracing the rule of law it can disentangle the government from business in the form of SOEs. Subsequently the third and fourth chapters focus on the European trade policy in dealing with the special nature of the Chinese economy. In the third chapter quantitative restrictions and emergency safeguards are examined as a response to increasing competition of Chinese imports. The fourth chapter looks more specifically at the antidumping policy of the EC *vis-à-vis* China. Finally, the fifth chapter draws some conclusions.

It may come as a surprise that this thesis, although dealing with safeguards and antidumping, would not look into subsidies and countervailing measures. The reason is simply because traditionally subsidy cases were never brought against NME countries, because the determination of a subsidy or bounty in a planned economy was practically impossible in a country where every detail of the economy seemed to depend on government funding or subsidisation[23]. It can therefore be argued that the use of antidumping measures against these countries is a substitute for the lack of possible countervailing duty cases. This situation may be turned around sooner or later when domestic economic reforms will allow subsidies to be better defined and determined.

It should further be noted here that although this thesis deals with European law, sometimes references are made to relevant US law and practice; and, finally, I wish to note that the research for this thesis was completed in July 2002 and therefore speaks as of 1 August 2002.

Jan Hoogmartens,

London, 1 August 2002

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[23] See, *e.g.*, HORLICK, G. and SHUMAN, S., "Nonmarket Economy Trade and US Antidumping/Countervailing Duty Laws", 18 *Int'l Lawyer*, Fall 1984, p. 807; and LANTZ, R., "The Search for Consistency: Treatment of Nonmarket Economies in Transition under United States Antidumping and Countervailing Duty Laws", 10 *Am. Univ. J. Int'l L. & Pol'y*, Spring 1995, p. 993.

Chapter One: Of Bretton Woods, The WTO and The Integration of Transition Economies – Background

In 1944 Allied Forces met in Bretton Woods, New Hampshire, to discuss an international monetary and economic system to rebuild and maintain economic and financial order to establish long-term peace. Today the International Monetary Fund (IMF), the World Bank (or hereafter Bank) and their long-lost sister the World Trade Organisation (WTO) are influential in allocating financing, capital, trade and economic growth. The monetary affairs and trade policies under their influence go hand in hand. More than half a century

later these organisations still play an important role in balancing the world's economic system.

Since its creation in 1995, after the end of the Cold War, the WTO as part of the Bretton Woods institutions faces the challenge of admitting members, which under communist rule developed a different economic and legal system. Similar challenges occurred in the 1960s and 1970s during the then GATT era when Poland, Hungary and Romania joined its predominantly capitalist membership base[24], except that nowadays the large majority of these formerly planned economies have embarked on profound domestic economic and legal reforms modelled on the - all be it illusive - principles of free market economy and rule of law. These countries find themselves in different stages of transition, and hence are often denominated as economies in transition or transition economies. Although the reasons for these profound domestic reforms may differ from country to country, these restructuring processes can be seen as an important step in improving their economies' integration in the Bretton Woods monetary and economic system. In this regard the recent Chinese WTO accession and integration is a hotly debated topic in international economic law and explored further in this thesis.

In integrating these transition economies, the WTO plays a crucial role because IMF and World Bank membership normally do not require domestic policy reforms as profound as are required for WTO membership. This chapter discusses the domestic reforms these countries have embarked on, and it is argued that for the integration of transition economies to work well, there ought to be created by these countries some regulatory framework to support the development and maintenance of a transparent and stable economic environment conducive to efficient private sector activities, which comes close to what the Bretton Woods institutions understand to be an important facet of good economic governance. Furthermore, a transparent legal system with judicial access advances and helps the integration into the Multilateral Trading System (MTS). At the same time the MTS will also need rules to cabin the risks and the costs of integration, with a sufficient amount of flexibility to make swift adjustments to changing

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[24] Of the original 23 Contracting Parties in GATT 1947 Cuba, the Czech Republic and China later came under Communist rule, but by far the GATT consisted of a group of capitalist countries.

circumstances and to find compromises when necessary. In this regard WTO emergency safeguards and antidumping might have an important role to play.

This chapter will begin with a sketch of the Bretton Woods international economic and financial order and the challenges ahead caused by transition economies joining the WTO's Multilateral Trading System. It will then move on to discuss briefly the role of the WTO in integrating these economies into the global economy. Subsequently much time is devoted to the process of domestic restructuring, which involves the adoption of market economic principles and a functioning legal system. Throughout this chapter special attention is paid to these issues in light of the Chinese WTO accession. However, it will not be until the next chapter that the Chinese domestic reforms are discussed in much greater detail to develop the main argument that the European Community (EC) and the United States (US) still use the ongoing domestic Chinese economic and legal reforms as an excuse to maintain special trade policies with regard to safeguard and anti-dumping measures inherited from the communist era to treat China differently. As will be argued in subsequent chapters, these policies should be amended or abolished, in so far as they are outdated, abusive and inadequate.

I. Bretton Woods, Free Trade and the World

At the end of World War II, two worlds, ideologically and militarily, confronted each other, thereby espousing two different approaches to achieve prosperity and social change. Each side was drawing its own lessons from the terrible consequences of the economic disasters of the inter-war years. On one side of the spectrum, liberals considered economic interdependence to create positive bonds among peoples and to promote harmony of interest among societies. On the other side nationalists and Marxists regarded trade as pernicious, because economic specialisation and interdependence would make states insecure and vulnerable[25]. The memory of this event impresses upon us how closely the fortune of free trade remains tied to prospects for peace and how international

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[25] About these two theories of international trade, see GILPIN, R., *The Political Economy of International Relations*, Princeton, Princeton University Press, 1987, p. 172ff. See also the discussion at the beginning of the book at p. 25ff.

politics affects international trade[26]. A glance along the horizon from Korea to the Balkans to Rwanda and the Middle East will remind us how far we still are from the ideal of an international civil society, and how important it is that steady, sustained efforts in that direction be made[27]. According to liberals the promotion of peace should encompass the promotion of international trade[28].

As a result of this ideological split between a liberal capitalist and a socialist bloc, international economic law reflected for many years a bipolar character to guarantee international stability[29]. Since the end of the Cold War the current international system is described by one commentator as:

"[A] liberal international order, which comprises a degree of order, but no over-arching governmental structures; a continued diversity of types of States and political systems; a broad consensus, but not unanimity, on market economies; and a degree of consensus on democracy, but without general agreement on the forms and true content that it should assume".[30]

Within this international system the pace of international economic activity and the interdependence of national economies is head spinning. Because this activity often

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[26] See, *e.g.*, DELORS, J., "The Future of Free Trade in Europe and the World", 18 *Fordham Int'l L. J.*, March 1995, p. 715-725.

[27] See, *e.g.*, ALBRIGHT, M., "International Law Approaches in the 21st Century: A US Perspective on Enforcement", 18 *Fordham Int'l L. J.*, May 1995, p. 1595-1606; UL HAQ, M., JOLLY, R., STREETEN, P. and HAQ, K. (Eds.), *The UN and the Bretton Woods Institutions – New Challenges for the 21st Century*, New York, St. Martin's Press, 1995 and BOARDMAN, R., *Post-socialist World Orders: Russia, China and the UN System*, London, St. Martin's Press, 1994. About the direct role of Bretton Woods institutions in international peace and security, see CIORCIARI, J., "A Prospective Enlargement of the Roles of the Bretton Woods Financial Institutions in International Peace Operations", 22 *Fordham Int'l L. J.*, December 1998, p. 292-354.

[28] GILPIN, *o.c.*, *supra* note 25, p. 172. See also FABRICIUS, F., "The Universal and Regional Harmonisation of International Trade Law as a Means of Maintaining World Peace", in SCHMITTHOFF, C. and SIMMONDS, K. (Eds.), *International Economic and Trade Law – Universal and Regional Integration*, Leyden, Sijthoff, 1976, p. 201-225.

[29] See, *e.g.*, FABRICIUS, *o.c.*, *supra* note 28, p. 202-3. The author notes that international trade law must harbour the germ of conflicts and that to maintain peace is the dominant aim of a legal system. This delicate balance in international trade law can also be found in LOWENFELD, A., *Trade Controls for Political Ends*, New York, Matthew Bender, 1983 (dealing with the controls on trade with communist countries and the patterns of evolution in East-West trade). For further reference, see also WOLF, T., *US East-West Trade Policy*, London, Lexington Books, 1973 and POLLARD, R., *Economic Security and the Origins of the Cold War 1945-1950*, New York, Columbia University Press, 1985.

[30] HIGGENS, R., "International Law in a Changing International System", 58 *Cambridge L. J.*, March 1999, n° 1, p. 78-95, at p. 81-82.

crosses borders it escapes the reach of much of national government control[31]. This phenomenon is often referred to as globalisation[32]. A broad inventory of subjects as diverse as insurance, brokerage, product health and safety standards, environmental protection, banking, securities and investment, professional services such as medical and legal, and many more, can be covered by international economic law. Notwithstanding this very broad inventory, the core aspects of international economic regulation are found in the three Bretton Woods institutions[33]: the International Monetary Fund[34] (IMF), the World Bank Group[35] (World Bank or Bank) and the World Trade Organisation[36] (WTO),

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[31] See, *e.g.*, JACKSON, J., "Interdisciplinary Approaches to International Economic Law: International Economic Law: Reflections on the 'Boilerroom' of International Relations", 10 *Am. U.J. Int'l L.&Pol'y*, Winter 1995, p. 595-606, at p. 595. Illuminating in this regard is also STEWART, M., *The Age of Interdependence*, Cambridge MA, MIT Press, 1984, p. 28-29 (discussing the impact of greater interdependence). See also SCHACHTER, O., "The Erosion of State Authority and Its Implications for Equitable Development" in WEISS, F. *et al.* (Eds.), *International Economic Law with a Human Face*, The Hague, Kluwer Law, 1998, p. 31-44 (noting that capitalism and global markets may be stateless, but that markets in one way or another need regimes that may go beyond the province of the state. Nevertheless, states will continue to play a major role in the creation and application of these legal and quasi-legal regimes); and MALANCZUK, P., "Globalisation and the Future Role of Sovereign States", in WEISS, F. *et al.* (Eds.), *International Economic Law with a Human Face*, The Hague, Kluwer Law, 1998, p. 45-65 (noting that sovereignty still is the cornerstone of international law).

[32] For some meanings of globalisation, see WALKER, G. and FOX, M., "Globalisation: An Analytical Framework", 3 *Global Legal Studies J.*, n° 2, at www.law.indiana.edu/glsj/vol3/no2/walker.html (last visited 4 August 2000). Authors note that globalisation differs from internationalisation because the erosion and irrelevance of national boundaries in markets only underlies the former concept. Because of technological progress geographical constraints recede and this adds to a sense of increased interconnectedness. For similar views see also DELBRUCK, J., "Globalisation of Law, Politics, and Markets – Implications for Domestic Law: A European Perspective", 1 *Global Legal Studies J.*, at www.law.indiana.edu/glsj/vol1/delbruck.html (last visited 4 August 2000). For further reference, see also RODRIK, D., *Has Globalisation Gone too Far?*, Institute for Int'l Econ. L., Washington DC, 1997; FOREMAN-PECK, J., *Historical Foundations of Globalisation*, Cheltenham, Edward Elgar Publishing, 1998; and TILLY, R., WELFENS, P. (Eds.), *Economic Globalization, International Organizations and Crisis Management*, Berlin, Springer, 2000.

[33] Called after the conference held at Bretton Woods, New Hampshire, in July 1944. See *United Nations Monetary and Financial Conference*, Bretton Woods, New Hampshire, July 1-22, 1944, Department of State, Vol. I-II (proceedings and documents). See also VAN DORMAEL, A., *Bretton Woods – Birth of a Monetary System*, Hong Kong, Macmillan Press, 1978.

[34] See, e.g., GOLD, J., Membership and Nonmembership, IMF, Washington DC, 1974, and GOLD, J., Interpretation: The IMF and International Law, London, Kluwer Law, 1996. See also GOLD, J., Legal and Institutional Aspects of the International Monetary System: Selected Essays, IMF, Washington DC, 1984; and DE VRIES, M., The IMF in a Changing World, 1945-1985, IMF, Washington DC, 1986.

[35] The World Bank Group comprises the IBRD, IDA, IFC, MIGA and ICSID. See *e.g.* WORLD BANK, *World Bank Operations*, Baltimore, John Hopkins University Press, 1972; MASON, E. and ASHER, R., *The World Bank Since Bretton Woods*, The Brookings Institution, Washington DC, 1973; SHIHATA, I., *The World Bank in a Changing World*, The Hague, Kluwer Law, 1995; KAPUR, D., LEWIS, J. and WEBB, R. (Eds.), *The World Bank – Its First Half Century*, The Brookings Institution, Washington DC, Vol. 1-2, 1997.

[36] The charter establishing the World Trade Organisation was signed at a ministerial meeting in Marrakesh on 15 April 1995. See JACKSON, J., *The World Trading System – Law and Policy of International*

which emerged from a transformed General Agreement of Tariffs and Trade (GATT), and was originally conceived as the International Trade Organisation (ITO)[37]. Of course the WTO or the three Bretton Woods institutions cannot deal with all these matters in a comprehensive way. Consequently initiatives have emerged from diverse sources such as the Organisation for Economic Co-operation and Development (OECD).

A. Managing the World Economy

International lawyers and scholars have helped elucidate the crucial compromises during the formative era of Bretton Woods institutions, the institutions' evolution through post-war reconstruction, economic recovery, and the trend toward more equal collaboration among developed countries, allied in the OECD, and developing countries[38]. The recent

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Economic Relations, Cambridge MA, The MIT Press, 2nd ed., 1997, p. 45-46. The same story line can also be found in the beginning chapters of JACKSON, J., *The World Trade Organisation – Constitution and Jurisprudence*, London, Royal Institute of International Affairs, 1999. The WTO was designed after negotiations were launched with the ambitious Punta del Este Declaration in the Uruguay-Round (1986-1995). By 1990 Canada proposed a new institution bearing the present name. The European Community supported the idea of a "Multilateral Trade Organisation" (MTO). This proposal ended up in the Dunkel Draft, called after then GATT director-general Arthur Dunkel, and led after intense negotiations in 1993 to a draft charter acceptable to the US as well. See also DILLON, T., "The World Trade Organization: A New Legal Order for World Trade?", 16 *Mich. J. Int'l L.*, Winter 1995, p. 350-402; and VERNON, R., "The World Trade Organisation: A New Stage in International Trade and Development", 36 *Harv. Int'l L. J.*, Spring 1995, p. 329-340.

[37] This history starting with the Bretton Woods system in 1944 is clearly depicted in Ch. 2 of JACKSON, *o.c.*, *supra* note 36, 1997, p. 31-46; and JACKSON, *o.c.*, *supra* note 36, 1999, Ch. 1-2, p. 1-35. Next to the International Monetary Fund (IMF) and the World Bank, the Bretton Woods system, devised to safeguard monetary and economic stability after the disaster of World War II, was supposed to comprise a third leg *viz.* the International Trade Organisation (ITO). Basically because the war momentum had faded away by 1947, only the precursor to the ITO, the GATT, came into existence. This temporary solution provided for in the Provisional Protocol of Accession (PPA), became a permanent *de facto* organisation until the Marrakesh meeting (see *supra* note 36). About the GATT, see also DAM, K., *The GATT Law and International Economic Organisation*, Chicago, University of Chicago Press, 1970; LONG, O., *Law and its Limitations in the GATT Multilateral Trade System*, Dordrecht, Martinus Nijhoff, 1987; and HUDEC, R., *The GATT Legal System and World Trade Diplomacy*, New Hampshire, Butterworths, 2nd ed., 1990. Interesting literature in this regard is also BRONZ, G., "An International Trade Organization: The Second Attempt", 69 *Harv. L. Rev.*, January 1956, p. 440-482; HANSEN, M. and VERMULST, E., "The GATT Protocol of Provisional Application: A Dying Grandfather?", 27 *Colum. J. Transnat'l L.*, 1989, p. 263-308; DEMARET, P., "The Metamorphosis of the GATT: From the Havana Charter to the World Trade Organisation", 34 *Colum. Transnat'l L.*, 1995, p. 123-171; and MOORE, P., "The Decisions Bridging the GATT 1947 and the WTO Agreement", 90 *Am. J. Int'l L.*, April 1996, p. 317-328.

[38] See generally VAN DORMAEL, *o.c.*, *supra* note 33; DE VRIES, *o.c.*, *supra* note 34; MIKESELL, R., *The Bretton Woods Debates*, Princeton, Essays in International Finance, n° 192, 1994; HELLEINER, E., *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s*, Ithaca, Cornell University Press, 1994; BORDO, M. and EICHENGREEN, B. (Eds.), *A Retropspective on the Bretton Woods System: Lessons for International Monetary Reform*, Chicago, Chicago University Press, 1993; SHELTON, J., *Money Meltdown: Restoring Order to the Global Currency System*, New York, Free Press, 1994; CAVANAGH, J. *et al.* (Eds.), *Beyond Bretton Woods: Alternatives to the Global Economic Order*,

post-Cold War era has caused scholars to focus on challenges including uneven economic development, wide income disparities, growing environmental concerns, extensive underemployment, expanding global investment and trade, exchange rate instabilities, trade imbalance-current account problems etc[39].

Our story of managing the world economy starts in the first heydays of Bretton Woods when the world benefited from a fixed dollar-gold exchange standard (1945-71). But when the US no longer was the most stable and predominant economy, the IMF soon became a crucial forum for managed floating[40]. Major OECD countries comprising the US, UK, Germany, Japan, France and later also Italy and Canada informally gathered in the G-5, enlarged to G-7. This group of strong economies gave some general leadership and guidance to the world economy. IMF and World Bank provided essential adjustment assistance and 'soft' loans to many developing countries (and to some developed countries until twenty-five years ago) with no access to commercial banks and capital markets[41]. Notwithstanding the IMF 's controversial conditionality discipline[42], its co-operation with the OECD nations and its major international banks fostered responsibility

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Amsterdam, Transnational Institute, 1994; BANDOW, D. and VASQUEZ, I. (Eds.), *Perpetuating Poverty: The World Bank, The IMF, and the Developing World*, Cato Institute, Washington DC, 1994; KENEN, P. (Ed.), *Managing the World Economy: Fifty Years after Bretton Woods*, Institute for International Economics, Washington DC, 1994; JAMES, H., *International Monetary Cooperation Since Bretton Woods*, Oxford, Oxford University Press, 1996; KIRSHNER, O. (Ed.), *The Bretton Woods – GATT System – Retrospect and Prospect after Fifty Years*, New York, M.E. Sharpe, 1996; GRIESGABER, J. and GUNTER, B. (Eds.), *Rethinking Bretton Woods*, London, Pluto, Vol. 1-5, 1996; and *Bretton Woods: Looking to the Future*, Bretton Woods Committee, Washington DC, 1994. For an introduction to public financial management see STEPHAN, P., WALLACE, D. and ROIN, J., *International Business and Economics – Law and Policy*, Charlottesville, Michie, 1993.

[39] See, *e.g.*, CRAFTS, N., "Globalisation and Growth in The Twentieth Century", IMF, March 2000, p. 10 (noting mainly that the gap between rich and poor has widened enormously).

[40] See, *e.g.*, GOLD, J., *Selected Essays*, *l.c.*, *supra* note 34; and DE VRIES, M., *The International Monetary Fund, 1966-1971: The System under Stress*, IMF, Washington DC, 1976.

[41] See generally "The IMF at a Glance" at www.imf.org, which lists the available IMF financial facilities. Similar development information on soft loans, usually a responsibility of the International Development Association (IDA) and an overview of World Bank Group activities can be found at www.worldbank.org. See, for further reference, also DRISCOLL, D., *What is the International Monetary Fund?*, IMF, Washington DC, 1992; DRISCOLL, D., *The IMF and the World Bank – How Do They Differ?*, IMF, Washington DC, 1992; GUITIAN, M., *The Unique Nature of the Responsibilities of the International Monetary Fund*, IMF, Washington DC, 1992; SHIHATA, I., "Development Policies and Strategies – With Emphasis on the World Bank Group" in SHIHATA, *o.c.*, *supra* note 35, p. 33-69; and other publications like the *World Bank Information Briefs*, World Bank, Washington DC.

[42] On IMF conditionality, see generally WILLIAMSON, J. (Ed.), *IMF Conditionality*, Cambridge MA, MIT Press, 1983; DENTERS, E., *Law and Policy of IMF Conditionality*, The Hague, Kluwer Law, 1996; and QURESHI, A., *International Economic Law*, London, Sweet & Maxwell, 1999, chapter 10. See also GOLD, J., *Selected Essays*, *l.c.*, *supra* note 34.

to creditors and broader capital markets. Hence the system encouraged international investment, trade and the development of a global marketplace. The foundation for a more stable reliable economic regime and more market-friendly state practices among developing nations was cast.

OPEC oil and other price shocks hurt many economies in the 1970s[43]. Worldwide flows of petroleum dollars, recycled through expanding Euro-currency banking and capital markets, were used to expand loans and international debt leading in turn to a worldwide inflationary surge. To crack down on inflation, interest rates increased greatly, bringing widespread recession and rising unemployment. Latin American countries suffering from serious debt overloads failed to service increased interest obligations by the early 1980s[44]. The IMF, the World Bank and the Paris Club of private multinational banks responded with a mix of rescheduling, additional credits and limited relief. Creditworthiness was gradually restored by accepting stronger fiscal discipline, emphasising export expansion, and stressing productivity improvement[45]. Successful rescheduling called for confidence in expanding global trade. Yet a rising trend of protectionism, subsidies and trade barriers could abort the recovery process by the mid-1980s.

To fight a greater slump in the global economy the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) was launched in 1986. Its multifaceted agenda comprised additional tariff reductions, especially among newly industrialised countries (NIC), market opening for agriculture, services and financial markets and stronger intellectual property rights. It hoped to limit protectionism on trade flows by addressing antidumping and countervailing duty proceedings, safeguard relief and such other equivalents in national law. The negotiations were difficult and slow, but nonetheless by accepting most of the Dunkel Draft provisions in late 1993 the world accepted a stronger version of the WTO than many had expected.

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[43] See, *e.g.*, SPERO, J. and HART, J., *The Politics of International Economic Relations*, London, Routledge, 5th ed., 1997, p. 172ff.
[44] *Idem*, p. 179-182 and 186ff.
[45] See, *e.g.*, SPERO and HART, *o.c.*, *supra* note 43, p. 189; see also, STEPHAN *et al*, *o.c.*, *supra* note 38, p. 283-287.

B. Post-Cold War Challenges

Adding three billion people, who currently live in formerly planned economies or transition economies, to the international system, in which the Bretton Woods institutions operate, is rightly called a challenge[46]. There probably will never be a successor conference to the Bretton Woods one of 1944 to deal with this challenge. Instead international governance is taken up by the existing international organisations and *ad hoc* meetings such as the G-7, which with the support of Russia continues its work[47].

In the post-Cold War era the Bretton Woods institutions face a wider range of controversies. The IMF, the World Bank and the WTO are on the one hand appreciated and on the other hand criticised for influencing the allocation of financing, capital, trade and economic growth among nations during recent crises such as in Latin America and Asia[48]. However, the rational for Bretton Woods institutions has not changed fundamentally. Sustained trade/current-account imbalances have long been a concern[49], and still need to be addressed in emerging markets. The lessons prescribed for deficit countries have remained and emphasise fiscal discipline, budget retrenchment, improved competitiveness, export enhancement, and devaluation or import restrictions, if necessary. Surplus nations can expect currency appreciation and reduced exports[50]. These concerns will be addressed further at the beginning of Chapter Three.

But what have changed since 1944, are the composition of the world and the process of international economic law. Whereas Bretton Woods was very much a dialogue between United States' Harry Dexter White and the British Empire, with ideas represented by John Maynard Keynes, today's world counts many voices more. More members

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[46] HALE, D., "Global Economic Integration After the Cold War", in UZAN, M. (Ed.), *The Financial System Under Stress*, London, Routledge, 1996, p. 81-131. See also BELLO, J. and HOLMER, F., "After the Cold War: Whither International Economic Law?", 32 *Harvard Int'l L. J.*, Spring 1991, n° 2, p. 323-329.

[47] See, *e.g.*, Report of G-7 Finance Ministers to the Köln Economic Summit, Cologne, Germany, 18-20 June, 1999 (discussing *inter alia* the strengthening and reforming of international financial institutions and arrangements, strengthening macroeconomic policies in emerging markets, debt management and crisis prevention).

[48] See, *e.g.*, CANOVA, T., "Banking and Financial Reform at the Crossroads of the Neoliberal Contagion", 14 *Am. U. Int'l L. Rev.*, Fall 1999, p. 1571-1645; and also EICHENGREEN, B., *Toward a New International Financial Architecture: A Practical Post-Asia Agenda*, Institute for International Economics, Washington DC, 1999.

[49] See, *e.g.*, FELLNER, W., MACHLUP, F. and TRIFFIN, R. (Eds.), *Maintaining and Restoring Balance in International Payments*, Princeton, Princeton University Press, 1966.

classified according to stereotypes such as Less Developed Countries (LDC), Newly Industrialised Countries (NIC) and divisions between North-South and East-West, means different needs[51]. This has caused Bretton Woods institutions to pay more attention to development. Therefore many believe the interests of poorer nations deserve more sympathetic attention and that environmental and population concerns demand more respect internationally[52]. But also the process of international economic law has changed dramatically. International economic law, especially in the case of the WTO, has become more rule-oriented.

This process of international economic law weighs heavily on the integration of transition economies and needs a mix of rigidity and flexibility. Rigidity meaning the need for a firm foundation based on rules to cabin the risks and the costs of the integration. At the same time a sufficient amount of flexibility is needed to make swift adjustments to changing circumstances possible and to find compromises when necessary[53]. The WTO definitely has the advantage of being a rule-based organisation, but does it still have enough flexible muscle to manoeuvre[54]? This will in large part depend on its safeguard and dispute settlement mechanisms.

It is against this background of rule-based international economic law and flexible safeguards that the WTO accession of transition economies must be depicted. Because of its size and possible precedent value for a future Russian accession, the accession of the Chinese transition economy to the WTO is a hot topic. The accession is not only complex because of its political sensitiveness, but also because it requires profound economic and legal reforms. Without these reforms the Chinese legal and economic system may cause a

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[50] MACHLUP, F., "In Search of Guides for Policy", in FELLNER *et al*, *o.c.*, *supra* note 49, p. 33-84.

[51] For definitional matters and an overview of the heterogeneous developing world, see SARKAR, R., *Development Law and International Finance*, London, Kluwer Law, 2000, p. 1ff.

[52] See, *e.g.*, DANAHER, K. (Ed.), *50 Years is Enough – The Case Against the World Bank and the IMF*, Boston, South End Press, 1994; more moderate are WEISS, F., DENTERS, E. and DE WAART, P. (Eds.), *o.c.*, *supra* note 31; and BHAGWATI, J. and HUDEC, R. (Eds.), *Fair Trade and Harmonization*, Cambridge MA, MIT Press, 1996, which pay attention to labour, environmental and human rights concerns in the international economy. These issues played an important role in the streets outside the Seattle Ministerial Conference of WTO in December 1999. See GANTZ, D., "Failed Efforts to Initiate the 'Millennium Round' in Seattle: Lessons for Future Global Trade Negotiations", 17 *Arizona J. Int'l & Comp L.*, Spring 2000, p. 349-369.

[53] See, *e.g.*, PATEL, I., "The Adjustment Problem", in Trade Policies for a Better Future – The 'Leutwiler Report', the GATT and the Uruguay Round, Dordrecht, Martinus Nijhoff, 1987, p. 87-94.

severe culture shock to the system. Nevertheless China needs to be integrated after the Cold war, if the WTO wants to legitimise itself as a truly global organisation next to the financial Bretton Woods institutions to enhance a global marketplace. Finally, policies of engagement are necessary to guarantee long-term peace, security, and hence economic stability in the world. China's integration into the world trading system will therefore be of concern during the next couple of decades. China understands this and has since 1986 stepped up its domestic economic and legal reform process. The next section deals with the importance and functions of the WTO in embracing economic stability and integration.

II. Role of the WTO

The previous sections have already explained in part how international monetary affairs and trade are intertwined, because monetary and fiscal discipline is also interconnected with export and productivity growths[55]. This section now examines what crucial role the WTO, as a long-lost sister of the two other Bretton Woods institutions, plays in light of the post-Communist challenges. The integration of transition economies into the international economy drives up the competition for capital and aid. This proves the large flow of capital finding its way through expanding financial markets by private investors, commercial banks and multinational enterprises. As recent financial crises have made

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[54] A dose of flexibility is needed to serve economics and economists. QURESHI, *o.c*, *supra* note 42, p. 102 (noting that sometimes an 'imaginative approach' is preferred in international economic law).

[55] See WTO, Decision of the General Council, 18 November 1996, Doc. WT/L/-194 (about the co-operation of IMF – World Bank – WTO). For further reference on the crossroads between international finance and trade, see, *e.g.*, SARCEVIC, P., "Impact of the International Monetary System on World Trade", in SARCEVIC, P. and VAN HOUTTE, H. (Eds.), *Legal Issues in International Trade*, London, Martinus Nijhoff, 1990, p. 207-219; ROESSLER, F., "The Relationship Between the World Trade Order and the International Monetary System", in PETERSMANN, E. and HILF, M. (Eds.), *The New GATT Round of Multilateral Trade Negotiations*, Deventer, Kluwer Law, 2nd ed., 1991, p. 363-386, and commented on by GIRARD, P., at p. 387-393; and BENEDEK, W., "Relations of the WTO with other International Organisations and NGOs", in WEISS, *et al.*, *l.c.*, *supra* note 31, p. 479-95 (who notes that the relationship between WTO – IMF – World Bank is not without problems). See also QURESHI, *o.c.*, *supra* note 42, p. 103 (noting that monetary problems are related to trade and development. International trade liberalisation is impossible without international financial payments, sufficient liquidity and currency exchange control regulations). See further BERGSTEN, F., "Effect on Trade of Exchange Rates and Policies", in NORTON, J. (Ed.), *World Trade and Trade Finance*, New York, Matthew Bender, 1985, p. 1/1-1/17; GOLD, J., "Aspects of the IMF's Activities in Relation to International Trade", in NORTON, J. (Ed.), *World Trade and Trade Finance*, New York, Matthew Bender, 1985, p. 8/2-8/71; and KAMPF, R., "Commitments in the WTO and their Impact on International Trade in Securities", in VAN HOUTTE, H. (Ed.), *The Law of Cross-border Securities Transactions*, London, Sweet & Maxwell, 1999, p. 277-312.

clear there are risks involved in this process as well. Therefore the IMF and the World Bank play an active role either as financier/trouble shooter or as surveyor/watchdog. The WTO plays a crucial role in attracting capital through trade and foreign investment liberalisation. International trade has been recognised as an important component of economic growth[56] and this explains why emerging economies such as transition economies accelerate economic reforms.

The liberalisation of world trade at the end of the Cold War, however, is not without possible danger. The rise of potential new and large economies in Asia, Latin America and the former Soviet block may create new trade tensions with mature economies such as the US and the EC. Low costs combined with technological changes in China, India and Brazil might revive 1980s protectionism focused on Japan and South Korea. Even when the completion of the Uruguay Round has ruled out the comeback of Orderly Market Arrangements[57] (OMA) or Voluntary Export Restraints[58] (VER) less confident European and American States such as France, Germany, UK, US and Canada may slowdown the pace of international co-operation.

A. Purposes of WTO Rules and Main Principles

The most important objectives that the WTO, as well as its predecessor the GATT, keeps in mind are: (1) to provide a forum to negotiate trade liberalisation, and to monitor and improve policy transparency; and (2) to settle trade disputes between members[59]. But principal objectives include also raising standards of living, ensuring full employment, expanding production and trade, and allowing optimal use of the world's resources[60].

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[56] See GILPIN, *o.c.*, *supra* note 25, p. 171 (noting that apart from technological diffusion, economies of scale, increased consumer choice and reduced costs of production international trade stimulates economic growth and enhances the overall efficiency of the economy).

[57] See, *e.g.*, MURPHY, C., "Orderly Market Arrangements", in NORTON, J. (Ed.), *World Trade and Trade Finance*, New York, Matthew Bender, 1985, p. 11/1-11/12.

[58] See, *e.g.*, LOWENFELD, A., *Public Controls on International Trade*, New York, Matthew Bender, 1983, p. 195ff; and JONES, K., "Voluntary Export Restraint: Political Economy, History and the Role of GATT", 23 *J. World Trade*, n° 2, 1989, p. 125-140.

[59] See, *e.g.*, LOWENFELD, A., "Remedies Along with Rights: Institutional Reform in the New GATT", 88 *Am. J. Int'l L.*, July 1994, p. 477-488; NICHOLS, P., "GATT Doctrine", 36 *Va. J. Int'l L.*, Winter 1996, p. 379-466; and JACKSON, J., "The WTO Dispute Settlement Understanding – Misunderstandings on the Nature of Legal Obligations", 91 *Am. J. Int'l L.*, January 1997, p. 60-64 (noting that the WTO has teeth to enforce international legal obligations); and PETERSMANN, E., *The GATT/WTO Dispute Settlement System*, The Hague, Kluwer Law, 1997.

[60] Read the preamble of the Marakesh Charter, Final Act of the Uruguay Round, *supra* note 36.

To realise these objectives, the technical purpose of GATT/WTO is to remove or limit the effects of trade barriers such as tariffs, quotas, customs procedures, state trading and subsidies, and to pave the way for liberal trade[61]. Tariffs are generally believed to distort competition and to attribute monopoly rents to producers in countries that uphold them[62]. Quotas are also believed to distort competition, but usually do not yield more profit for domestic producers. Furthermore, their administration may yield corruption[63], just as discriminatory licensing may[64].

According to Article II GATT, tariff concessions[65] are formalised in tariff bindings after negotiation rounds[66]. Sometimes countries are permitted to depart from bindings, called waivers, or may decide to withdraw certain concessions, in which case compensation and renegotiation must be offered to trading partners in an attempt to rebalance[67].

Apart from tariffs, there exist plenty of Non-Tariff Barriers (NTBs). It is the purpose of Article XI GATT to eradicate these trade-restricting measures[68]. But human creativeness

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[61] See generally GILPIN, *o.c.*, *supra* note 25. Since Medieval times countries tried to amass as much gold and silver by selling more than buying from neighbouring empires. This mercantilism came under attack from Adam Smith's *An Inquiry into the Wealth of Nations*, 1776. His theory of the "absolute advantage" was refined by David Ricardo in *The Principles of Political Economy* of 1817, who introduced the notion of "comparative advantage", meaning that each country, in order to increase overall prosperity, should produce and trade in those sectors of the economy, which have more abundant factors. See also TREBILCOCK, M. and HOWSE, R., *The Regulation of International Trade*, London, Routledge, 1995, p. 2-4.

[62] JACKSON, *o.c.*, *supra* note 36, 1997, p. 140.

[63] Although arguably bribes can also be considered as tariffs or tariff surcharges, see NICHOLS, P., "Corruption in the World Trade Organisation: Discerning the Limits of the World Trade Organisation's Authority", 28 *N.Y.U. J. Int'l L. & Pol.*, Summer 1996, p. 711-784.

[64] JACKSON, *o.c.*, *supra* note 36, 1997, p. 140, p. 153ff and 164. Concerning quantitative restrictions it is important that not only imports of a certain product from all countries is restricted, but that it is also done in a non-discriminatory manner, see HUDEC, R., "Tiger, Tiger in the House: A Critical Appraisal of the Case Against Discriminatory Trade Measures", in PETERSMANN, E. and HILF, M. (Eds.), *o.c.*, *supra* note 55, p. 177ff. Article XIII GATT thereto states that licensing must happen either on a first-come-first-serve basis or with global licenses to local importers or with country-specific quotas based on historic market shares or expected market share. Article XIV GATT, however, provides for discriminatory quantitative restrictions in case of Balance of Payment difficulties.

[65] WTO, *Guide to GATT Law and Practice*, WTO, Geneva, 1995 (hereinafter GATT Analytical Index), p. 63-119. See also TARULLO, D., "Law and Politics in Twentieth Century Tariff History", 34 *UCLA L. Rev.*, December 1986, p. 285-370.

[66] See JACKSON, *o.c.*, *supra* note 36, 1997, p. 142ff. See also DAM, *o.c.*, *supra* note 37, p. 79ff. On the negotiation process, see also MCRAE, D. and THOMAS, J., "The GATT and Multilateral Treaty Making: The Tokyo Round", 77 *Am. J. Int'l L.*, January 1983, p. 51-83.

[67] Article XXVIII GATT, see JACKSON, *o.c.*, *supra* note 36, 1997, p. 143.

[68] GATT Analytical Index, *o.c.*, *supra* note 65, p. 313-353.

seems to be boundless here[69]. Efforts to remove these have proven to be more difficult[70]. Important is also that these NTBs are not always in line with National Treatment (NT) required by Article III GATT. Once goods have entered the internal circuit of commerce, imported goods should not be treated differently from national products, unless this equal treatment would provoke *de facto* or implicit discrimination[71]. This might be true for taxes, licensing requirements, technical standards, inspections etc.

For most commentators rules governing international trade protect the welfare of small and weak nations against discriminatory trade policy actions of large and powerful nations. They believe that rules such as Article I GATT, the Most Favoured Nation (MFN) clause[72], and Article III GATT, the NT clause[73], are fundamental to instil confidence in the world trading system and to support the evolution towards more legality in global markets. Large economies have the potential to exploit their monopoly power by taxing their trade, but make the world worse off by such trade taxes. Multilateral rules disciplining trade policy are also beneficial in that they help governments to ward off domestic interesting groups asking special favours[74]. However, many commentators[75] do not naively believe in the increase of WTO authoritativeness. They question *inter alia* the exceptions fashioned in agriculture[76] and textiles, two domains in which subsidies and

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[69] Human creativeness is boundless in many policies trying to evade international obligations to liberalise trade. See again JACKSON, *o.c.*, *supra* note 36, 1997, p 139ff and 229ff.
[70] Again JACKSON, *o.c.*, *supra* note 36, 1997, p. 153.
[71] *Ibidem*, p. 216.
[72] See GATT Analytical Index, *o.c.*, *supra* note 65, p. 23-61. See also JACKSON, *o.c.*, *supra* note 36, 1997, p. 157ff; and TREBILCOCK, HOWSE, *o.c.*, *supra* note 61, p. 27. See also UN, "First Report on the Most-favoured-nations Clause", 18 April 1969, Document A/CN.4/23 and UN, "Second Report on the most-favoured-nations clause", 9 March and 18 May 1970, Document A/CN.4/228 and Add. 1. For an analysis, see also SCHWARTZ, W. and SYKES, A., "The Economics of the Most-favoured-nations Clause", in BHANDARI, J. and SYKES, A. (Eds.), *Economic Dimensions in International Law*, Cambridge, Cambridge University Press, 1997, p. 43-79.
[73] GATT Analytical Index, *o.c.*, *supra* note 65, p. 121-207. See also JACKSON, *o.c.*, *supra* note 36, 1997, p. 213ff; and TREBILCOCK, HOWSE, *o.c.*, *supra* note 61, p. 29.
[74] On the debate for and against free trade, see generally GILPIN, o.c., *supra* note 25; BHALA, R., *International Trade Law*, Charlottesville, Michie, 1996, Chapter I; and JACKSON, J., DAVEY, W. and SYKES, A., *Legal Problems of International Economic Relations*, St. Paul, West Publishing, 1995.
[75] These commentators point out the immanent and inherent objections to free trade like the impact on wages and employment. They argue that free trade may hurt domestically vulnerable industries, even if the overall net effect is positive. However, if trade liberalisation increases overall prosperity, it will also enable social policies to redistribute wealth. Other objections raised include the impact on cultural diversity with the creation of homogeneity and materialism and the impact on domestic sovereignty. See TREBILCOCK, HOWSE, *o.c.*, *supra* note 61, p. 11-14.
[76] See TREBILCOCK, HOWSE, *o.c.*, *supra* note 61, p. 191-214 for more details.

protectionism have survived. They also draw our attention to many escape routes that lead away from basic free trade principles, such as antidumping.

When it comes to the escape routes many good reasons can be found in national security, health and welfare, balance of payments difficulties and currency obligations to name the most important ones[77]. The Uruguay Round[78] came up with an ambitious new safeguard agreement[79]. If liberal trade policies and practices did not exist, then there perhaps would not exist any need to consider safeguards as such. Economic adjustment needs and practical politics, however, demand otherwise[80]. The reality of comparative advantage may sometimes provide little consolation to a suffering economy[81]. The economic costs of liberalisation are usually immediately felt by the industry affected, while the gains over time are often diffuse.

China's accession to the WTO cannot drag us away from this constant tension between the further institutionalisation and rationalisation over the creation of free trade, and the empirical reality of global protectionism by devising exceptions to address domestic concerns. In support of safeguard mechanisms some authors contend that an economy like China may create stress vis-à-vis other trading partners[82]. Or as one leading scholar

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[77] On Safeguards, see BRONCKERS, M., *Selective Safeguard Measures in Multilateral Trade Relations*, The Hague, Kluwer Law, 1985. See also JACKSON, *o.c.*, *supra* note 36, 1997, p. 175ff and p. 241 for Balance-of-Payments exceptions. See in this regard GATT Article XXVIII, as the main provision to free oneself from tariff bindings. See GATT Article XIX, the escape clause, also at GATT Analytical Index, p. 515-539, and GATT Article XII, for restrictions to safeguard the balance of payments, also at GATT Analytical Index, *l.c.*, *supra* note 72, p. 355-391. General exceptions can be found in GATT Article XX, GATT Analytical Index, *o.c.*, *supra* note 65, p. 561-597. On the recent controversy whether unilateral measures to protect life and health in the context of sustainable development should be considered by Article XX, see *e.g.* DE WAART, P., "Quality of Life at the Mercy of WTO Panels: GATT's Article XX an Empty Shell?", in WEISS, *et al.*, *o.c.*, *supra* note 31, p. 108-131.

[78] On the achievements of this trade negotiations round, see *e.g.* BELLO, J. and FOOTER, M., "Symposium: Uruguay Round – GATT/WTO", 29 *Int'l Law.*, Summer 1995, p. 335-343 (which gives a good chronology of events and sums up the American perspective). See also LEEBRON, D., "An Overview of the Uruguay Round Results", 34 *Colum. J. Transnat'l L.*, 1995, p. 11-35. A more elaborate study is from KENNEDY, K., "The GATT-WTO System at Fifty", 16 *Wisconsin Int'l L. J.*, Summer 1998, p. 421-528.

[79] See TREBILCOCK, HOWSE, *o.c.*, *supra* note 61, p. 172-173 on the Uruguay Round Agreement on Safeguards. Article 5 states that safeguard measures apply to a product regardless the country of origin.

[80] JACKSON, *o.c.*, *supra* note 36, 1997, p. 175.

[81] See TRUBEK, D., "Protectionism and Development: Time for a New Dialogue?", 25 *N.Y.U. J. Int'l L. & Pol.*, p. 345-366, at p. 353. For some of the objections against free trade, see also *supra* note 75.

[82] See, *e.g.*, CAI, W., "China's GATT Membership: Selected Legal and Political Issues", 26 *J. World Trade*, n°1, 1992, p. 44 (who contends that China's potential competitiveness in international markets and its volume of low-cost labour-intensive products might constitute a threat to developed domestic industries).

comments, that, by the very different nature that exists between certain domestic economic systems, parties may interpret certain behaviour as unfair. GATT safeguards might therefore serve as a buffer zone between opposite economic systems[83]. The risk of damage to liberal trade in employing these safeguards, however, always remains immanent. In light of China's and other transition economies' WTO accession, the WTO should nonetheless put more effort in becoming an interface for all trading nations; and safeguards may be helpful in this regard. This will be examined more closely in subsequent Chapters.

B. Communist Trade Legacy

The Soviet Union and the communist countries of Europe were minor participants in world trade and finance[84]. Before the collapse of communism none of these states had attracted significant amounts of foreign direct investment. The most significant form of economic interaction with the international economy was borrowing. Several Eastern European countries encountered severe balance of payments difficulties beginning in the late 1970s. Both Poland and Romania were forced to ask for a rescheduling of their external convertible currency debt in 1981. Western banks, under the influence of the Reagan administration, withdrew from further lending to Eastern Europe. Since the early 1990s, these countries have regained access to private international capital markets only gradually[85].

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[83] See JACKSON, *o.c.*, *supra* note 36, 1997, p. 319ff. The urgency to improve GATT rules for trade between the nonmarket economies and other Contracting Parties was already noted in 1986 by PATTERSON, E., "Improving GATT Rules for Nonmarket Economies", 20 *J. World Trade L.*, n° 2, March-April 1986, p. 185-205. However, PATTERSON still emphasises one-way compliance with GATT/WTO standards, whereas it may be necessary for the WTO to adapt itself also to the accession of nonmarket economies.

[84] International trade in these countries was limited and usually confined to other members of the Council of Mutual Economic Assistance (CMEA). On the history of the CMEA, the organisational structure, institutional principles, and the emergence of awareness of the need to reform the system, see SCHRENK, M., "The CMEA System of Trade and Payments: Initial Conditions for Institutional Change", in HILLMAN, A. and MILANOVIC, B. (Eds.), *The Transition from Socialism in Eastern Europe – Domestic Restructuring and Foreign Trade*, World Bank, Washington DC, 1992, p. 243-262.

[85] See LARDY, N., *China in the World Economy*, Institute for International Economics, Washington DC, 1994, p. 5. On international trade and nonmarket economies, see generally KOSTECKI, M., *East-West Trade and the GATT System*, New York, St. Martin's Press, 1979 and KOSTECKI, M., *State Trading in International Markets: Theory and Practice of Industrialised and Developing Countries*, New York, St. Martin's Press, 1982.

The largest of these economies, the Soviet Union, had no relations with the IMF, the World Bank or GATT, even though it had been a participant in the Bretton Woods conference[86]. Poland and Czechoslovakia were founding members of the Fund and the Bank in 1946. But this happened shortly before they became centrally planned economies. The former country withdrew in 1950 and the latter was expelled in 1955. In 1972 Romania was the first communist country to become a member of the IMF and the Bank. Hungary and Poland followed respectively in May 1982 and May 1986. However, Romania discontinued all borrowing from the Bank after 1983 and the World Bank never approved any loans for Poland prior to the collapse of the Communist regime[87].

The only significant borrower of IMF and World Bank was Hungary with two stand-by loans of almost a billion dollar from latter institution by 1984. Together with 700 million dollar co-financing from commercial banks, Hungary could stave off a formal debt rescheduling at that time. Later in the decade Hungary scaled back it's borrowing. At the end of the fiscal year in June 1989 the combined cumulative borrowing of Romania and Hungary was a little more than two percent of the Bank's outstanding loans[88].

The participation of these countries in the GATT was slightly more complex. Czechoslovakia, as a founding member of GATT in 1948, participated unobtrusively. Poland, Hungary and Romania became contracting parties in 1967, 1973 and 1971 respectively. Yugoslavia became GATT observer in 1962 and a full member in 1966[89]. Poland's accession was unusual since it was based not on reciprocal tariff reductions, but rather a promise to increase imports from other Western market economies by seven percent per year. Poland's economic reform had not yet begun and was the first traditional centrally planned economy ever to join the GATT. Romania's entry was conditional on its use of planning to ensure that imports from market economies grew at least as fast as total imports during its then-current five-year plan. Hungary's accession came after it had launched its reform, the so-called "new economic mechanism". Although all three of

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[86] VAN DORMAEL, *o.c.*, *supra* note 33, p. 169ff and 191ff about Russia at the Bretton Woods conference. See also JACOBSON, H. and OKSENBERG, M., *China's Participation in the IMF, the World Bank and GATT: Towards a Global Economic Order*, Ann Arbor, University of Michigan Press, 1990, p. 26-27.
[87] See LARDY, *o.c.*, supra note 85, p. 6. JACOBSON, OKSENBERG, *o.c.*, *supra* note 86, p. 26-27.
[88] LARDY, *o.c.*, supra note 85, p. 6.
[89] It should be noted that at the moment of writing WTO membership of the Former Yugoslav Republic is still under consideration since the end of the civil war in the region.

them participated in the GATT, the nature of their trade regimes made it very difficult, if not impossible, to implement the basic principles of the GATT: reciprocity and non-discrimination. Therefore their participation was severely constrained[90]. The examples of these nonmarket economies[91] acceding to GATT showed, however, that tariff cuts were meaningless instruments of trade control in such countries at the time. Commitments other than tariff cuts are therefore necessary to achieve an acceptable level of imports from WTO members[92].

China's role in the world economy has already far surpassed that played by Russia and (post-)communist states. Prior to the late 1970s, China was not a borrower either in international commercial markets or from international financial organisations such as the World Bank[93]. However by the early 1990s China's role in the international economy had been totally transformed[94]. In both 1992 and 1993 it was the single largest borrower from the World Bank and sold large quantities of bonds on international credit markets, and China was already attracting substantial inflows of foreign direct investment since the 1980s[95]. In Chapter Two China's relationship with IMF and World Bank, as well as its original membership of GATT is discussed in greater detail.

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[90] LARDY, *o.c.*, supra note 85, p. 7.

[91] For a more detailed account, see the works of KOSTECKI, *l.c.*, *supra* note 85. The principal documents can be found in GATT, *Basic Instruments and Selected Documents* (BISD). Yugoslavia 8 BISD, 17, 18, 64ff; 9 BISD, 56ff; 10 BISD, 61ff; 11 BISD, 52, 79, 50ff; 14 BISD, 15, 16, 49ff; 15 BISD, 53ff, 63. Poland 8 BISD, 12, 61; 11 BISD, 72ff; 12 BISD, 62ff; 13 BISD, 33ff; 14 BISD, 46ff; 17 BISD, 96ff; 18 BISD, 188ff, 201ff; 19 BISD, 109ff; 20 BISD, 209; 21 BISD, 112; 22 BISD, 63ff; 24 BISD, 139ff. Romania 18 BISD, 5ff, 23, 94ff; 20 BISD, 217ff; 24 BISD, 149ff; 27 BISD, 166ff; 30 BISD, 194ff. Hungary 20 BISD, 3, 17, 34ff; 22 BISD, 54ff; 24 BISD, 4; 25 BISD, 155ff; 27 BISD, 156ff; 29 BISD, 129ff; 31 BISD, 156ff. See on the accession of these countries and their parallels with China: FENG, Y., "China's Membership of GATT: A Practical Proposal", 22 *J. World Trade L.*, n°6, 1988, p. 60-62 and LI, C., "Resumption of China's GATT Membership", 21 *J. World Trade L.*, n°4, 1987, p. 34ff.

[92] PATTERSON, G., "The GATT: Categories, Problems and Procedures of Membership", *Colum. Bus. L. Rev.*, 1992, p. 7-17, at p. 11. He notes that the Polish and Romanian accession formulae proved to have many weaknesses. JACOBSON, OKSENBERG, *o.c.*, *supra* note 86, p. 27-28 also note the disappointment in trade performance of these countries. Imports did not increase as expected, but neither did their exports increase greatly. See also KOSTECKI, *East-West Trade*, *l.c.*, *supra* note 85 (noting that the removal of trade barriers in these accession protocols were little and that as a result no leverage existed for these countries to force market access to the West).

[93] LARDY, *o.c.*, supra note 85, p. 1. See also JACOBSON, OKSENBERG, *o.c.*, *supra* note 86, p. 27-28 (noting that these countries received relatively favourable treatment in World Bank and IMF, and also that they were not always diligent in fulfilling obligations).

[94] LARDY, *o.c.*, supra note 85, p. 2.

[95] *Ibidem*, p. 3.

C. WTO Membership for Transition Economies

It is advocated here that WTO membership advances the integration of countries in transition in the global economy and ends the isolation of these countries from the economies of their historical enemies. The integration of transition economies in the WTO represents nonetheless challenges, but one of the more complex issues is the relationship between the WTO system of multilateral rules and the domestic regulatory and economic systems of its members[96]. It is true that transition economies have started profound domestic economic and legal reform modelled on the, all be it illusive principles, of "free market economy" and "rule of law". Governments differ widely in the practical application of these principles[97]. This is even true for different governments in Western economies, but it is especially true also for those governments who previously adhered to a centrally planned economy. There are *e.g.* fundamental differences regarding the extent of government intervention in markets and the kinds of goods to be provided by state-controlled enterprises, as well as their governance. These differences may be rooted in ideologies, or may be related to the interests of the powers that determine economic policies or just reflect the preferences of society at large.

Ideally the integration of transition economies into international organisations should be as reciprocal and beneficial for all member countries, leading to a more peaceful, stable and equitable world[98]. But what would a successful process of engagement involve? What standards should be met? And what impact will the integration process have on the neo-liberal economic and legal order that these institutions serve? Of course a fruitful interaction depends on the immediate resolution of contentious issues, regular contact, an effective network for transmission of information, and institutionalised relationship, which must survive political reversals of leaders and administrators, and of course nothing should disrupt the international organisation[99]. In what follows I will concentrate on the domestic economic and legal reforms that transition economies have generally undertaken to integrate their economies. I will also try to answer what standards

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[96] See VAN DIJCK, P. and FABER, G. (Eds.), *Challenges to the New World Trade Organisation*, The Hague, Kluwer Law, 1996.
[97] See generally ALBERT, M., *Capitalism vs Capitalism*, New York, Four Walls Eight Windows, 1993.
[98] JACOBSON, OKSENBERG, *o.c.*, *supra* note 86, p. 8.
[99] *Ibidem*, p. 57-58.

transition countries have to live up to, as part of their engagement. Although these standards and principles are most illusive indeed, a thin consensus on these principles exists. However, there are no clear graduation criteria by which the transition from centrally planned economy to a full-fledged market economy is considered to come to completion. Instead economists only depend on a long list of preconditions, which they demand to be in place. The clear graduation from the state trading or nonmarket economy label is important, however, because the practice of using state-trading methodologies in safeguard and antidumping legislation depends on it. In the absence of such clear criteria by which these countries can demonstrate their graduation, the risk exists that WTO members will continue these methodologies unnecessarily.

III. Market Economy

Countries of transition seem to have accepted that the creation of a market economy is the best way to improve their economic performances. And although there is no agreement among economists as to how this market economy should look like and how to achieve it, because *e.g.* the initial economic conditions in these countries may be different, it should be acknowledged that there are also clear similarities[100]. Therefore a loose consensus exists as to what the ingredients of a market economy should be and for the transition to be successful[101]. In the next paragraphs, I will proceed discussing this cocktail of ingredients, firstly by focussing on the different types of market economy and the difficulty in finding an economic interface. Secondly, I will discuss the methods and

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[100] See FISCHER, S. and GELB, A., "Issues in Socialist Economy Reform", in MARER, P. and ZECCHINI, S. (Eds.), *The Transition to a Market Economy*, OECD, Paris, 1991, p. 184-201.

[101] In this respect the "Washington consensus" is a term often used to refer to the dominant paradigm in development thinking among the three Bretton Woods institutions. This development paradigm has changed profoundly over the last decades, since Law and Development was first articulated in the 1960s. At that time the emphasis was placed on import substitution industrialisation, state trading and central planning. Nowadays the "Washington consensus" promotes markets as allocative institutions, favours privatisation and promotes closer linkages to the global economy. See WAELBROECK, J., "Half a Century of Development Economics", 12 *World Bank Econ. Rev.*, 1998, n° 2, p. 323-52; TRUBEK, D., "Law and Development: 'Then and Now', *Am. Soc. Int'l L. Proceedings*, 90th Ann. Meeting, 1996, at p. 223-224; see also ROSTOW, W., *The Stages of Economic Growth: A Non-Communist Manifesto*, Cambridge, Cambridge University Press, 3rd ed, 1990, at p. 4-16. More recently the Washington consensus as coined by Williamson has triggered a debate of its own. See BURKI, S. and PERRY, G., "Beyond the Washington Consensus: Institutions Matter", World Bank, Washington DC, 1998; STIGLITZ, J., "More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus", The 1998 WIDER Annual Lecture,

therapies of restructuring former centrally planned economies. Finally, I will assess the impact of the economic engagement of these countries on free trade liberalisation.

A. Different Types of Market Economy

Most of the countries of Eastern Europe, having attempted various reforms, and having failed[102], have set their sights on a transition from command socialist economies to genuine market economies after the Western pattern[103]. A market involves the exchange of goods and services in a public way. A market entails such exchanges on the basis of economic freedom that both parties enjoy in the transaction. It simply means that both parties can and do decide whether or not to give away what she or he has in exchange for what the other party offers, only on the economic merits each perceives. If one or both parties think otherwise, the deal is off[104].

Schematically there are three "market models" such as the social market economies of Western Europe, the consumer-directed market economy of the US, and the Japanese administratively-guided market economy. Although there are vast differences among countries in Western-Europe, the social market economy is characterised not only by its commitment to the predominance of market forces, but also to the responsibility of the state for sound monetary and fiscal policies, for efficient infrastructure, the environment, adequate health care, education and housing to help the unemployed and the poor. The

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Helsinki, Finland, January 7, 1998; and WILLIAMSON, J., "What Should the Bank Think about the Washington Consensus?" at www.iie.com/TESTMONY/Bankwc.htm (last visited 21 January 2001).

[102] See, *e.g.*, KAMINSKI, B., "The Legacy of Communism", in *East-Central European Economies in Transition*, Joint Economic Committee Congress of the United States, Study Papers, Washington DC, 1994, p. 9-24, at p. 14 (noting that during the last few years before the collapse of communism, the Hungarian and Polish authorities introduced changes effectively overhauling some important components of the central planning system and indicating their willingness to move to a market economy).

[103] GABRISCH, H. and LASKI, K., "Transition from Command to Market Economies", in HAVLIK, P. (Ed.), *Dismantling the Command Economy in Eastern Europe*, The Vienna Institute for Comparative Economic Studies Yearbook III, Oxford, Westview, 1991, p. 11-29, at p. 15.

[104] See generally FRIEDMAN, M., *Capitalism and Freedom*, Chicago, University of Chicago Press, 1962. See also BUCHANAN, J., "General Implications of Subjectivism in Economics", in BUCHANAN, J. (Ed.), *What Should Economists Do?*, Indianapolis, Liberty Press, 1979, p. 81-91 (who notes that the most important central principle in economics, is the principle of spontaneous order. It is the idea that individuals seeking their own gain in a system of private ownership and free markets bring about mutually beneficial exchanges, and that competitively determined prices co-ordinate economic decisions without central planning).

basic idea is a humane capitalism sustained by social democratic values, but not to interfere with market forces as to lose too many efficiency gains[105].

The US model thrives on a vigorous entrepreneurial spirit and the mobility of the factors of production is high. The efficiency of the market is praised and government interference widely criticised. Corporations often think short-term, and regulation and deregulation by the government target the consumer as the beneficiary. There generally is an underprovision of social investment. A large underclass, with no stake in the prevailing social and economic order, has emerged and is being perpetuated[106].

In Japan, another blend of features exists, rooted in intense domestic competition for greater market shares rather than for short-term profits. Long-term thinking and continuous improvements in efficiency, productivity and cost-competitiveness are counted among the results. Domestic markets have been protected from foreign competition until firms in an industry have matured and become competitive internationally. Japan has allowed the rate of growth of consumption to lag behind its rate of growth of production[107].

Whatever interpretation of market economy former centrally planned economies may follow, the assimilation of their economies into the world economy crucially depends on a radical change of their previous systems into a market system. A third road, in between plan and market, a 'socialist market economy'[108], seems unrealistic to some observers[109]. However, on their way to a non-socialist economy, a shorter or longer transitional period

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[105] See MARER, P., "Models of Successful Market Economies", in MARER and ZECCHINI, *o.c.*, *supra* note 100, p. 108-113, at p. 108.

[106] *Ibidem*, p. 109.

[107] *Ibidem*, p. 110.

[108] This term is specifically relevant for China. On the notion of a 'socialist market economy', see GAO, S. and CHI, F., *Theory and Reality of Transition to a Market Economy*, Foreign Languages Press, Beijing, 1996, p. 19 (noting that China's socialist market economy is an operating system, which integrates both planning and the market, with the market mechanism mainly playing a regulatory role in micro-economic sectors. Planned regulation must continue to play its role in the macroeconomic sphere).

[109] See DORN, J., "China's Future: Market Socialism or Market Taoism", in DORN, J. (Ed.), *China in the New Millennium: Market Reforms and Social Development*, CATO, Washington DC, 1998, p. 101-117, at p. 101 (who notes that building a socialist market economy is a grand illusion. The market and its supporting institutions, notably private property and the rule of law, cannot be grafted onto socialism. Markets are based on voluntary exchange. Socialism, however, destroys the spontaneous nature of markets and substitutes government control for individual responsibility. Market socialism, even with Chinese characteristics, is an unnatural and artificial system and therefore destined to fail like the Yugoslav experiment. In citing Alexander Tsypko p. 103, the author notes that there is no third way between modern

of cohabitation of state enterprises and market mechanisms is inevitable[110]. But these countries can still retain distinctive features in the structure and operation of their economic systems, while strengthening their economic ties with the West by interacting more closely through trade, or labour and capital movements, or technology transfers.[111]

In China the 14th Party Congress[112] clearly defined the country's reform objective as being the establishment of a 'socialist market economy'. The market is established as the main instrument for resource allocation, as is enshrined in the Constitution[113]. However, what constitutes a socialist market economy is a much-debated subject. It seems to be generally agreed that a socialist market economy, while allowing market forces to play the major role in market allocation[114], additionally incorporates two fundamental socialist principles[115]. First, public ownership would be the mainstay in the economy, supplemented by private ownership[116]. Second, it would adopt measures to prevent 'unfair' income distribution, and emphasise the elimination of remaining poverty[117].

Apparently China's economic approach points out some parallels with the modern market economy in France. However, France's large public sector and state planning have always operated in the context of a competitive private sector. State enterprises have been

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civilisation and socialism as it is. The five wasted years of perestroika have shown that the market cannot be combined with public ownership of the means of production).

[110] GAO and CHI, *o.c.*, *supra* note 108, p. 15-18.

[111] See ZECCHINI, S., "Assimilating Central and Eastern Europe into the World Economy", in MARER and ZECCHINI, *o.c.*, *supra* note 100, p. 27-37, at p. 27.

[112] The 13th Congress in 1987 characterised the new economic system as one in which the state regulates the market, and the market guides the enterprises, but it did not indicate whether planning or market should be the main method of resource allocation. See also HARROLD, P. and LALL, R., "China: Reform and Development in 1992-93", World Bank, Washington DC, 1993, p. 30.

[113] The constitutional amendment of 29 March 1993 replaced the text "Planned economy under public ownership" with the words "socialist market economy".

[114] GABRISCH and LASKI, *o.c.*, *supra* note 103, p. 18 (who define market socialism as a market economy with prevailing collective (mostly state) ownership of the means of production but without any form of directive planning).

[115] GAO and CHI, *o.c.*, *supra* note 108, p. 18 (noting that the market economy does not only exist under the capitalist system where it plays its due role in economic regulation, but also exists and plays the same role under socialism. Therefore the socialist market economy is in fact a market economy operating under socialist conditions).

[116] *Ibidem*, p. 18 (noting that the socialist economy is characterised by the public-owned economy and is better equipped than capitalism to amass quite a large proportion of GNP under state control. On page 19-20 they continue to say that the question what a socialist market economy in fact means, is a simple one, but that the reality is quite the opposite. So to a certain extent, the Chinese themselves seem not to know what it should mean in practice).

expected to be competitive, and have always operated under contractual relations with the state[118]. Second, the French planning system has been neither complete nor compulsory, but rather has been principally a process within which the public and private sectors have co-ordinated their expectations and plans. Pervasive state interventionism was rejected from the beginning, but important is the process of building a social consensus, the attempt to develop a common view among civil servants, business leaders and labour groups[119]. Parallels probably also exist between China and the economies of Japan and South Korea where managed trade plays a large role in the development strategy.

The main question remains, whether the Chinese market approach represents a practical and functional market economy that can survive WTO membership[120]. It provides an underlying philosophy for the design of economic reform, but can it be considered a coherent whole rather than just a collection of efficiency-enhancing measures? In understanding the market in China, the parties to the exchange do not always have an adequate sense of economic freedom, or due respect for the economic freedom of the other party. It is going to take time for the basic rules of a free market to develop and mature in China, but the awareness is certainly building up[121]. In Chapter Two the Chinese efforts in this regard are studied in greater detail.

It is clear that in obtaining a Western-type market economy, different scenarios exist. In any event, China and the other transition economies in their engagement to embrace the free market will have to duplicate those basic features and policies that seem to account for much of the successes of the well-performing market economies[122]. Only practice can prove whether China's scenario with enterprises, mostly state-owned and instructed to act

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[117] HARROLD and LALL, *o.c.*, *supra* note 112, p. 30. And also GAO and CHI, *o.c.*, *supra* note 108, p. 19 (agreeing and holding that the socialist market economy means a combination of social fairness and market efficiency).

[118] HELLIWELL, J., "Creating Market Economies in Central and Eastern Europe: Lessons from the West", in MARER and ZECCHINI, *o.c.*, *supra* note 100, p. 115-131, at p. 119.

[119] *Ibidem*, p. 119-120.

[120] HOOGMARTENS, J., "Can China's Socialist Market Survive WTO Accession? Politics, Market Economy and Rule of Law", VII *L. & Bus. Rev. Am*, Winter-Spring 2001, p. 37-83.

[121] See further ZHOU, D., "A True Market Economy for China", in DORN, *o.c.*, *supra* note 109, p. 95-100, at p. 98.

[122] See ZECCHINI, *o.c.*, *supra* note 111, p. 27. Those features comprise according to MARER, *o.c.*, *supra* note 105, p. 111-13, the rule of law; private ownership; competition and trade; sound currency; savings, taxation, financial intermediation; infrastructure and the environment; political and economic freedom to seek personal fulfilment.

in a market-conforming manner next to private entrepreneurship, would represent a viable solution[123]. To some the results of such cohabitation may sound uncertain, even if it is assumed that the Chinese government shows enough perseverance in creating a functioning market mechanism.

B. Different Types of Therapy

The experience of transition economies indicates that to ensure a successful transition from a centrally planned to a market economy, governments must take several steps. These steps are discussed here in a seemingly logical order, but as will be noticed further on, the right sequence and timeframe for these steps to be implemented is vigorously debated among economists.

Price liberalisation provides consumers and businesses with the signals and incentives necessary to create markets. However, to derive full benefits from markets, governments have to dismantle barriers to entry for would-be entrepreneurs, so as to ensure a supply-side response to market signals, for as lower barriers to entry foster competition, and force loss-making enterprises to restructure[124]. Hence foreign trade must be liberalised to provide competition for producers in these sectors. Freer trade requires, that importers be able to freely convert domestic currency to foreign currencies, so as to make purchases. Consequently current account convertibility must succeed[125]. To keep exchange rates

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[123] GABRISCH and LASKI, *o.c.*, *supra* note 103, p. 18. And also GAO and CHI, *o.c.*, *supra* note 108, p. 19 (also asking the question whether socialism can coexist with the market economy. Viewed in a traditional way, socialism is incompatible with the market economy. Socialism can be regarded as a social system, a policy, or a moral. Nevertheless, the final objective is to attain social fairness combined with market efficiency).

[124] See, *e.g.*, FISCHER and GELB, *o.c.*, *supra* note 100, p. 184-201, at p. 190-191.

[125] MARER, P., "Pitfalls in Transferring Market-Economy Experiences to the European Economies in Transition", in MARER and ZECCHINI, *o.c.*, *supra* note 100, p. 38-55, at p. 52-53; and DORNBUSCH, R., "Strategies and Priorities for Reform", in *ibidem*, p. 169-183, at p. 177-178. Particular questions as to when to introduce, what type of convertibility, under which kind of exchange rate regime, and at what exchange rate level appear here. Some advocate a pegged exchange rate as an anchor for expectations and thus in helping to control inflation. Among those advocates there are differences of judgement about how firmly such a rate should be defended and for how long. If no credible defence of a pegged rate is possible, a flexible rate (temporary or permanent) may be more appropriate. Costs of such defence can be high in terms of lost reserves, import controls etc. Others believe a floating rate is the best. Regarding the type of convertibility, some advocate that it should be guaranteed only for some, such as only on transactions by enterprises, or all current account transactions. Others advocate full convertibility because the difference between current and capital transactions is impractical. As to timing some believe some preconditions must be in place, such as freeing of most prices, macroeconomic stabilisation and a strong balance of payments position. Concerning the exchange rate level, some are concerned about excessive initial depreciation. On

stable, when inflation is high, is impossible. Especially capital markets work less well under high inflation. Therefore inflation should be controlled[126]. Another step, privatisation of state-owned enterprises[127], is more complicated and in China heavily debated. In privatisation, the formal and informal property rights have to be transferred from one set of institutions or people, to others, and thus entail substantial transfers of wealth. Most economic assets that remain in state hands are found to be used less efficiently than those under private ownership[128]. Instead of outright privatisation, it may be less controversial to speak about enterprise restructuring. Restructuring may range from a simple cleanup of the balance sheet, to substantial closures, and layoffs, replacing management and possibly privatisation, or bankruptcy[129]. The Chinese enterprise restructuring as an important step to adapt its economy to the standards of WTO membership is discussed in Chapter Two.

The breakdown of the old economy of central planning, and the lack of a new consistent system of market co-ordination, often compounds to a confused situation in transition countries. Usually the transition results in a dysfunctional mixture of bureaucratic and market principles[130] leading to losses in production and inflationary pressures. The stabilisation programmes accompanying the steps and targets indicated in the previous paragraph comprise elements such as the hardening of the budget constraints[131] on the firms. That will mean that over a longer run the enterprises may only spend what they can earn, and that they bear full financial responsibility for their decisions. State enterprises in a command economy are characterised by a tendency towards expansion and lack of cost- and profitability consciousness. This is caused by the 'soft budget constraint', Janos Kornai's term to denote the expectation of enterprises to be supported by the state in case

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the choice and function of exchange rate regimes, see also DRABEK, Z. and BRADA, J., "Exchange Rate Regimes and the Stability of Trade Policy in Transition Economies", WTO, July 1998.

[126] On inflation and macroeconomic imbalances, see *e.g.* MARER, *o.c.*, *supra* note 125, p. 41-42.

[127] See, *e.g.*, DORNBUSCH, *o.c.*, *supra* note 125, p. 176-77.

[128] CRANE, K., "The Costs and Benefits of Transition", in *East-Central European Economies in Transition*, Joint Economic Committee Congress of the United States, Study Papers, Washington DC, 1994, p. 25-48, at p. 27.

[129] MARER, *supra* note 125, p. 44.

[130] NOLAN, P., "The Chinese Puzzle", in FAN, Q. and NOLAN, P. (Eds), *China's Economic Reforms – The Costs and Benefits of Incrementalism*, New York, St. Martin's Press, 1994, p. 1-20.

[131] GABRISCH and LASKI, *o.c.*, *supra* note 103, p. 19.

of economic difficulties, which results in a lack of financial discipline[132]. However, some economists question whether through appropriate budgetary and monetary policies the behaviour of state-owned enterprises can be changed in the desired direction while they still constitute a majority of all enterprises[133].

Reducing deficit spending[134] plays a weighty part as well in stabilisation programmes. These budget deficits should be financed via the money market, but never by unrestrained, free-of-interest borrowing from the central bank. Because command economies subsidise many consumer goods, basic inputs (such as coal), services and tariffs, a balanced budget requires the cutting of these excessive expenditures. Cuts of subsidies are necessary to make the price structure more transparent and more dependent on costs of production. Expenditures, however, are difficult to control as long as a large state sector exists, because of the soft budget constraint and the social benefits, such as housing and education provided by the state sector. To modernise the earning side of the budget, a value added tax as well as income tax system is necessary[135]. An increased tax burden, however, could slow down the badly needed expansion of private firms[136].

It is also necessary to control the demand of private households[137]. Voluntary savings may reduce excess purchasing power. These surplus funds must be taken out of circulation and invested in privatisation such as participation in state enterprises or in the sale of bonds[138]. The fight against inflation also requires control over current incomes,

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[132] KORNAI, J., "The Soft Budget Constraint", 39 *Kyklos*, 1986, p. 3-30. He defines the soft budget constraint as including cases of soft subsidies, soft taxation, soft credit, soft prices, and more. These are the consequence of an overloading demand of society on the state to become a protector, responsible for welfare, growth and national economic interest. See also GAO, S. and SCHAFFER, M., "Financial Discipline in the Enterprise Sector in Transition Countries: How Does China Compare?", in COOK, S., YAO, S. and ZHANG, J. (Eds.), *The Chinese Economy under Transition*, Macmillan, Basingstoke, 2000, p. 64-86.

[133] GABRISCH and LASKI, *o.c.*, *supra* note 103, p. 20; see also FISCHER and GELB, *o.c.*, *supra* note 100, p. 185 about macro-imbalances.

[134] GABRISCH and LASKI, *o.c.*, *supra* note 103, p. 20-21; and MARER, *o.c.*, *supra* note 125, p. 48 (about the problems of cutting expenditures and balancing the budget. Sales of state enterprises and housing generate nonrecurring revenue. Therefore the money should be used to reduce the government's foreign or domestic debt).

[135] Important in this regard is the problem of tax arrears in transition economies, which is different from problems concerning tax evasion. Tax arrears usually only becomes a problem if these countries try to harden the budget constraint. See, *e.g.*, GAO and SCHAFFER, *o.c.*, *supra* note 132, p. 80.

[136] GABRISCH and LASKI, *o.c.*, *supra* note 103, p. 20.

[137] *Ibidem*, p. 21.

[138] *Ibidem*.

and keeping the rise of money wages below the increase in labour productivity, and when necessary, even below the increase of consumer prices[139].

A necessary precondition for a successful stabilisation of the economy in transition is an effective monetary and credit policy[140]. Reforms of the banking system involve the separation of specialised banks from the central bank. The former are expected to become real commercial banks and hence to act as independent profit-oriented institutions. The central bank's task is to adjust the money supply to the requirements of the economy, while at the same time to maintain price stability. This often means a restrictive monetary policy to end the irresponsible monetary expansion of the past. The credit policy should take care of the borrowers' credit standing and maintain a real positive rate of interest for savers. Often a reorganisation of the credit system is necessary to prevent that the new commercial banks will be burdened by old debts.

Important also is the creation of better competitive conditions[141]. The dismantling of the monopolistic structure of the state sector may help in creating a competitive environment in which state-owned firms would react in a market conforming manner to the lifting of price controls, increased interest rates and tightening of the terms of credit, new forms of taxation etc. The new behaviour of these enterprises is absolutely necessary to respond to market signals and to make decisions according to market considerations as is required by article XVII GATT.

Serious consideration should also be given to an active labour market policy and social policy measures[142]. To safeguard the transitional programme socially and politically, the stabilisation of the economy must be accompanied by an adjusted social policy. An efficient system of social benefits should compensate the price rises, the housing

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[139] *Ibidem.*

[140] GABRISCH and LASKI, *o.c.*, *supra* note 103, p. 21-22; MARER, *o.c.*, *supra* note 125, p. 50 (about mobilising savings and the improvement of financial intermediation). To encourage private saving and to improve the efficiency of intermediation a couple of necessary reforms are necessary, such as the compilation of financial information in accordance with definitions and standards customary in market economies; a sound legal and regulatory framework to let financial markets operate; procedures must be established to handle current and future losses of commercial and other banks; the ownership of banks and the competition between them must be studied; expertise and resources to service small private business ventures must be found; equity markets must be nurtured to play more than a marginal role in mobilising and allocating savings. On financial system evolution, see also, THIESSEN, U., *Aspects of Transition to Market Economies in Eastern Europe*, Avebury, Aldershot, 1994, p. 117ff.

[141] GABRISCH and LASKI, *o.c.*, *supra* note 103, p. 22.

[142] *Ibidem,* p. 23.

shortages etc., so as not to stop general consumption. Also workers' interests should be advanced by the protection against (unlawful) dismissal, introduction of unemployment insurance and genuine trade unions, by defining workers' rights in management participation, and by taking also consumer protection measures. Of course these social values will depend heavily on the type of market economy these countries' leaders wish to implement. But let us not forget that politically a government should enjoy society's full confidence.

Although most economists agree with the several steps governments should take to restructure their economy, the sequencing, and especially the pace of the reforms is subject to more debate.[143] The determination of the proper sequence and timetable for the successive reform measures is one of the key issues, because shortages, inflation, deficits in the trade balance, the growing burden of indebtedness, liquidity bottlenecks, and many other types of tension, and unhealthy disequilibria, often serve as ready excuses for a return to centralist methods. While a gradualist approach[144] may cause less social tensions, a long period of moderate reform entails the danger that both reformers and the population will resist further reforms, as they do not always immediately improve the

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[143] See generally WAPENHANS, W., "Is there a Consensus on the Scope, Sequencing and Pace of Transition?", in MARER and ZECCHINI, *o.c.*, *supra* note 100, p. 280-282; and BUNCE, V., "Sequencing of Political and Economic Reforms", in *East – Central Economies in Transition*, *l.c.*, *supra* note 128, p. 49-61. As for pace and sequencing, HELLIWELL, *o.c.*, *supra* note 118, p. 128, notes that the evidence of transition countries is mixed, so that there is no clear message. There is much framework building to be done before a market economy can function well. These countries are being forced by the pace of political events to react almost on a day-to-day basis and thus not much freedom to plan the sequencing of reforms. Whatever the chosen sequence and speed of reforms, the improvements in standards of living will in most cases come about slowly and the gains unevenly distributed. This suggests that heavy investment in political stability and consensus should have a high priority, coupled with finding ways to keep expectations realistic. DORNBUSCH, *o.c.*, *supra* note 125, p. 170-71 notes that transition needs to be accomplished extremely fast because the ice is melting, the distance to go is far, and the task is overwhelming. Countries that drag their feet risk falling into deep poverty, where even the unsatisfactory living standards of the past decade can no longer be maintained because the organisation of the economy has vanished. Gradualism may seem a low risk strategy in that day-to-day events seem under control. But this appeal is only superficial, because it seems to take away the harshness of adjustment, whereas it is only appropriate if going slowly promises better results at a lower cost. See also FISCHER and GELB, *o.c.*, *supra* note 100, p. 194ff; and TARDOS, M., "Sequencing the Reform", p. 202-207. GANG, F., "Development of the Nonstate Sector and Reform of State Enterprises in China", in DORN, *o.c.*, *supra* note 109, p. 75-85, at p. 75 (noting that the high cost for maintaining the inefficient state enterprises may be justified by the opportunity costs of social unrest and reduction of GDP caused by radical changes).

[144] The so-called gradual or incremental approach to reform refers to the way of institutional transition in which the first step toward the market economy is not restructuring the existing old economic sectors, but developing the new system outside the old ones through economic growth. See GANG, *o.c.*, *supra* note 143, p. 75.

individual situation of the people. The Chinese experience is often called a successful case of gradualism[145]. A compact and radical reform or shock therapy[146] is not free from dangers either. Moreover such a therapy may become uncontrollable, unless it is very skilfully managed by an able political leadership[147]. It imposes not only a heavy burden on the population in terms of a sudden reduction of real wages and consumption, but a severely restrictive fiscal and monetary policy may set off a chain of enterprise bankruptcies, while only a small proportion of the resources thus set free, such as capital, material inputs and labour, can be absorbed into other sectors of the economy. Secondary effects, such as a decline in demand for goods produced by the efficient sectors, may exacerbate recessive tendencies and lead to a drastic increase in unemployment[148]. Given the primary comparative advantage of wage costs in transition economies, the question

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[145] See GAO and CHI, *o.c.*, *supra* note 108, p. 7 (defending gradual reform as a successful experience for China, as a practice that is in line with the actual conditions of the country. The Chinese advocate that the best use of the situation is, to gradually expand in line with the given conditions and possibilities. On page 10 the authors stress that gradual reforms are built on public awareness, involving every member of the social community, and that reform must win the understanding of people from all walks of life. Nevertheless, the Chinese authors warn that gradualism may cause contradictions within an economic system and lead to disorder in economic performance. They continue to explain why Chinese gradualism is more successful than trials of gradual reform in other transition economies, such as Hungary in 1968). See also FUKASAKU, K. and SOLIGNAC LECOMTE, H., "Economic Transition and Trade Policy Reform: Lessons from China", in BOUIN, O., CORICELLI, F. and LEMOINE, F., *Different Paths to a Market Economy – China and the European Economies in Transition*, OECD, Paris, 1998, p. 63-86, at p. 63 (noting, however, that Chinese gradualism stems from political constraints on policy makers under a communist regime, rather than from a clear economic policy option). This will be discussed further in Chapter Two. See also, *e.g.*, CHEN, K., JEFFERSON, G. and SINGH, I., "Are There Lessons from China's Economic Policies?", in HILLMAN, A. and MILANOVIC, B. (Eds.), *The Transition from Socialism in Eastern Europe – Domestic Restructuring and Foreign Trade*, World Bank, Washington DC, 1992, p. 105-129; SALVINI, G., "Private Sector and Economic Reforms in the Soviet Union and China", in FRATESCHI, C. and SALVINI, G. (Eds.), *A Comparative Analysis of Economic Reforms in Central and East Europe*, Dartmouth, Aldershot, 1992, p. 127-142; and HU, X., "What Can Be Learned from China's Transition", in *Problems in China's Transitional Economy – Property Rights and Transitional Models*, EAI Occasional Paper, n° 6, Singapore, University Press, p. 39-69.

[146] In general, a shock therapy consists of almost simultaneously or in rapid succession implemented price liberalisation, trade liberalisation, adoption of non-inflationary macroeconomic policies and legalisation of the private economic activity and privatisation.

[147] But a sceptical DORNBUSCH, *o.c.*, *supra* note 125, p. 171, notes that the administrative capacity for successful gradual reform simply does not exist either. Nothing has changed with new and highly committed talented personnel joining the ranks, because they too will be unable to mastermind an economy-wide soft landing.

[148] On unemployment, see, *e.g.*, THIESSEN, *o.c.*, *supra* note 140, chapter 2, p. 89ff. The author on page 108 notes that the primary comparative advantage of transition economies may be given by wage costs.

remains whether these economies will come to an unemployment rate compatible with society's values[149].

Despite some difficulties China has had considerable success in expanding the role of the market for goods. Markets for factors of production, such as land, labour and capital, have developed more slowly[150]. In Chapter Two, the Chinese economy, and especially the country's enterprise restructuring process, will be discussed against the background of article XVII GATT.

C. Towards Integration in the World Economy

Once transition economies have chosen the kind of market-economy they wish to pursue, the price liberalisation inside the country should sooner or later be linked with foreign trade liberalisation[151], to adjust the internal price and output structure to the world market conditions. Liberalisation is normally accompanied by a full convertibility of the currency, the abandonment of the central foreign exchange control, the foreign trade monopoly and the introduction of appropriate tariff policies. Governments may opt to assist some exporting industries and to protect some sectors, so as not to expose the economy to the pressures of world competition all too sudden[152].

A central problem to be mastered in the search for new ways towards integration in the world economy and world trade is the expansion of exports[153]. The expansion of exports is the only factor in the long run, which determines the import prospects of any economy[154]. The chances for a successful restructuring of the economy, improving efficiency, and raising living standards, are not very encouraging if exports cannot be

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[149] THIESSEN, *o.c.*, *supra* note 140, p. 108. See also HUSSAIN, A. and ZHUANG, J., "Impact of Reforms on Wage and Employment Determination in Chinese State-owned Enterprises, 1986-91", in COOK, *et al*, *o.c.*, *supra* note 132, p. 87-109.

[150] LARDY, *o.c.*, *supra* note 85, p. 8.

[151] CRANE, *o.c.*, *supra* note 128, p. 40 (noting that the centrally planned economies suffered from the most complete trade protection in the world. Despite the rapid change in trade policies, trade liberalisation has been only partial).

[152] *Ibidem* (noting that transition economies continue to employ high tariffs, strict quotas, and other nontariff barriers to trade to protect domestic industries. These protectionist measures impose all the attendant associated costs on the economy). Also inappropriate exchange rate policies have led to protectionist pressures, as noted by DRABEK and BRADA, *o.c.*, *supra* note 125, p. 9.

[153] The success of most transition economies in increasing exports to the West has been one of the most pleasant surprises of transition, as is noted by CRANE, *o.c.*, *supra* note 128, p. 41.

expanded. This expansion is difficult given the outdated production structures, the lack of investment funds, and the old management lacking entrepreneurial acumen and experience. In this regard foreign direct investment is absolutely necessary, what in turn presupposes the removal of barriers to the entry of foreign capital. Integration in the world economy thus necessitates also integration into the international capital flows.

The Bretton Woods institutions and their Western members are faced with the question how to support the transition economically, and also in other respects, such as technical assistance, training, counselling, and know-how[155]. It would be a mistake for Western countries to take the opening of the East to be nothing but an opportunity for increasing exports. Of course only corresponding import earnings can assure the servicing of credit by the West. But the West must also open its markets to imports from transition countries[156]. The attitude of the European Community and the United States *vis-à-vis* transition economies is sometimes dangerous for further trade liberalisation, as will be discussed in Chapters III and IV. These Chapters will focus on the bifurcated trade policy instruments Western countries employ against transition economies. However, let us first turn to the importance of the rule of law in the transformation process of these transition economies.

IV. Legal System

Apparently the development of a market economy in countries of transition also entails the creation of a legal system. If we agree that some form of market economy is an essential underpinning of integration, integration into the WTO will also require the

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[154] See, *e.g.*, COOPER, R. and GACS, J., *Trade Growth in Transition Economies*, Cheltenham, Edward Elgar, 1997 (noting that Eastern and Central Europe are a reference to prove that exports are necessary to pay for imports. Good export performance is necessary for general economic progress).

[155] See generally AZIZ, A., "The Role of International Financial Institutions", in *East – Central Economies in Transition*, *l.c.*, *supra* note 128, p. 191-201. See further GUITAN, M., "The International Monetary Fund", in MARER and ZECCHINI, *o.c.*, *supra* note 100, p. 236-239 and on the role of the World Bank WAPENHANS, W., "The World Bank", in *ibidem*, p. 241-246. Finally, on the role of the West, see ZECCHINI, S., "Economic Reform and 'Western' Assistance", in *ibidem*, p. 256-269; and ASSAF, G., "Technical Assistance toward Restructuring and Privatisation in Central and Eastern Europe", in *East – Central Economies in Transition*, *l.c.*, *supra* note 128, p.239-258.

[156] DORNBUSCH, *o.c.*, *supra* note 125, p. 179 (noting that if reform fails, citizens of Central and Eastern Europe will start migrating to the West. Free trade with these countries is hard to accept, but the prospect of massive, unstoppable migration should lead to second thoughts on this issue. Economic integration therefore should mean opening doors with a far easier flow of resources, technology, education, and capital).

adoption of the necessary legal infrastructure to support the free market economy. The need for legal institutions can be found in several articles of different WTO texts. The WTO Agreements cover a large number of provisions requiring the availability of judicial, arbitral or administrative tribunals and independent domestic review procedures[157]. Some of the covered agreements provide specific means for the enforcement of WTO rules by national administrative and judicial bodies[158]. The general principle of legal transparency, however, is reflected in Article X GATT[159].

The last ten years have seen an enormous investment in legal reform efforts in transition and developing economies to facilitate emerging markets. This often involves the importation of legal models from mature economies to speed up these reforms. Important in this respect is also the relationship between domestic and international economic law. It is one process to formulate the national foreign policy acceptance of international economic law. But this should then be followed by a process of implementation, *i.e.* of policing and enforcing international economic law at the national level. And finally, what is needed is legal scrutiny depending on the status of national law at the international level and vice versa[160]. In the course of these processes being formed, it is always necessary to remain vigilant, because the adoption of WTO texts could be window dressing only, and therefore misguide foreign investors.

Whatever system a state adopts, monism or dualism, incorporation or transformation, the presumption in all states should exist that domestic legislation is to be interpreted in such a manner so as to avoid conflict with international law and thus WTO law[161].

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[157] Article X GATT, Article 13 Antidumping Agreement, Article 11 Agreement on Custom Valuation, Article 2 (j) Agreement on Rules of Origin, Article 4 Agreement Pre-shipment Inspection, Article 23 Subsidies Agreement, Article VI GATS, Article 41-50 and Article 59 TRIPS, and Article XX Government Procurement.

[158] See, *e.g.*, Article 70.8 (a) TRIPS.

[159] See OSTRY, S., "China and the WTO: The Transparency Issue", 3 *UCLA J. Int'l L. & For. Aff.*, Summer 1998, p. 1-19.

[160] QURESHI, *o.c.*, *supra* note 42, p. 80. Also relevant in this regard is PETERSMANN, E., "Strengthening the Domestic Legal Framework of the GATT Multilateral Trade System: Possibilities and Problems of Making GATT Rules Effective in Domestic Legal Systems", in PETERSMANN and HILF, *o.c.*, *supra* note 55, p. 33-113.

[161] QURESHI, *o.c.*, *supra* note 42, p. 85-88. On monism and dualism, see DICKE, D., "Public International Law a New International Economic Order", in SARCEVIC and VAN HOUTTE, *o.c.*, *supra* note 55, p. 23-51, at p. 29ff.

The next paragraphs will first explain the intricate relationship between the capitalist free market and the rule of law, to conclude with many great thinkers that markets need legal institutions. However, just as different attitudes exist towards the adoption of a market economy, also different cultural attitudes towards law exist, which need to be interfaced, as the Chinese example will illustrate at the very end of this Chapter. Notwithstanding these different attitudes to the law in different parts of the world, integration into the global economy will also need a certain degree of legal convergence. Therefore, harmonisation and standardisation of legal rules may be a solution to smoothen the process of change from commercial institutions in transition countries based on relational orientation to institutions based on formal orientation. A formal orientation allows businesses and businesspersons in emerging economies to enter into commercial relations with persons and entities outside of their own polity[162]. Nonetheless the adoption of foreign legal models and the process of harmonisation itself are not without difficulty. Therefore tensions will remain between the international and domestic level. Foremost it should be taken into account that building a legal framework to interface the different trade policies cannot escape an environment that is replete with existing institutions[163].

A. Capitalism and the Rule of Law

With the economic failure of communism, it also became clear that the socialist legal system was ill prepared for the changes needed to suit an open market economy[164]. In "New Institutional Economics",[165] it is generally accepted that law plays a fundamental

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[162] See in this regard NICHOLS, P., "A Legal Theory of Emerging Economies", 39 *Va. J. Int'l L.*, Winter 1999, p. 229-300.

[163] *Ibidem.* For the meaning of institutions, see below note 165.

[164] The aim of socialist law is not to define standards of conduct in the private or public sphere, and therefore laws need not be clear or accessible to ordinary citizens. Structural limits on governmental entities are considered artificial and contrived. The communist ideal is the development of a society in which government and law are completely unnecessary. In practice, socialist law operates according to the dictates of political expediency. See *Encyclopedia of Soviet Law*, Boston, Martinus Nijhoff, 2nd rev. ed., 1985, p. 706. For discussion of the development of the rule of law in the Soviet Union, see KARATASHKIN, V., "Human Rights and the Emergence of the State of the Rule of Law in the USSR", 40 *Emory L.J.*, 1991, p. 889ff; BERMAN, H., "Counterrevolution of Transition: A Response to Human Rights and the Emergence of the State of the Rule of Law in the USSR", 40 *Emory L.J.*, 1991, p. 903ff.

[165] New Institutional Economics is built upon *inter alia* the ideas of both the Chicago and Virginia Schools of law and economics (Coase, Demsetz, Posner, Buchanan, Tullock, Krueger), the Austrian theory on institutions and entrepreneurship (Hayek, Menger and Kirzner), and the new economic history of Douglas North. These ideas are amplified in subsequent paragraphs. In short it defends the position that the emergence of markets and entrepreneurship is promoted by institutions, such as for the protection of

role in facilitating the development of markets and entrepreneurship. To this end the implementation, acceptance and legitimacy of a new legal system has to take place alongside the creation of a market economy in transition countries.

According to neo-classical economists of the "Chicago School", a link exists between economic returns and the autonomy in using and operating property, because a legal system is the necessary complement of an open market economy. This link depends on legal rights, especially ownership. Therefore in neo-classical economics it is thus believed that institutions of formal and well-defined property rights are the precondition for economic prosperity and are set up to reduce transaction costs[166]. Because the true owners have the power and incentives to stop losses and encourage profitability, true private property blocks the inefficiency, which is characteristic of the old socialist economic system[167].

Also the "Virginia School of Law and Economics" defends that the emergence of markets and entrepreneurship depends on the creation of formal laws and institutions for the protection of property rights and the enforcement of contracts. In their approach laws/legal norms of the state conceptually emerge endogenously via a *public choice* or

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property rights and the enforcement of contracts. It is relevant for our discussion here, that post-communist market building should coincide with the creation of an appropriate legal system. Sociological institutionalism offers perhaps the broadest definition of institutions of any of the new forms of institutionalism. The definition includes formal and infomal rules, symbols, cognitions, norms, and any other templates that organise or give meaning to the human condition. International law scholarship in particular has embraced two iterations of institutionalism. See, *e.g.*, SLAUGHTER-BURLEY, A., "International Law and International Relations Theory: A Dual Agenda", 87 *Am. J. Int'l L.*, April 1993, p. 205-239; SETAER, J., "An Iterative Perspective on Treaties: A Synthesis of International Relations Theory and International Law", 37 *Harv. Int'l L.J.*, Winter 1996, p. 139-229; KEOHANE, R., "International Relations and International Law: Two Optics", 38 *Harv. Int'l L. J.*, Spring 1997, p. 487-502; and SLAUGHTER, A., TULUMELLO, A., and WOOD, S., "International Law and International Relations Theory: A new Generation of Interdisciplinary Scholarship", 92 *Am. J. Int'l L.*, July 1998, p. 367-397. For the most part institutionalism as used by legal scholars either borrows from other disciplines or refers to the judiciary and other political entities. It is not just courts and political agencies, but also the law itself, which are considered to be an institution.

[166] See, *e.g.*, COASE, R., "The Nature of the Firm", 4 *Economica*, 1937, p. 386-405; COASE, R., "The Problem of Social Costs", 3 *Journal of Law & Economics*, 1960, p. 1-44. Transaction costs, unlike costs of production, are defined as those costs that are incurred in the process of exchange, such as the costs of searching for prices and/or trading partners, the costs of negotiation and enforcement of contracts, and the costs of breach. Coase argues that, in a real world with positive transaction costs, institutions, including the state, have important roles to play in economising on transaction costs.

[167] See, *e.g.*. BARZEL, Y., *Economic Analysis of Property Rights*, Cambridge, Cambridge University Press, 1989.

contractarian process[168]. Property rights and contracts in a market economy should therefore be protected by the 'protective state'[169]. Other prominent economists, such as Williamson, emphasise the importance of different forms of private ordering[170], of which relational contracting is a prime example. Williamson emphasises the importance of *ex post* monitoring of contracts, that is, how contracts are to be protected from 'opportunism'[171].

The intricate connection between market and legal infrastructure is also studied by Douglas North[172], Friedrich Hayek[173] and Max Weber, just to name a few others. North argues *e.g.* that, traditional economic history has been preoccupied with the development of technology, but has neglected the emergence of the legal structure that facilitates the exchange and the development of markets. Therefore capitalism requires a rational and autonomous legal system. Without secure legal rules there is no confidence to make investments or commitments for the future, and of course independent organisations and institutions are needed to give advice and guidance to the economy.

Profit making needs predictability and calculability, according to sociologist Max Weber[174]. This is enhanced by clear rules of property and ownership. The more property, capable of being privately owned, becomes alienable, the more transactions in the market will take place. And exchange is the key of capitalism. Rules of contract, especially the

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[168] See, *e.g.*, BUCHANAN, J. and TULLOCK, G., The Calculus of Consent: Logical Foundations of Constitutional Democracy, Ann Arbor, University of Michigan Press, 1962; BUCHANAN, J., The Limits of Liberty: Between Anarchy and Leviathan, Chicago, The University of Chicago Press, 1975.

[169] BUCHANAN, J., *The Limits of Liberty*, *l.c.*, *supra* note 168, at p. 95-96.

[170] Unlike the Chicago and Virginia Schools, which follow the Hobbesian legalist centralist tradition emphasising the importance of the state in achieving social order via its role in protecting property rights and enforcing contracts, Williamson emphasises 'private ordering'. See WILLIAMSON, O., *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*, New York, The Free Press, 1985. See also RUBIN, P., "Growing a Legal System in the Post-Communist Economies", 27 *Cornell Int'l L. J.*, Winter 1994, p. 1-47 (demonstrating that private ordering and government involvement are complementary in growing a legal system).

[171] WILLIAMSON, *o.c.*, *supra* note 170, p. 61.

[172] NORTH, D., Institutions, Institutional Change, and Economic Performance, Cambridge, Cambridge University Press, 1990.

[173] See HAYEK, F., *Individualism and Economic Order*, Chicago, The University of Chicago Press, 1948. Hayek and others provide a "spontaneous order" to explain the emergence of social institutions. In this spontaneous order, institutions evolve as a result of market processes and other forms of spontaneous individual action. They emerge in an invisible-hand manner, without any conscious will, directed toward their creation by the individuals concerned.

[174] See, *e.g.*, RHEINSTEIN, M. (Ed.), *Max Weber on Law in Economy and Society*, Cambridge, Harvard University Press, 1954.

freedom of contract, take a very important place. Fairness, impartiality and equality also become overly important, because they are necessary to manage and to calculate commercial risks.

The need for the development of a legal system in transition countries can be looked at from the economic and social angles depicted above. However, it is not the purpose of this Chapter to necessarily equal the development of the legal system in these transition economies with the transplantation and implementation of the Western rule of law. The rule of law is a Western politico-philosophical concept with the objective to establish individual freedoms and to protect against any manifestation of arbitrary power by the public authorities[175]. This concept has enabled certain basic conditions and principles such as the separation of powers, judges' independence, respect for individual fundamental rights and freedoms, the legality of administrative action, control of legislation and administration by the independent judiciary and other legal professions[176]. Weber argued that the formal, rational and logical characteristics of the Western legal system provided the basis for creating a steady, predictable system, which supported capitalism. In this light democracy and freedom are also often viewed as a proper basis towards marketisation[177].

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[175] See, *e.g.*, Aristotle's *dictum* that: "The rule of law (...) is preferable to that of any individual. On the same principle, even if it be better for certain individuals to govern, they should be made only guardians and ministers of the law." *Politics*, ch. 3.16. In ROSS, D., *Aristotle*, London, Methuen, 1949. Official behaviour must be constrained by sound legal institutions and law is one of the few available mechanisms to curb arbitrary power. For further discussion of the rule of law in the US legal system, see TRIBE, L., "Revisiting the Rule of Law", 64 *N.Y.U. L. Rev.*, 1989, p. 726. For a discussion of the differences between Western concepts of law and communist ideology, see DAVID, R., "On the Concept of 'Western' Law, 52 *Cin.L.Rev.*, 1983, p. 126.

[176] See, *e.g.*, DIENG, A., "Role of Judges and Lawyers in Defending the Rule of Law", 21 *Fordham Int'l L. J.*, December 1997, p. 550-557, at p. 551. For a discussion of the relationship between the rule of law and judicial decision-making, see SCALIA, A., "The Rule of Law as a Law of Rules", 56 *U.Chi. L. Rev.*, 1989, p. 1175. On the relevance of the principle of separation of powers, see THORNBURGH, D., "The Separation of Powers: An Examplar of the Rule of Law", *Wash. U. L. Q.*, 1990, p. 485. On the Rule of Law as an analytic framework for legal reform programmes, see SARKAR, *o.c.*, *supra* note 51, p. 28ff.

[177] GHAI, Y., "The Rule of Law and Capitalism: Reflections on the Basic Law" in WACKS (Ed.), *Hong Kong and China 1997*, Hong Kong, Hong Kong University Press, 1993, p. 343. See also in this respect PREWORSKI, A., *Democracy and the Market: Political and Economic Reforms in Eastern Europe and Latin America*, Cambridge, Cambridge University Press, 1992. See also in following Buchanan's economic constitutionalism QURESHI, *o.c.*, *supra* note 42, p. 82 (noting that national constitutions should provide effective means to safeguard transnational economic rights related to an open liberal international economic system. These rights comprise *e.g.* the right to export-import, to remit and exchange currencies, the right to be involved in IMF and World Bank conditionalities, to repatriate profits etc). See also HILF, M. and

However, the rule of law may be inextricably linked with, but is more than just an operational and workable infrastructure that promotes foreign direct investment and international trade and, in so doing, enhances the functions of the Bretton Woods institutions[178]. The legal system that serves the purpose of integration into the WTO may be limited to a regulatory framework supporting the development and maintenance of a transparent and stable economic environment conducive to efficient private sector activities, which comes close to what the IMF understands to be an important facet of good economic governance[179]. Nevertheless the socio-cultural legacy of the three Bretton Woods institutions gives away all the characteristics of the Western rule of law, also because it is very difficult to separate the economic aspects of governance from the political aspects. This is true also for the WTO.

Creating a legal system is more than legislative activity; it should also permeate the legal consciousness of the people living in the region under transition. Western influence raises the concern of "transplantability" of Western social and political institutions, and post-communist state building[180]. Moreover economic troubles often compound the problem of popular acceptance to establish a rule of law in transition economies[181]. It is, however, not questioned that the economic transformation of transition economies inevitably entails legal reform and legal system development.

According to some, the industrialised democracies have an essential, indispensable role in determining the policies and programs for globalisation that will promote common values, balance competing values, solidify respect for the rule of law, and increase

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PETERSMANN, E. (Eds.), *National Constitutions and International Economic Law*, The Hague, Kluwer Law, 1993.

[178] In this regard it is often referred to economies, such as Singapore and Hong Kong. See on the link between politics and economics in the so-called "little dragons": JOHNSON, C., "Political Institutions and Economic Performance: The government-business relationship in Japan, South Korea and Taiwan" in SCALAPINO, R., SATO, S. and WINANDI, J. (Eds.), *Asian Economic Development – Present and Future*, Institute of East Asian Studies, Berkeley, 1985.

[179] See *Good Governance – The IMF's Role*, IMF, Washington DC, 1997.

[180] CHUA, A., "Markets, Democracy, and Ethnicity: Toward a New Paradigm for Law and Development", 108 *Yale L.J.*, p. 1, at p. 5 (noting that entrenched ethnic divisions permeate most developing countries, and these divisions bear a distinctive and potentially subversive relationship to the project of marketisation and democratisation).

[181] STORIN DOTY, K., "Economic Legal Reforms as a Necessary Means for Eastern European Transition into the Twenty-first Century", 33 *Int'l Law.*, Spring 1999, p. 189-225, at p. 195-97. For a discussion, see also Recent Development Symposium, 26 September 1996, in "Constitutional 'Refolution' in the Ex-Communist World: The Rule of Law", 12 *Am.U.J. Int'l L. & Pol'y*, 1997, p. 45-143.

empathy among nations[182]. Although this view to others sounds paternalistic[183], it cannot be denied that the harmonisation of business practices and the accommodation of competing values is a major issue raised by the integration in a global economy. Without common rules to govern trade, companies from one country might compete at a disadvantage against those of another, because each country could have dissimilar rules for acceptable practice in international business. Setting up the 'rules of the game' in international business is important not just to promote economic competition under fair conditions, but also to determine the proper balancing of competing values[184]. It can therefore be argued that the integration process of transition economies also requires a certain degree of convergence in accepting WTO standards. This will be explored in more detail below.

B. Integration into the International Legal System

Integration into the WTO, as part of the larger international legal system in the Bretton Woods order, is not just an economic process, but also presupposes profound domestic law reform. At the same time, integration may need some degree of legal convergence on the international level, to foster the domestic law reform process. So basically there are two interrelated forces at work. On the one hand there is the restructuring of the world economy on a regional and global scale through transnational legal co-operation from above. On the other hand and simultaneously, there are domestic social and legal forces working from below. It is important, however, that each level is receptive of what happens at the other level.

Yet, the implementation of international WTO obligations in a domestic legal system is influenced by the different political systems, constitutions and legal traditions of member states, and continues to be widely regarded as a domestic matter[185].

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[182] SEITA, A., "Globalization and the Convergence of Values", 30 *Cornell Int'l L.J.*, 1997, p. 429-491, at p. 471.

[183] ANGHIE, A., "Time Present and Time Past: Globalization, International Financial Institutions, and the Third World", 32 *N.Y.U. Int'l L. & Pol.*, Winter 2000, p. 243-290, at p. 245 (criticising the civilising mission whose extension results in the entire globe being governed by a single international law with European origins).

[184] SEITA, *o.c.*, *supra* note 182.

[185] PETERSMANN, E., "Strengthening the Domestic Legal Framework of the GATT Multilateral Trading System: Possibilities and Problems of Making GATT Rules Effective in Domestic Legal Systems", in PETERSMANN and HILF, *o.c.*, *supra* note 55, p. 33-113, at p. 37.

The international level can be quite useful to tackle the domestic problems[186], which in a global context push nations towards greater co-operation. These co-operative efforts raise several general questions, such as whether this co-operative approach should be voluntary, or binding[187]; whether the emphasis should be on procedural rather than substantive rules; and whether with respect to substantive rules some sort of minimum standards as the basis of a rule should apply[188].

Globalisation and interdependence will definitely influence the techniques of this co-operation and integration. Harmonisation is a first technique that gradually induces nations towards uniform approaches to a variety of economic regulations and structures[189]. A second technique is a system of continuous 'trades' or 'swaps' of measures to liberalise (or restrict) trade, which is referred to as reciprocity. Finally, what is termed 'interface' by John Jackson is a technique, which recognises that different economic systems will always exist in the world, and tries to create the institutional, legal means to ameliorate international tensions caused by those differences, perhaps through buffering or escape clause mechanisms[190]. These techniques are of course not mutually exclusive, but the question exists as to what the appropriate mixture is[191].

It should further be considered that, tensions exist between globalisation and the law that also influence the integration into the international order. The very concept of law traditionally and historically has been associated with national sovereignty and therefore

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[186] A common argument is that the international level may help countries to commit to their reform efforts and, in so doing, in the case of transition economies ideally provide guidance for the domestic social forces working from below.

[187] See JACKSON, J., "Global Economics and International Economic Law", 1 *J. Int'l Econ. L.*, 1998, p. 1-23, at p. 21. See in this regard also, *e.g.*, CHINKIN, C., "The Challenge of Soft Law: Development and Change in International Law", 38 *I.C.L.Q.*, October 1989, p. 850-866.

[188] See JACKSON, *o.c.*, *supra* note 187, p. 21.

[189] An example in the WTO context could be the uniformity of procedures for applying countervailing duties or escape clause measures. On harmonisation, see LEEBRON, D., "Lying Down with Procrustes: An Analysis of Harmonisation Claims" in BHAGWATI and HUDEC, *o.c.*, *supra* note 52, p. 41-117 (noting at p. 62 that harmonisation is at best a crude tool to deal with systemic and structural trade imbalances, and that harmonisation raises significant resource allocation and efficiency questions). See also ROESSLER, F., "Diverging Domestic Policies and Multilateral Trade Integration" in *ibidem*, p. 21-56 (noting that GATT focuses on the reduction of trade barriers and not on the harmonisation of competitive strategies or conditions in the market. The Agreement on Technical Barriers to Trade is a first effort to harmonise, and demands are increasing; and p. 37 questioning how an agreement on minimum standards can be achieved among so many countries with different values and resources without a clever mix of carrots and sticks).

[190] ROESSLER, *o.c.*, *supra* note 189, p. 41 (noting that the more safeguards and impairment procedures are adopted, the less need will be felt for domestic policy harmonisation and *vice versa*).

[191] See JACKSON, *o.c.*, *supra* note 187, p. 21.

to a certain extent inherently contradicts globalisation[192]. A close analysis of sovereignty turns out to be very complex, and the subject can be 'decomposed' into dozens of more specific issues[193]. Nevertheless national regulatory reforms must be connected to an emerging global regulatory order of which the Bretton Woods institutions are the key representatives. I therefore do not agree with those, who associate globalisation only with deregulation and regulatory meltdown. But it is fundamental that in this relationship between international economic and domestic law, law reformers in countries of transition stress the effectiveness of the law and the policies they implement.

The integration of transition economies into the WTO and the larger international and global environment, in which the Bretton Woods institutions operate, also raises a series of very basic legal questions that are not new to international legal scholars. In the context of the WTO and John Jackson's research in international economic law, these questions involve rule-making at the international level (rule-oriented system) and whether scientific and moral concerns should be taken into due consideration in international trade[194]. They involve questions of international dispute settlement resolution and to what extent they should adequately consider opposing policy goals, or provide for appropriate advocacy from interested authorities and citizen groups. This also leads to questions of transparency and democratic processes. Also important is the relationship between international rules and domestic constitutional and other laws, and problems of regulatory competition.

WTO integration is not just about the formulation of international economic law and the acceptance of international, liberal trade policies, but it is in the case of transition economies at this stage enormously important to cast the foundations suitable to

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[192] See SCHAUER, F., "The Politics and Incentives of Legal Transplantation", CID Working Paper, n° 44, April 2000.

[193] See JACKSON, *o.c.*, *supra* note 187, p. 18 and p. 20. To a great extent these issues concern the 'allocation of power' as between a nation-state and an internationally regulatory system. For example there are questions whether a product safety standard should be controlled by an international body, or a nation-state government, or even by sub-federal government units. Sovereignty is not a magical wand to ward off any 'entanglement' in the international system, but is rather a policy-weighing process. See also BHAGWATI, J., "The Demands to Reduce Domestic Diversity among Trading Nations" in BHAGWATI and HUDEC, *o.c.*, *supra* note 52, p. 9-40 at p. 12 about the loss of sovereignty and philosophical arguments against diversity.

[194] See in this regard the question whether any country can afford a moral foreign trade policy. See KOH, T., *The Quest for World Order: Perspectives of a Pragmatic Idealist*, Singapore, Times Academic Press, 1998.

implement, monitor and possibly enforce the WTO legal standards[195]. Any law reform process should take this into account. In the absence of such foundations a transition economy could formally accept norms with sincere intent to follow them except in the case of danger to the national ideology or to its political system. This is certainly true in the case of China. But also in other countries of transition many domestic stumbling blocks may hinder the effective implementation of WTO legal standards, such as the lack of legal transparency and the defective ownership rights of state enterprises[196]. The latter may upset sound commercial decision making in the global economy and the former adds higher risks to foreign investment and uncertainties to market access commitments. These issues again stress the importance of profound domestic law reform to convince other nations that these countries are receptive to international legal standards.

Most law reform today aims to foster the healthy expansion of market-driven economies. In principle these law reform initiatives, to induce the desired results, should be tailored to local circumstances. But notwithstanding the commitment to tailoring law to local circumstances, this law should fit in with the international economic law system, to cater to international investors, as much as possible national laws likely to affect them[197]. Besides, post-communist countries have looked at Western models as a ready supply for legislative convergence[198].

It can be inferred from the previous paragraphs that the integration of transition economies into the international legal system requires standards from the top down, but also that transition economies have already pre-existing regulatory systems in place; and, for their legal reform plans to work, it is necessary that existing domestic frameworks are

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[195] Or in the words of PETERSMANN, *o.c.*, *supra* note 185, p. 37: "The proper functioning and effectiveness of international trade rules depend on the degree to which the rules are actually observed by the legislative, administrative and judicial branches of governments *within* the member states and enable individual producers, investors, traders and consumers to act in accordance with the rules".

[196] The effective judicial review of trade restrictions should be available not only in technical, rule-oriented areas such as customs valuation and antidumping procedures, which are administered according to detailed rules, but also in more discretionary, policy-oriented areas, such as escape-clause proceedings.

[197] See SEIDMAN, A., SEIDMAN, R. and WAELDE, T., "Good Governance and Legislative Reform: Making Development Work: Introduction", available at www.dundee.ac.uk/cepmlp/journal/html/article4-1.html (last visited May 2001).

[198] See AJANI, G., "By Chance and Prestige: Legal Transplants in Russia and Eastern Europe", 43 *Am. J. Comp. L.*, Winter 1995, p. 93-117; and DELISLE, J., "Lex Americana?: United States Legal Assistance, American Legal Models, and Legal Change in the Post-Communist World and Beyond", 20 *U. Pa J. Int'l Econ. L.*, Summer 1999, p. 179-308.

receptive of the international standards. The section below briefly discusses the Chinese social and legal institutions that traditionally and historically are in place. Any Western or international legal influence to reform these institutions will have to take these pre-existing social institutions into account.

C. China's Legal Culture

China carries the difficult burden to prove that it has cast the domestic fundaments not only to accept WTO legal standards as formulated on the international level, but also that it will be able to make these WTO legal standards effective in the domestic legal order. This exercise methodologically brings us first to China's legal history, because the emergence of law as an institution in China cannot escape the typical Chinese cultural and historical environment replete with pre-existing social institutions.

To apply universal economic and legal models to all transition or emerging economies is an obvious mistake[199]. As to the legal component, a sound understanding of the historical and current environment is necessary before one can start to graft a legal or regulatory model, such as the WTO's, onto an emerging or transition economy. This is also true to fully understand the interaction between the multilateral trade system and its reception in the domestic legal order. This urge is even felt more in the case of China, which is culturally remote from the Western concepts behind the Bretton Woods institutions. The Chinese system has already shaped many important legal notions, which will influence inescapably the carving out of the content, form and implementation of the legal reform in this country. This system should first be fully appreciated. In terms of WTO accession it should be held that the fabric of traditional Chinese law, and the role of law in the lives of the political and administrative institutions within China, is of the utmost importance[200]. This leads one inevitably also to the political dimensions of economic policy formulation and implementation.

Although Western influence in the development and creation of economic law in transition countries is heavy, and Western laws have shaped the content and practice of

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[199] There is no consciously comprehensive strategy to replicate Western legal development. See KEITH, R., *China's Struggle for the Rule of Law*, Basingstoke, Macmillan, 1994, p. 1.
[200] See POTTER, P., "China and the WTO: Tensions between Globalized Liberalism and Local Culture", 32 *Canadian Business Law Journal*, 1999, p. 440-473.

Asian economic regulation in many ways, transition countries, such as China, do not necessarily accept Western law as a universal standard. Western law is only selectively adopted as part of a strategy to facilitate certain aspects of foreign trade and investment while protecting other national and local interests. Resistance in the form of cultural and political values and practices modify and shape Western models[201].

On the assumption that commerce also is powerfully shaped by culture, scholars have come up with the notion of "Chinese capitalism"[202]. This capitalism in Asia does not draw so much from the rule of law but from autocracy, paternalism and personalism (*guanxi*). It is the motivation to succeed and to control its own destiny, to implement social order via micro-units headed by a *pater familias*, and to institute business by means of reliable connections. To this end the rule of law only plays a more limited role[203]. It requires a different framework, one of social relationships, more than impersonal laws[204]. On the other hand Chinese culture and Asian values in economy and law, though a force to be taken into account, should not be overemphasised. Basically the role of these values is similar to the 19th century Protestant ethics, which also impacted the market economy and the legal system[205].

Modern Western law, as it is found in democratic countries, is based on the rule of law, and primarily upon the protection of the rights and freedoms of the individual[206]. This can be traced back to Roman law and theories developed in seventeenth and eighteenth century philosophy until today. This is one of the reasons why Western law developed

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[201] See KAMARUL, B., "Western Economic Law and Asian Resistances", 5 *Australian Journal of Corporate Law*, 1995, p. 84-99. See also PISTOR, K., WELLONS, P. *et al*, *The Role of Law and Legal Institutions in Asian Economic Development 1960-1995*, Oxford, Oxford University Press, 1998, p. 280 (noting that persistent differences in Asian law are not so much substantive, but procedural legal differences such as in the role of the courts and the function of administrative agencies).

[202] See HAMILTON, G. *et al*, *The Economic Organization of East Asian Capitalism*, Thousand Oaks, Sage Publications, 1997; REDDING, G., *The Spirit of Chinese Capitalism*, Berlin, Walter De Gruyter, 1990 and WONG, "Chinese Entrepreneurs and Business Trust" in HAMILTON, G. (Ed.), *Business Networks and Economic Development in South and South East Asia*, Hong Kong, Centre of Asian Studies, 1991, p. 13-29.

[203] See JOHNSON, *o.c.*, *supra* note 178, p. 121. See also generally TURNER, K., FEINERMAN, J. and GUY, K. (Eds.), *The Limits of the Rule of Law in China*, Seattle, University of Washington, 2000.

[204] Of course, personal and social elements are to a certain extent also important for the law as well.

[205] See LOCKETT, M., "The Nature of Chinese Culture", in CAMPBELL, N. (Ed.), *Advances in Chinese Industrial Studies*, London, JAI Press, Volume I, Part A, 1990, p. 269-276.

[206] Of course I should note here, and I repeat from previous paragraphs, that differences between 'rule of law' notions exist even within Western countries; and, I acknowledge that I am oversimplifying the notion here.

mainly as a contractual model of obligations and rights that were important to a society based on agriculture and trade.

The Chinese have not developed this horizontal contractual model like in the West because there is no pertinent concept of the individual[207]. In traditional Chinese law, public law, such as penal law, is emphasised[208]. According to the Legalist school *fa,* meaning law, is the only reliable bureaucratic tool for government. To be effective, however, *xing*, meaning punishment, should be severe[209]. Also the Chinese planned economy was characterised by the priority of power by superior administrative authority and of duties by economic units to whom commands were issued, duty-bound to perform according to the plan[210].

The Chinese individual is traditionally moulded by Confucianism[211]. According to this important School of thought a person does not exist as an isolated entity, but as a father to his son, a son to his father, a younger brother to his elder brother, a husband to his wife, a ruler to his subject and *vice versa.* It is in the fulfilment of these reciprocal obligations and responsibilities that the individual realises his or her personal fulfilment. For this reason, it is difficult to extract from Confucianism a concept of an abstract individual,

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[207] See MA, H., "The Chinese Concept of the Individual and the Reception of Foreign Law", 9 *J. Chinese Law*, n° 2, Fall 1995, p.207; and HOOK, B. (Ed.), *The Individual and the State in China*, Oxford, Oxford University Press, 1996. For further reference, see BODDE, D. and MORRIS, C., *Law in Imperial China*, Harvard Studies in East Asian Law, 1971; CHEN, P., *Law and Justice – The Legal System in China 2400 B.C. to 1960 A.D.*, New York, Dunellen, 1973; CHU, C., *Law and Society in Traditional China,* Westport, Hyperion, 1980 (reprint 1961); LIU, Y., *Origins of Chinese Law – Personal and Administrative Law in its Early Development*, Oxford, Oxford University Press, 1998; and CHEN, J., *Chinese Law – Towards an Understanding of Chinese Law, Its Nature and Development*, The Hague, Kluwer Law, 1999. See also COHEN, J., "Is there Law in China?", p. 1-14; LUBMAN, S., "Studying Contemporary Chinese Law: Limits, Possibilities and Strategy", p. 14-41; JI, W., "The Sociology of Law in China: Overview and Trends", p. 109-119; LIANG, Z., "Explicating Law: A comparative Perspective of Chinese and Western Legal Culture", p. 121-157; TURNER, K., "Rule of Law Ideals in Early China", p. 231-274; ALFORD, W., "'Seek Truth from Facts' – Especially when They are Unpleasant: America's Understanding of China's Efforts at Law Reform", p. 295-314; and YU, X., "Legal Pragmatism in the PRC", p. 315-337 in LEE, T. (Ed.), *Basic Concepts of Chinese Law*, New York, Garland, 1997.

[208] *E.g.* in the Code of the Tang Dynasty (618-905 AD).

[209] See MA, *o.c.*, *supra* note 207, p. 211.

[210] See CHEN, A., "The Developing Theory of Law and Market Economy in Contemporary China", in WANG, G. and WEI, Z. (Eds.), *Legal Developments in China – Market Economy and Law*, Hong Kong, Sweet & Maxwell, 1996, p. 3-20 at p. 10. See also CHEN, A., "Toward a Legal Enlightenment: Discussions in Contemporary China on the Rule of Law", 17 *UCLA Pac. Bas. L. J.*, Fall/Spring 1999-2000, p. 125-165.

[211] Confucius (551-470 BC) and Mencius (371-289 BC). To Confucius and his disciples human nature is good and the cultivation of a person's own virtue is the basis of regulating one's family, the state and the

entirely separate from other individuals. The traditional Chinese individual is an ethical concept. The rules each individual should follow in this duty-oriented structure are called *li*, referred to as mores[212].

Another traditional Chinese School of thought is relevant as well. The Yin-Yang School interconnects nature and mankind. Because man is a part of nature, the justification of his behaviour should be found in nature's behaviour. Dominating in this School is the idea that *yang* is superior and *yin* is inferior. Hence the ruler is *yang*, the subject is *yin*; the father is *yang*, the son *yin*; the husband is *yang*, the wife is *yin*, just like earth is beneath heaven[213].

When Emperor Wu[214] of the Han Dynasty[215] made Confucianism the official state teaching, the state doctrine gave a proper sphere of application to all three Schools. The Legalists provided the instrument of government, the content of the law and the punishment was provided for by Confucianism, and Yin-Yang ideas helped to uphold the superiority of the Emperor and the vertical structure of society[216].

Following the forced opening of China by Western powers, China changed its laws and legal system to meet Western standards, based on individual rights and equal protection before the law. In a social structure that demanded each person to behave in a certain manner as became his or her status in the family or society, this foreign law, at least according to one Chinese scholar, cannot be entirely successful[217].

Although Confucian ethical doctrines and the traditional concepts are almost completely expelled by the legal codes as formulated in the late 1920s and early 1930s, some obstacles in the implementation of modern Westernised Chinese law possibly remain. The existence of modern laws in China does not mean that there is a Western rule of

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whole world. Benevolence is the characteristic element of humanity. Nonetheless, the cultivation of the person is not achieved by oneself alone. One must feel natural affection for those who are related.

[212] MA, *o.c.*, *supra* note 207, p. 208ff.

[213] *Ibidem*, p. 211-212.

[214] WU (140-87 BC).

[215] Han Dynasty (206 BC – 220 AD).

[216] This is referred to as the "legalisation of Confucianism".

[217] MA, *o.c.*, *supra* note 207, p. 214ff. What already makes things more difficult is the Chinese translation for the word "right", which is *quan li*. It literally means "power" and "profit", which Chinese people are taught to despise by Confucianism. There is not exactly a positive connotation like in German *Recht* or French *droit*.

law[218]. But it is also surprising that Chinese thinkers increasingly have acknowledged the autonomy of the will of private parties. Striking is the growing affirmation of values of freedom, autonomy and equality that was denied and suppressed by the planned economy. Hence individuals have become liberated human beings, autonomous subjects, and equal status subjects exercising free will[219]. And so economic participants should be treated equally too. More and more Chinese legal scholars argue that the market economy demands rational law in the sense of Weber[220].

International collaboration, foreign economic exchanges and foreign investment all require legal protection. When China first re-opened in 1978, there was hardly a legal system to speak of. Gradually laws were adopted to orchestrate foreign investment and economic exchanges. But according to Western China specialists the legal values and the legal consciousness have grown less rapidly than the amount of legislation[221]. Values like openness, fairness and justice are legal guiding principles, which obviously need time to settle in. So far China has predominantly looked at pressing economic advantages of implementing foreign law. A good number of Chinese companies are listed in foreign securities markets, and only by ensuring that its securities regulations are compatible with those jurisdictions enables China to reap the benefits. Some critics might argue there is much window dressing and that the fundament of Chinese legal culture is not appropriate to the legal institutions and instruments the Chinese hastily erect. They argue that Chinese Westernised law only leads to a common vocabulary without bridging, however, the profound differences between historical and current concepts of rule and government. They also argue that the law is nothing but a tool to guide, regulate, safeguard and control

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[218] *Ibidem*, p. 215.

[219] See CHEN, *o.c.*, *supra* note 210, p. 9. The transition from a planned economy to a market economy brings about the restoration of rights and freedoms, which were originally subsumed within the state power.

[220] CHEN, J., "Market Economy and the Internationalisation of Civil and Commercial Law in the People's Republic of China", in JAYASURIYA, K. (Ed.), *Law, Capitalism and Power in Asia – The Rule of Law and Legal Institutions*, London, Routledge, 1999, p. 69-94 at p. 75-76. For a discussion, see SHEN, Y., "Conceptions and Receptions of Legality – Understanding the Complexity of Law Reform in Modern China", in TURNER *et al, o.c., supra* note 203, p. 20-44.

[221] LUBMAN, S., "Dispute Resolution in China after Deng Xiaoping: 'Mao and Mediation' Revisited", 11 *Colum. J. Asian L.*, Fall 1997, p. 229-391, at p. 248 (suggesting that popular behaviour in China could be changing faster than in other countries because the government does have the ability to persuade the populace. China's cultural tradition facilitates the acceptance of ideas sown by an authoritarian system of education).

the development of the socialist market economy[222]. In developing its law as an instrument China may boldly learn, experiment and borrow from the legislative experience of the economically advanced nations of the West[223], because such experience belongs according to the Chinese to the common heritage of human civilisation; and, globalisation requires Chinese law on trade and investment to be compatible with foreign and international practice[224]. Many Chinese scholars stress the importance of international conventions and practices in the process. Their emphasis is not on Westernising Chinese law, but on the internationalisation of Chinese law determined by the goals of structural and economic reforms and the liberalisation of productive forces as required by the market[225].

Some observers indicate that traditional values and values promoted during decades of Communism are being threatened by the effects of economic reforms in China[226]. The increase in personal freedom and the improvement in material living standards have caused also changes in the social fabric. There is rural discontent at the exploitation by local cadres, crime has risen, corruption has increased and the Chinese are gradually losing their faith in Marxism-Leninism as adapted by Mao Zedung. The Party's legitimacy might increasingly be questioned, and China is ideologically adrift[227].

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[222] The Chinese state is in command of socio-economic change and laws have been used to promote economic development. See ZHENG, Y., "From Rule by Law to Rule of Law? – A Realistic View of China's Legal Development", East Asian Institute, Working Paper n°1, 18 March 1998. For further reference, see WHITE, G. (Ed.), *The Chinese State in the Era of Economic Reform: The Road to Crisis*, London, Macmillan Press, 1992; and WHITE, G. (Ed.), *Development States in East Asia*, London, Macmillan Press, 1988.

[223] CHEN, *o.c.*, *supra* note 220, p. 81 (noting that what is transplanted is not the will of a particular country or that of a particular historical period or of a particular ruler, but a scientific management system. The market economy has its own rules and mechanisms, technical and managerial norms). On Western legal transplants, see EPSTEIN, E., "Codification of Civil Law in the People's Republic of China: Form and Substance in the Reception of Concepts and Elements of Western Private Law", 32 *U.B.C. Law Review*, 1998, p. 153-197.

[224] CHEN, A., *o.c.*, *supra* note 210, p. 4. See also CHEN, J., *o.c.*, *supra* note 220, p. 74 (noting that also the market economy is a result of human wisdom and not a privilege of the West and that establishing a market economy in China demands a revolution in legal thought and legal theory).

[225] CHEN, *o.c.*, *supra* note 220, p. 81 (noting also that the legal reform is to liberate productive forces).

[226] See LUBMAN, *o.c.*, *supra* note 221, p. 241-243. See also ZHENG, S., *Party vs State in Post-1949 China*, Cambridge, Cambridge University Press, 1997, p. 4 (noting that China is facing a deep institutional crisis, and p. 6 saying that no magic formula exists to revitalise the Communist Party); and CHANG, G., *The Coming Collapse of China*, London, Random House, 2001.

[227] *Idem*.

As this section shows, legal systems are influenced by culture, history and tradition, and this is not different for the Chinese legal system. As a result legal systems may diverge, notwithstanding the growing internationalisation of markets resulting in the development of law and legal institutions that, if not identical in language, perform largely similar functions around the world. However, economic convergence does not necessarily imply convergence of legal systems[228]. The shift to the market paradigm may have caused economic convergence, but many other forms of control, such as the form of negotiation between the state and private business, state guidance about the use of economic resources, bargained policies between the state officials and the business community to look for common interest, and essentially to shelter the domestic market against too much foreign intrusion, are usually not part of any convergence. The WTO in this regard demands a transparent legal system in article X GATT to partly resolve the uncertainty. How China complies with article X GATT will be discussed in Chapter Two.

Apart from the general transparency requirement of article X GATT, the government should be separated from enterprises, and the economic functions of the government should be distinguished, so that enterprises can become truly independent civil law subjects, capable of resisting undue intervention from state administrative authorities. In this respect China has started to acknowledge the autonomy of private law and the precedence of private law over public law in a market economy during the last couple of decades[229]. China's progress during these decades in building a functional and operational legal system is astonishing. So has, contrary to mainstream predictions, a vaguely defined system of property rights in China resulted in rapid economic growth[230]. However, in the eyes of Western economists, China may still need an ownership

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[228] PISTOR and WELLONS, *o.c.*, *supra* note 201, p. 264.

[229] CHEN, *o.c.*, *supra* note 220, p. 75.

[230] See HU, X., "Transformation of Property Rights in Reforming China", EAI Occasional Paper n° 6, *Problems in China's Transitional Economy, Property Rights and Transitional Model*, Singapore, Singapore UP, 1998, p. 3-35; and NEE, V. and SU, S., "Local Corporatism and Informal Privatisation in China's Market Transition", in NEE, V. and LYONS, T. (Eds.), *The Economic Transformation of South China: Reform and Development in the Post-Mao Era*, Ithaca, Cornell University East Asia Program, 1994. On property rights in China, see also HOOGMARTENS, J., "Establishing a Market Economy: Commercialisation of Land-Use Rights in China", in NORTON, J. (Ed.), *Yearbook of International Financial and Economic Law 1999*, London, Kluwer Law, 2001, p. 445-470; and HOOGMARTENS, J., "Taking and Enforcing Mortgages in China: A Lender's Perspective", 30 *Hong Kong Law Journal*, December 2000, p. 520-537.

transformation with a combination of privatisation, denationalisation, and pluralisation as discussed in Chapter Two, to really convince trading powers such as the EU and the US. To ease criticism from these countries, China may also need to establish an effective corporate governance regime[231]. This idea will be elaborated further in Chapter Two.

V. Final Observations

The integration of transition economies into the economic and legal international order presents challenges to the Bretton Woods institutions. One such challenge represents the implementation of the WTO's multilateral trade rules in the domestic regulatory framework of these transition economies, such as China, which has its own set of initial conditions and cannot escape its own historical and cultural environment replete with pre-existing social institutions. Because governments differ widely in the practical application of legal and economic principles at home, it will be necessary to interface the WTO system of multilateral rules and the domestic regulatory systems of its members, especially if they previously adhered to a planned economy. Transition countries are currently in the process to create a regulatory framework to support the development and maintenance of a transparent and stable economic environment conducive to efficient private sector activities and a transparent legal system with access to the judicial system. These reform efforts help the integration into the Multilateral Trading System, which in turn will also need rules to cabin the risks and the costs of integration, with a sufficient amount of flexibility to make swift adjustments to changing circumstances, and to find compromises when necessary. It is against this background that flexible safeguards come into play to ward off the possible risks and dangers of integration. The rise of potential new and large economies in Asia, Latin America and the former Soviet block may create new trade tensions with mature economies. The constant search for new export markets in an integrated world economy may pose a central problem. The expansion of exports is often seen as the only factor in the long-run, which determines the development of any economy; and, the low cost structure of emerging and transition economies, as a threat to more mature economies, may slow down international co-operation. China's accession in

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[231] See, *e.g.*, QIAN, Y., "Enterprise Reform in China: Agency Problems and Political Control", 4 *Economics of Transition*, 1996, p. 427-447.

this regard draws our attention to the tension between, on the one hand, the institutionalisation and rationalisation of world trade, and the empirical reality of global protectionism, on the other hand. WTO safeguards might therefore serve as a buffer zone between opposite economic systems.

The WTO as a "rule-oriented" institution has certain safeguards, such as Articles VI and XIX GATT in place to alleviate part of this tension. But the risk of damage to liberal trade in employing these safeguards always remains immanent. The transformation process from centrally planned economy to market economy is built on illusive principles, which use long lists of preconditions for economic and legal guidance. Because there are no apparent and clear graduation criteria that mark the successful completion of the transition to a market economy, the risk exists that WTO members will continue to use state-trading or nonmarket economy methodologies for protectionist purposes. It would be a mistake for Western countries to take the opening to the Chinese market to be nothing but an opportunity for increasing exports. The West also should open its markets to imports from transition economies, such as China's. The next Chapter will show how China's critics in Europe and America may use China's domestic legal and economic reforms as an excuse to maintain state-trading methodologies in safeguards, which can be used to their protectionist advantage.

Finally, it should be noted that Western countries and Bretton Woods institutions, in their response to integration, should be receptive of the domestic reforms in transition economies and appreciate the cultural underpinnings of these reforms

Chapter Two: China's WTO Accession and Domestic Economic and Legal Related Reforms

A. Policy versus Law

B. Administrative System

C. Legal Redress and Law Enforcement

a. Legal Redress

b. Law Enforcement

IV. Final Observations

The previous Chapter made clear that adding three billion people from transition economies to the Bretton Woods institutions puts a challenge to the WTO in integrating these new entrants. It was also noted that these countries have taken on the challenge themselves by introducing profound domestic legal and economic reforms. This Chapter focuses on some aspects of the Chinese domestic restructuring process. China faces the daunting task to convince WTO members that it can implement the WTO requirements. Coming to terms with the expected competition from China, WTO members are allowed to use trade policy instruments especially designed in the Chinese Protocol of Accession. These trade policy instruments, which are dealt with separately in subsequent Chapters, are to a certain extent based on the assumption that China still is a state-trading country or nonmarket economy. Therefore the success of China's domestic economic and legal reform is directly relevant for the use of these specially designed trade policy instruments, because if China can graduate from its state-trading or nonmarket economy label, the employment of these trade policy instruments will become largely superfluous. Although no clear graduation criteria exist, the first Chapter identified many different preconditions that involve the reform to a full market economy. However, it is argued here that the disentanglement of government from business is one of the more pressing reforms needed if China wishes to avoid the label of still being a state-trading country, and to avoid being the target of nonmarket trade policies. This disentanglement of government from business is most probably only possible through acceptance of the rule of law in China.

Whereas it is the ultimate purpose for both China and its trading partners to be better off economically, it is also important to look at the broader foreign policy concerns that

surround China's WTO accession. Therefore the first part of this Chapter will look at the geopolitical complexities of China's WTO accession, because after all, the decision whether a party can join as a WTO member is not a legal or economic decision, but a political one. The second and third parts of this Chapter will focus on the domestic economic and legal reform process in China respectively. The success of these domestic reforms is directly relevant for the use of state-trading or nonmarket trade policy methodologies.

I. Socio-political and Historical Background

Undoubtedly China's entry into the WTO is of great political significance. Over the years many stumbling blocks had to be cleared from the road of China's accession. As one author put it, the story about China joining the WTO is "an epic saga", and no country currently seeking WTO membership could possibly raise a more complex array of issues than the PRC[232]. China's accession does not only presuppose profound domestic economic and legal reforms, it also presupposes engagement policies from other WTO members to receive the new entrant.

A. China and the World Community

Although it is the wish of many politicians now, that China's accession to the WTO, in the words of President Bill Clinton, will ensure the country to become a "constructive member" of the global community[233], these policies of engagement, however, are of the recent past. The position of China in the international political community is explored somewhat further in the paragraphs below.

a. Early International Relations

Apart from trade along established routes, the Chinese Empire had no significant political relationship with the West prior to the Opium Wars beginning in 1839. The Chinese, as

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[232] See BHALA, R., "Enter the Dragon: An Essay on China's WTO Accession Saga", 15 *Am. Univ. Int'l L. Rev.*, 2000, p. 1470-1538, at p. 1470.

[233] See GESTELAND, L., "Clinton Says WTO Will Make China 'Constructive Member' Of Global Community", www.chinaonline.com, 29 January 2000, quoting from President Clinton's State of the Union Address: "We must continue to encourage our former adversaries, Russia and China, to emerge as stable, prosperous, democratic nations".

the Japanese, were very much reluctant to open doors for Westerners, who they believed were Barbarians[234]. Traditionally, Chinese foreign relations did not fully recognise foreign countries as sovereigns. Only when a country paid tribute to appreciate the superiority of the Chinese culture, China allowed it the opportunity for trade[235].

The attitude of China that it did not need anything from other countries sparked conflicts with nineteenth century imperial powers, such as France and Great Britain. These conflicts caused the "Tributary System" to give way to the "Treaty System". Through the "Unequal Treaties" of the 19th and early 20th centuries, these Western powers finally forced themselves a way in. China was compelled to conclude treaties with many countries that provided for extraterritoriality (also known as consular jurisdiction) for the nationals of those countries in China, restrictive tariff regulations, territorial cessions and leases, the right to station foreign troops in China, and other humiliating infringements on sovereignty[236]. Pursuant to these treaties and the initial hostile contacts, which accounted for the xenophobia in the age of imperialism[237], China was treated, like a semi-colonial country.

While China had manipulated tributary countries under the tribute system, China became the subject of manipulation under the unequal treaties. Foreign powers rushed to obtain

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[234] See BRANDT, C., SCHWARTZ, B and FAIRBANK, J., *A Documentary History of Chinese Communism*, New York, Athenaeum, 1952, p. 17: "Ethnocentrism was inbred in Chinese language and institutions, with the assumption that outer barbarian states, however strong in arms, were always inferior in the attributes of strong civilisation". According to the authors anyone taking a quick look at Chinese history should agree that nationalism has not yet by any means realised its full potentialities in Modern China. The Chinese people thought and acted as the centre of the known world in a recorded history for 3000 years. China viewed itself as superior, not just materially, but culturally. Barbarians could come to appreciate the superiority of the Chinese culture, if they recognised the unique position of China as the central kingdom exercising the mandate of heaven.

[235] On the tributary system from the Ming dynasty (1368-1644) through the Manchurian Qing dynasty (1644-1912), see generally FAIRBANK, J., *Trade and Diplomacy on the China Coast – The Opening of the Treaty Ports 1842-1854*, Stanford, Stanford University Press, 1953 and MANCALL, M., *China At the Center: 300 Years of Foreign Policy*, London, Macmillan, 1984. For its relevance in present day China, see HARDERS-CHEN, G., "China MFN: A Reaffirmation of Tradition or Regulatory Reform?", 5 *Minn. J. Global Trade*, Summer 1996, p. 381-413.

[236] See CHIU, H., "Comparison of the Nationalist and Communist Chinese Views of Unequal Treaties", in COHEN, J. (Ed.), *China's Practice of International Law: Some Case Studies*, Cambridge MA, Harvard University Press, 1972, p. 239-267, at 243.

[237] On anti-foreignism in China, see LIAO, K., *Anti-foreignism and Modernisation in China 1860-1980*, Hong Kong, The Chinese University Press, 1984. See also DENG, Y., "The Chinese Conception of National Interests in International Relations", *The China Quarterly*, n° 154, June 1988, p. 308-329. According to DENG (p. 311) the "Realpolitik Thinking" of China is still profoundly conditioned by the

the advantages. However, the MFN principle, introduced as a bargaining tool for China, created the opposite effect of destroying China's bargaining power[238].

A weakened country, China lost the imperial monarchy in the 1911 revolution led by Sun Yat Sen. The following decades were rare times at which China was actively involved in world politics[239]. Soon after, it was divided by civil warfare between the communists and the capitalist Kuomintang government. When the Communist Party came to power in 1949 and established the People's Republic of China, the country fell prey to the Cold War politics of isolationism. China was involved in the two hot spots of Korea and Vietnam and therefore put under embargo by the US between 1953 and 1972[240]. Both the international and domestic situation had limited any further expansion of economic relations with China.

According to at least one author, these early psychological and material sufferings under Western treaty rule explain China's insistence on reciprocity to bring home fairness and equity in multilateral trade[241].

b. Present International Relations

Notwithstanding the grim past of early international relations, Western governments have adopted policies of engagement *vis-à-vis* China since recent decades. In an effort to isolate the Soviet Empire by driving it apart from other Communist allies, President Nixon and his policy advisor, Kissinger, adopted normal diplomatic relations with

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historical memory of the "one hundred years of sufferings and humiliations" at the hands of Western powers and fascist Japan. China suffered both materially and psychologically.

[238] The MFN clause proved to be a one-way street – any concession or privilege gained by one Western power, at once, accrued to all. China could never reverse the tide and, by abolishing the privileges of one power, eliminate those of others. Treaty privileges steadily accumulated against her interest, thus weakening Chinese institutional structure. See HARDERS-CHEN, *o.c.*, *supra* note 235, p. 390ff.

[239] China was represented, *e.g.*, at the Congress of Versailles where it signed the 1919 peace treaty, and in the League of Nations, where it objected to the invasion of Manchuria by the Japanese in 1931. For further reference, see COHEN (Ed.), *o.c.*, *supra* note 236.

[240] As a result of the deterioration of the political atmosphere at the beginning of the 1950s, normal trade relations between China and many of the GATT Contracting Parties ceased to exist, but since the 1960s the share of trade with GATT Contracting Parties gradually acquired more importance. See LI, C., "Resumption of China's GATT Membership", 21 *J. World Trade*, n° 4, 1987, p. 28. Despite the U.S. embargo, trade and barter arrangements with the UK, France and Denmark were concluded and in the early 1960s China purchased a number of industrial plants from EC Member States. See YUE, X., *Current EC Legal Developments – The EC and China*, Brussels, Butterworths, 1993, p. 4.

[241] See HARDERS-CHEN, *o.c.*, *supra* note 235.

China[242]. The European Community (EC) soon followed[243], notwithstanding that some EC Member States already had established individual diplomatic relations long before the Americans[244].

Notwithstanding the repeated US commitments to support China's WTO accession in almost every bilateral negotiation, the Chinese accession process suffered from the unpredictable nature of its US relationship.[245]. Issues like human rights[246], the Taiwan channel[247] and nuclear proliferation,[248] to name the more important ones, strained the Chinese accession. US President Clinton once explained this 'pragmatic policy of engagement' as "expanding our areas of co-operation with China while confronting our differences openly and respectfully"[249].

The overall aim of the European policy is to foster a greater European presence in the Asia Pacific region. Political-strategic matters thereto are reviewed in an EC

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[242] The official visit by Nixon led to the Shanghai Communiqué in 1972. On 1 January 1979 the relationship was bolstered in the Joint Communiqué on the Establishment of Diplomatic Relations (79 Dep't St. Bull., Jan. 1979, p. 25), followed by People's Republic of China, Consular Relations, 31 January 1979 (U.S.-P.R.C., 30 U.S.T.17). Soon thereafter on 7 July 1979 the Agreement on Trade Relations between the two countries was signed (U.S.-P.R.C., 31 U.S.T. 4651). See also BUTTERFIELD, F., "US and China Mark Resumption of Ties in Peking Ceremony", *N.Y. Times*, 2 January 1979, at A1, A10.

[243] Official relations between the European Economic Community and China were initiated in 1975; in 1983 the relationship was officially expanded to include also the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (EAEC). A trade agreement was signed in 1978, followed by the 1985 Trade and Co-operation Agreement (OJ L250, 19 September 1985, p. 1). In 1995 a *Long-term Policy for China-Europe Relations* was adopted (Com (95) 0279-C4-0288/95). For a rundown on China – Europe relations see VAN DER GEEST, W., "Bringing China into the Concert of Nations – An Analysis of its Accession to the WTO", 32 *J. World Trade*, n° 3, June 1998, p. 99-114 and YUE, *o.c.*, *supra* note 240, p. 4ff. For the latest details on EU – China relations see "Report from the Commission to the Council and the European Parliament on the Implementation of the Communication 'Building a Comprehensive Partnership with China'", available from www.europe.org, (COM (2000) 552, 08.09.2000). The latest document in the European engagement policy is a Country Strategy Paper on China, issued in March 2002 (working document).

[244] Among the earliest were Denmark (11 May 1950), United Kingdom (17 June 1954), Netherlands (19 November 1954) and France (27 January 1964). A number of EC Member States took the opportunity to establish diplomatic relations during the 1970s. These are *inter alia*: Italy (6 November 1970), Belgium (25 October 1971), Greece (5 June 1972), Germany (11 October 1972), Luxembourg (16 November 1972), Spain (9 March 1973), Portugal (8 February 1979) and Ireland (22 June 1979).

[245] ZHAO, W., "China's WTO Accession – Commitments and Prospects", 32 *J. World Trade*, n° 2, April 1998, p. 51-75, at p. 65.

[246] See further below, p. 81ff.

[247] See *infra* Taiwan 's WTO Accession, p. 79ff.

[248] *E.g.* the proposal to add weapons non-proliferation language to the Permanent Trade Relations Bill. See SNYDER, C., "US Senate rejects Thompson amendment, virtually assuring passage of PNTR", www.chinaonline.net, 13 September 2000. On Permanent Trade Relations, see further below, p. 82.

[249] Remarks by President in Address on China and the National Interest, *Voice of America*, Washington D.C., 24 October 1997.

Communication. The EC approach of "engagement" focuses on increasing the likelihood that China will act as a "responsible" member of the international community. This encompasses the degree of economic openness, the reliability of the judicial system and the protection of individual, human and social rights[250]. Although the European demands during Chinese accession did not differ much from the American ones, at least one author noticed that the Europeans introduced division in the allied ranks by playing the "good cop"[251].

As a result of engagement policies, the People's Republic of China replaced capitalist rival Taiwan in the United Nations Organisation (UN) and took a seat in its Security Council in 1971[252]. By 1980, China joined the IMF and the World Bank[253] and, after it gained observer status to the GATT in 1984, it applied for resumption of its original membership in 1986. It renewed this application in 1995 to become a member of the newly established WTO[254]. Further, China developed good relations with its trading partner Japan; strong relations with Vietnam, India and Nepal; and diplomatic ties with Uzbekistan, Turkmenistan, Kyrgyzstan, Kazakhstan and Tajikistan were also established[255].

Because of the difficult beginnings in establishing international relationships and the Cold War legacy, many Western observers are interested in how China will develop as a member of international organisations and the international community at large. As a growing economic power China understands the need of participating in international and

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[250] See COM (1998) 181 and COM (2000) 552, *supra* note 243. See also VAN DER GEEST, *o.c.*, *supra* note 243, p. 101.
[251] BHALA, *o.c.*, *supra* note 232, p. 1496.
[252] On 25 October 1971 the United Nations General Assembly adopted Resolution 2758 (XXVI) to restore the lawful rights of the People's Republic of China and to expel the representatives of Chiang Kai-shek's Republic of China (Taiwan) from the UN. See General Assembly Official Records, 26th Session, Supplement No 29 (A/8429) p. 2.
[253] See JACOBSON, H. and OKSENBERG, M., *China's Participation in the IMF, the World Bank and GATT: Towards a Global Economic Order*, Ann Arbor, University of Michigan Press, 1990, p. 59 ff. IMF and World Bank were, just like the UN, initially not open to communist Beijing but to capitalist Taipe. In 1950 Czechoslovakia, Yugoslavia and India already asked the PRC to replace Taiwan.
[254] For full details, see *infra* under China's Road to WTO Accession, p. 78ff.
[255] WANG, G., "Economic Integration in Quest for law – The Chinese Experience", 29 *J. World Trade*, n° 2, April 1995, p. 10.

regional affairs[256], and its domestic economic reforms require this kind of participation[257]. This participation in the Bretton Woods institutions is evaluated below.

c. China's Participation in IMF and World Bank

China's participation in the Fund and the Bank might reveal us something about the possible course China will take in the WTO. However, the policy *vis-à-vis* IMF and World Bank is distinct from an envisaged WTO membership, because neither IMF nor World Bank membership involved such large economic reforms in China as the WTO. WTO membership is therefore quite different from Chinese membership in Fund and Bank. The only requirement for China beyond meeting the financial obligations in its IMF quota and in its subscription to the Bank was the publication of substantial data[258]. IMF and World Bank have never been the source of ambitious economic reforms in China, but rather inspired a convergence of views.

The importance of lending by the World Bank and the International Development Agency (IDA) should not be underestimated[259]. These loans serve as a sign of security to private investors and help to divert foreign capital and technology to China[260]. Several Chinese bureaucrats highly praise the technical assistance that they have received from the Bank and the Fund[261]. Not only financial assistance, but also competitive bidding,

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[256] See, *e.g.*, KIM, S., "Mainland China in a Changing Asia-Pacific Regional Order", 30 *Issues & Studies*, n° 10, October 1994, p. 1ff. China must play a role in global economic management. Some Western authors therefore believe China should participate in the finance G-7, the club of finance ministers and central bank governors. See, *e.g.*, BERGSTEN, F., "The New Agenda with China", *International Economics Policy Briefs*, May 1998, (also available at www.iie.com).

[257] WANG, *o.c.*, *supra* note 255, p. 7. Specific steps to participate in multilateral organisations were taken almost immediately after China started economic reforms.

[258] JACOBSON, OKSENBERG, *o.c.*, *supra* note 253, p. 105.

[259] China is a major recipient of multilateral official lending. The US has recently questioned whether China should continue to receive concessional finance through the International Development Agency (IDA), the World Bank soft loan window. IDA funds have accounted for about a quarter of China's $22 billion in World Bank loans since 1980, and China has been receiving approximately $1 billion annually from IDA for the last several years. See NOLAND, M., "China and the International Economic System", Institute for International Economics, Working Paper 95-6, (also at www.iie.com).

[260] See LING, B., "China and International Institutions", 90 *Am. Soc'y Int'l L. Proc.*, March 1996, p. 397. Since China's membership of the World Bank, the latter has approved many projects. China has been the Bank's biggest borrowing member country since 1993, and has one of the best project implementation records. To attract more loans the country joined the Asian Development Bank without the pre-condition of Taiwan's leaving in 1986. See WANG, *o.c.*, *supra* note 255, p. 8. On China's membership in the Asian Development Bank, see MURRAY, B., "Prospects for Prosperity", available at www.chinaonline.com, 19 October 2000.

[261] JACOBSON, OKSENBERG, *o.c.*, *supra* note 253, p. 141-142.

foreign consultants, and training of personnel have changed the Chinese mind about how to undertake certain projects, and how to reduce costs and improve quality[262].

But according to some, China wants to get rid of its image as a passive receiver of capital, technology or economic and social values from other nations. Gradually developing its economic power, China also would wish a share of mercantile diplomacy to influence decisions at the international level[263]. In this sense the incorporation of China into the IMF, the World Bank and WTO, on terms that preserve and advance the neo-liberal international economic order, is not easy. It is a test to the capacity of these institutions to adjust to a changing environment[264]. So far China is not seeking to make incremental changes in the rules of the Bretton Woods institutions so that Chinese traditions and practices would be incorporated into the operations of these institutions. But this does not reassure those who think that in future the existing arrangements could come under challenge if China gets the political power it searches to gain via its economic nationalism. Therefore some authors contend that bringing China into the rule-based world trading system might cause a clash of cultures – with different systems and different objectives having to be accommodated within the context of the WTO and the final act of the Uruguay Round. Indeed it may shock the WTO and the multilateral rule-based system at large[265].

By and large World Bank and IMF have not treated China as an exceptional case, but they have treated China sympathetically[266]. China, however, knows that special treatment might come at a discernible cost for other transition economies or developing country members[267]. Countries like Poland, Romania, Hungary, former Czechoslovakia and Yugoslavia received relatively favourable treatment especially in IMF and World Bank. However, they were not always diligent in fulfilling obligations and at times there was

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[262] The US administration regards technical assistance as the primary channel through which it can influence economic reform in China. See NOLAND, *o.c.*, *supra* note 259.

[263] DENG, *o.c.*, *supra* note 237, p. 314 (noting that China's foreign policy is still very much pulled back by power politics formed by the school of *Realpolitik* thoughts).

[264] JACOBSON, OKSENBERG, *o.c.*, *supra* note 253, p. 4.

[265] VAN DER GEEST, *o.c.*, *supra* note 243, p. 113.

[266] Instances of special treatment at the margin do exist: but similar allowances existed for other large developing countries like Egypt and Indonesia. See JACOBSON, OKSENBERG, *o.c.*, *supra* note 253, p. 138.

[267] JACOBSON, OKSENBERG, *o.c.*, *supra* note 253, p. 133. India *e.g.* has been concerned that Chinese claims would restrict Indian access to Bank and Fund resources, see *idem*, p. 137.

disappointment in the trade performance of these countries. So did imports not always increase as expected, but neither did their exports increase greatly[268].

There is no doubt that the involvement in these Bretton Woods institutions noticeably affects the structures and policies of the Member State. Placed in an optimistic perspective, the interaction between international organisation and state should be reciprocal and beneficial for all members, hence leading to a more peaceful, stable and equitable world[269]. Many institutional changes and policy modifications have occurred both within China, and within the IMF and World Bank, to facilitate co-operation. It is difficult to measure the exact influence and sort out the cause and effect, because in the search for mutual adjustment each international player seeks to protect an image of independence[270].

As an active member of the Fund and Bank, China's executive directors and their deputies have received wide praise for their competence. They have sought to maintain the effectiveness of the organisations. They have not been ideological and have not introduced extraneous political considerations into the debates[271]. The Chinese value the meetings as occasions to broaden their contacts in the international financial community and to acquire additional knowledge[272].

China's membership of the IMF and World Bank blunted the charge that they were instruments of Western imperialism. It has weakened the UNCTAD and strengthened the present position of the WTO. China's coming into the Bank has helped other developing countries to look more realistically at development. The debate about the "New International Economic Order" has been pushed into the background by the realities of economic difficulties. Developing countries therefore sometimes contend that China has adopted the rhetoric of the developed world[273]. Other critiques include that China's participation in multilateral organisations has been very limited and that its attitude to

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[268] *Idem*, p. 28.
[269] *Idem*, p. 8.
[270] *Idem*, p. 129.
[271] *Idem*, p. 131.
[272] *Idem*, p. 132.
[273] *Idem*. p. 132.

such bodies has been marked by scepticism[274]. And in China the government's soft policy towards the US has been criticised over time[275].

Nevertheless, China's involvement in the World Bank and the Bank's involvement in China today reflect a normal and appropriate partnership between a borrowing member country and an international institution[276]. China's membership in IMF and World Bank has further demonstrated a cautious approach to building a relationship[277].

By joining the international economy, China tries to enhance its national aggrandisement[278]. China's WTO membership brings the country international acclaim and prestige. The international investor confidence resulting from WTO membership determines its attractiveness and allows the country to amass foreign capital to pay for sound domestic reforms and hence further industrialisation. The momentum of this drive may advance the Chinese economic powerhouse[279].

But according to some, China has taken the protective coloration of a market economy while at the same time retaining an overall mercantilist policy[280]. It should be acknowledged, however, that with China joining the "citadels of capitalism" and with the transnational issues in the age of globalisation, certain political views have been put in the defensive in favour of some more liberal rhetoric in China[281]. In making WTO

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[274] See the so-called McMillan-Scott report. VAN DER GEEST, *o.c.*, *supra* note 243, p. 110-111. China's response to this report prepared by McMillan-Scott in the European Parliament 1997, was decidedly negative as it denounced the debate as "Anti-China clamour". See European Parliament, 1997: *Report on the Communication from the Commission on a Long-term Policy for China-Europe Relations* (Com (95) 0279-C4-0288/95) session document A4-040198/97, PE 221.588/fin; 29 May 1997.

[275] WANG, *o.c.*, *supra* note 255, p. 24-25.

[276] LING, *o.c, supra* note 260, p. 398.

[277] JACOBSON, OKSENBERG, *o.c.*, *supra* note 253, p. 197. The authors recognise different stages in the incorporation process of a member. First, there is the engagement policy followed by initial participation. Second, tests of compatibility occur in the phase of mutual adjustment to see whether organisation and regular participant can really join harmoniously. Finally, this stage is followed by a mature partnership.

[278] See HSIAO, M., "China and the GATT: Two Theories of Political Economy Explaining China's Desire for Membership in the GATT" 12 *UCLA Pac. Basin L.J.*, Spring 1994, p. 431ff, at p. 437. Illuminating in this regard is also the article by DENG, *o.c.*, *supra* note 237.

[279] See in general HSIAO, *o.c.*, *supra* note 278, p. 439ff.

[280] JACOBSON, OKSENBERG, *o.c.*, *supra* note 253, p. 10.

[281] Read, *e.g.*, Jiang Zemin's speech at the quasi-summit on 15 November 1994, talking about how nuclear proliferation, AIDS prevention etc. are all of an interdependent nature and require co-operation and commonly observed standards. So do trade contracts and market development. *FBIS-China*, 15 November 1994, p. 2. See also DENG, *o.c.*, *supra* note 237, p. 320 and 329, who acknowledges a liberal undercurrent in the dominant realist paradigm.

commitments, China is devoted to economic efficiency, maximisation of economic growth and improvement of living standards[282].

WTO accession helps local leaders to reinforce their domestic reforms[283]. These reforms are the focal point to improve domestic performance, if they achieve success, then China might seek greater voice and power and a more assertive China could begin to express itself. In any case, WTO membership legitimises China's stance in the world community and the country can no longer be singled out. It will also confirm China's further economic integration in the world economy by adopting a free market economy and legal system.

B. China's Road to WTO Accession

Any state or customs territory having full autonomy in the conduct of its external commercial relations may accede to the WTO on terms agreed with WTO Member States. The process of accession begins when a country submits a request for accession[284]. In 1986, after having gained observer status in 1984[285], China applied to resume its original membership of the GATT[286], and in 1987 a working party was

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[282] See again HSIAO, *o.c.*, *supra* note 278, p. 446ff.

[283] See, *e.g.*, JACOBSON, OKSENBERG, *o.c.*, *supra* note 253, p. 93.

[284] WTO Secretariat, Accession to the World Trade Organisation: Procedures for Negotiations under Article XII, WT/ACC/1 (24 March 1995), available at www.wto.org [hereinafter Accession Procedures]. See also JACKSON, J. and RHODES, S., "United States Law and China's WTO Accession Process", *J. Int'l Eco. L.*, 1999, p. 497-510. The process of Accession can be divided into an introductory phase of formalities and three substantive phases involving: (1) the applicant's preparation of a Memorandum on the Foreign Trade Regime describing in detail its policies and institutions that have a bearing on the conduct of international trade; (2) the members' fact finding phase that allows questions and answers; (3) the negotiation phase. For the accession process and strategy of transition economies, see MICHALOPOULOS, C., "WTO Accession for Countries in Transition", on file with author. For the accession procedures under GATT, see also PATTERSON, G., "The GATT: Categories, Problems and Procedures of Membership", 1992, *Colum. Bus. L. Rev.*, p. 7-17.

[285] GATT Activities 1984 (1985), p. 55. Before that, the PRC had already been accepted as an observer to the GATT Textile Committee. By unanimous consent of all Contracting Parties, China attended the meetings of the GATT Council and other specialised agencies within the GATT in 1984. See GATT Activities 1983 (1984), p. 35. For secondary literature, see WANG, *o.c.*, *supra* note 255, p. 8; FENG, Y., "China's Membership of GATT: A Practical Proposal", 22 *J. World Trade*, n° 6, 1988, p. 53 (stating that the Chinese government submitted to the GATT a formal application requesting the restoration of China's status as a Contracting Party in the organisation on 11 July 1986) and LI, *o.c.*, *supra* note 240, p. 39 (contending that the Chinese ambassador in his statement on 17 June 1986 at a GATT Special Council Meeting indicated that China wished to participate in the Uruguay Round, leading to a Chinese government communication informing the Contracting Parties of its candidacy on 11 July 1986).

[286] See footnote above for secondary literature. See also GATT Activities 1986 (1987), p. 76-77. Membership would be negotiated under Art. XXXIII of the GATT.

established to consider its entry[287]. China renewed its application under the WTO in 1995, when it had missed the opportunity to accept the WTO Agreement as an original WTO Member State,[288] and requested that the GATT working party continue its work as a WTO working party[289].

The accession process is conducted at both the multilateral and the bilateral level. At the multilateral level, a working party prepares a Report, a Protocol of Accession, and Schedules of Concessions and Commitments on Goods and Services. The Protocol of Accession contains the terms and conditions of entry into the WTO. China acceded to the WTO when both the WTO members by a two-thirds majority decision and the Government of the PRC accepted the Protocol of Accession[290].

At the bilateral level negotiations resulted in market access for all WTO members. The PRC engaged in bilateral market access negotiations with WTO members on concessions and commitments on goods and commitments on services[291]. Although these bilateral and multilateral market access negotiations advanced very well, some political hurdles had to be taken along the road. The more important ones are described below.

a. Taiwan 's WTO Accession

International organisations are created by states to serve the needs of states[292]. Becoming a member of the WTO is a political decision and for many years international politics overshadowed China's membership. A key factor in the delay was Taiwan's bid to join

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[287] GATT Activities 1986 (1987), p. 75, 108-109.

[288] Although the PRC wanted to obtain GATT membership in time for it to become an 'original member' of the WTO, the US and other WTO members failed to agree on terms for the PRC 's entry before the December 1994 deadline. See GATT Activities 1993 (1994), p. 105 and "China Delay on Trade Pact", *N.Y Times*, 15 December 1994, D7.

[289] Communication from China, WT/ACC/CHN/1 (7 December 1995), requested that the GATT working party on China's status as a Contracting Party be converted to the Working Party on China's Accession to the WTO. The WTO General Council agreed. See WTO Secretariat, General Council (31 January 1995): Minutes of Meeting, WT/GC/M/1 (28 February 1995).

[290] See JACKSON, RHODES, *o.c.*, *supra* note 284, p. 498; and the Accession Procedures, *supra* note 284. See also the declaration of China's membership at the Doha summit in Qatar on 10 November 2001, WT/L/432.

[291] See, *e.g.*, the Sino-US Bilateral Trade Agreement of 15 November 1999, the Sino-Canada Bilateral Trade Agreement of 23 November 1999, and the Sino-EU Bilateral Trade Agreement of 19 May 2000.

[292] FISLER DAMROSCH, L., "GATT Membership in a Changing World Order: Taiwan, China and the Former Soviet Republics, *Colum. Bus. L. Rev.*, 1992, p. 19-38, p. 20.

the WTO[293]. Since the early 1980s the Republic of China, or Taiwan, has been eager to gain admission to the WTO[294]. As for international politics, the entrance of a regime, which is neither a member of the UN, nor recognised by most of the world's nations, is a troubling prospect[295]. But the candidacy for WTO membership of the PRC presented a further obstacle[296]. The position of Taiwan and its relationship with China[297] became evident again prior to Taiwan's presidential elections in 1996 and 1999, when the Chinese threatened with a military takeover of Taiwan and were launching missiles close to Taiwan's north and south seaports.

Though Taiwan's Protocol of Accession was substantially completed in May 1999[298], the PRC made clear that only after it would be admitted to the organisation, that it would be willing to help Taiwan joining under an appropriate name[299]. Both Hong Kong and Macao became members of WTO through the sponsorship of Great Britain and Portugal after China consented to their respective handover[300]. In the case of Taiwan the PRC always feared that allowing Taiwan into the WTO would allow it a back door entry as a recognised member of the world community.

It should further be mentioned that China was a founding member of GATT 1947. It participated in the negotiations in 1947 and became a party to the Protocol of Provisional Application, which came into force in 1948. In the aftermath of the October 1949 Communist coup, the government of the Republic of China, from its new home base in

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[293] Taiwan applied to join the GATT under Art. XXXIII in September 1992 as the autonomous customs territory of Taiwan, the Pescadores, Kinmen, and Matsu (referred to as Chinese Taipe). See GATT Activities 1992 (1993), p. 95.

[294] See for further reference, CHAN, S., "Taiwan's Application to the GATT: A New Urgency with the Conclusion of the Uruguay Round", 2 *Ind. J. Global Legal Stud.*, Fall 1994, 275-299; and FEINERMAN, J., "Taiwan and the GATT", *Colum. Bus. L. Rev.*, 1992, p. 39-60.

[295] See for further reference, HENCKAERTS, J. (Ed.), *The International Status of Taiwan in the New World Order: Legal and Political Considerations*, The Hague, Kluwer Law International, 1996. This work explains Taiwan's past and present political and legal positions in the international community. For the same reasons, see CHEN, L., "Taiwan's Current International Legal Status", *New England Law Review*, Spring 1998, p. 675-683.

[296] See the elaborate discussion in CAI, W., "China's GATT Membership: Selected Legal and Political Issues", 26 *J. World Trade*, n° 1, February 1992, p. 35-61, at p. 51ff.

[297] On the relationship between China and Taiwan, see JOYNER, C., "The Spratly Islands Dispute: What Role for Normalizing Relations Between China and Taiwan", *New England Law Review*, Spring 1998, p. 819-852.

[298] See JACKSON, RHODES, *o.c.*, *supra* note 284, p. 501.

[299] The PRC is afraid to lose face in its 'one China policy' if Taiwan were to become a member first.

[300] Macau was granted full membership of the GATT on 11 January 1991 and Hong Kong on 23 April 1986. See CAI, *o.c.*, *supra* note 296, p. 37.

Taiwan, gave notice of withdrawal from the GATT in 1950. The PRC does not acknowledge this withdrawal, but neither did it contest the legality at the relevant time, in the 1950s. Nor did the PRC observe the obligations of membership from the 1950s onwards[301]. This historical event created the difference over China's accession than well its resumption of membership. The Chinese Protocol of Accession starts with recalling that China was an original Contracting Party to GATT 1947.

b. Human Rights Concerns

Since 1989 there are pressing demands on China to improve its human rights record. These demands have overshadowed the Chinese accession debate as well. Some legal scholars therefore propose a "single basket approach", *i.e.* linking all political and economic dealings with China to human rights, including its WTO accession[302].

The Tiananmen massacre in June 1989[303] left some wounds in the political relationships with major trade powers[304]. The US had negotiated some of its bilateral terms for the PRC 's accession to the GATT, but withdrew its support for accession after the June protests and the June meeting of the working party was cancelled due to the political upheaval[305]. The EC also condemned the Chinese Government's suppression of the pro-democracy demonstration[306].

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[301] See, *e.g.*, FISLER DAMROSCH, *o.c.*, *supra* note 292, p. 21. See also JACKSON, J., *The World Trading System – Law and Policy of International Economic Relations*, The MIT Press, Cambridge MA, 1997, p. 329; and TAIT, A. and LI, K., "Trade Regimes and China's Accession to the World Trade Organisation", 31 *J. World Trade*, 1997, p. 93ff, at p. 98.

[302] See, *e.g.*, STIRLING, P., "The Use of Trade Sanctions as an Enforcement Mechanism for Basic Human Rights: A Proposal for Addition to the World Trade Organization", 11 *Am. U. J. Int'l L. & Pol'y*, 1996, p. 1-46 (she proposes that the multilateral enforcement of human rights should be made possible through the investigative and dispute settlement procedures already in place within the WTO). See also GREEN, R., "Human Rights and MFN Tariff Rates for Products from the People's Republic of China", 17 *U. Puget L. Rev.*, Spring 1994, p. 611-636; ORENTLICHER, D. and GELATT, T., "Public Law, Private Actors: The Impact of Human Rights on Business Investors in China", 14 *Nw. J. Int'l L. & Bus.*, Fall 1993, p. 66-129; and MORRIS, J., "Human Rights Violations During the Tiananmen Square Massacre and the Precedents Obliging United States Response", 13 *Cardozo L. Rev.*, December 1991, p. 1375-1411.

[303] See, *e.g.*, KRISTOF, N., "Troops Attack and Crash Beijing Protest; Thousands Fight Back, Scores are Killed", *NY Times*, 4 June 1989, p. A1.

[304] On the US response, see MORRIS, *o.c.*, *supra* note 302. See also CHENEY, M., "Trading with the Dragon: A Critique of the Use of Sanctions by the United States against China", 8 *J. Int'l L. & Practice*, Spring 1997, p. 1-28.

[305] JACKSON, RHODES, *o.c.*, *supra* note 284, p. 500. See further ROSS, R., "Enter the Dragon", 104 *Foreign Affairs*, 1996, p. 18ff., at p. 22. See also CHAN, *o.c.*, *supra* note 294, p. 279 and FEINERMAN, *o.c.*, *supra* note 294, p. 43, who both mention that the student massacre in June 1989 caused a set back in the WTO accession negotiations. See also CAI, *o.c.*, *supra* note 296, p. 35-36 (who notes that due to the

But already in September 1989 GATT decided to resume consideration of the Chinese accession, and the working party met in December of that year[307]. By 1992, foreign investment was roaring again, and following a period of inactivity, the working party resumed its task in February 1992[308].

c. China's Nonmarket Economy

Because of the ideological differences that exist between the capitalist West and the communist East, US statutes sometimes still constrain the ability to enter into a commercial agreement with a nonmarket economy[309]. With respect to China's accession these statutes come into play as well. Theoretically China could have become a member of WTO without the support of the US as soon as a two-thirds majority approved the accession[310]. But if the US voted in favour of China's entry, it would have had to opt out and could not have extended permanent, unconditional most-favoured-nation treatment to the PRC[311]. So this hurdle had first to be considered by US Congress.

Pursuant to Title IV of the in 1974 enacted Trade Act, it is required that the US President denies non-discriminatory treatment to products of any country whose products were not eligible for such treatment on 3 January 1975[312]. It involved products of communist

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June 1989 political disturbance the Uruguay Round did not become a success for the Chinese). Nonetheless the GATT working party on China's accession had reached a relatively advanced stage. See thereto GATT Activities 1989 (1990), p. 130.

[306] On 6 June 1989, the then 12 Member States issued a joint statement of condemnation. See EC Bull. 6-1989, point 2.4.1. During the Madrid Summit in the same month, the EC announced sanctions against China. The US, Japan and other industrialised countries acted likewise.

[307] JACKSON, RHODES, *o.c.*, *supra* note 284, p. 500 and GATT Activities 1989 (1990), p. 130. See also "GATT Weighs China's Entry", *NY Times*, 15 September 1989, p. D2.

[308] GATT Activities 1992 (1993), p. 94.

[309] Particularly useful in this regard are JACKSON, RHODES, *o.c.*, *supra* note 284, and McLARTY, T., "MFN Relations with Communist Countries: Is the Two-Decade Old System Working, or should it be Revised or Repealed?", 33 *Richmond L. Rev.*, March 1999, p. 153-226.

[310] See BORICH, J., "China, The WTO, And Permanent Normal Trade Relations With China", www.chinaonline.com, 24 March 2000 (noting that China's bid to join the WTO is now on its own trajectory, and cannot be blocked by US legislative action).

[311] The US would be obliged to invoke the "non-application" clause of WTO Article XIII, and China would certainly reciprocate.

[312] See Trade Act of 1974 § 401, 19 USC § 2431 (1994). According to the legislative history of section 401 non-discriminatory treatment should be denied to the products of communist countries except Poland and Yugoslavia. S. Rep. No. 93-1293 (1974), reprinted in 1974 USCCAN 7186, 7333. The following countries were ineligible to receive non-discriminatory treatment: Albania, Bulgaria, the PRC, Cuba, Czechoslovakia, East Germany, Estonia, Hungary, those parts of Indochina under communist control or domination, North Korea, the Kurile Islands, Latvia, Lithuania, Outer Mongolia, Romania, Southern Sakhalin, Tanna Tuva, Tibet and the USSR. *Idem.*

countries that deny its citizens the right to emigrate, or impose conditions on emigration. This Section 402, the so-called Jackson-Vanik amendment, contains a complicated scheme for determining when the US will grant non-discriminatory treatment to communist countries. In 1998, the term 'most-favoured-treatment', which was interchangeably used with the term non-discriminatory treatment, was changed to 'normal trade relations'[313].

Under Jackson-Vanik the President may extend normal trade relations status to the PRC only if the PRC permits free emigration. It requires him to submit a report to Congress twice a year certifying that the PRC is in full compliance with the freedom of emigration requirements. The President may waive the freedom of emigration requirements if he determines that the PRC is making certain progress toward the goal of free emigration. Presidential waivers are subject to a joint resolution of disapproval by the two Houses of Congress. The President can veto the joint resolution, but Congress has the authority to override it. To override each House must vote such action by a two-thirds vote[314].

Following the 1979 US-China bilateral trade agreement, the US first granted MFN treatment in 1980 and extended it every year since. The issue became controversial, however, after the 1989 Tiananmen Square incident. President Bush senior continued to renew MFN treatment altogether[315]. In 1993 Bill Clinton, a critic of the Bush administration, renewed MFN treatment and declared his intent to link MFN status to improvements in the PRC 's human rights performance. Despite some views that progress on human rights was limited, President Clinton renewed MFN again in 1994. At the same time his administration announced the intention to break the link between MFN treatment and human rights issues[316]. After passing through the US House of Representatives and the Senate, a historic trade bill, granting permanent normal trade relations to China, was signed by President Bill Clinton[317]. The hurdle was taken.

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[313] JACKSON, RHODES, *o.c.*, *supra* note 284, p. 502-503.
[314] *Idem*, p. 503.
[315] Determination No. 90-21, 55 Fed. Reg. 23, 183 (1990).
[316] JACKSON, RHODES, *o.c.*, *supra* note 284, p. 504.
[317] See "Clinton Signs PNTR Bill into Law", www.chinaonline.com, 10 October 2000, and SNYDER, C., "PNTR given green light by US Senate", *Ibidem,* 19 September 2000. See also BERGSTEN, F., "The Next Trade Policy Battle", *International Economics Policy Briefs*, www.iie.com, January 2000, and HUFBAUER, G. and ROSEN, D., "American Access to China's Market: The Congressional Vote on PNTR", *International Economics Policy Briefs*, *Ibidem* , April 2000. For trade policy views on China's

Although permanent normal trade relations definitely was an issue in the US during the Chinese accession debate, the Jackson-Vanik amendment is not the only reminder of China's communist legacy in Western trade policy. More important nowadays are the antidumping methodologies[318] both the EC and the US employ against China, based on the country's state-trading record. The Chinese Protocol of Accession approves of the continuation of these methodologies until fifteen years after China's accession. The same Protocol of Accession also allows for selective safeguards to be used in case of market disruption until twelve years upon accession. The term "market disruption" is a reminder of section 406 of the 1974 Trade Act, and allows for a special safeguard to be invoked against nonmarket economies to prevent them from flooding Western markets with cheap subsidised imports. Unfortunately the Protocol of Accession does not provide for detailed graduation criteria, but it is obvious that the success of China's domestic economic reforms based on the rule of law would make these antidumping and safeguard methodologies largely superfluous. Chapters Three and Four will discuss these issues in great detail. Below some aspects of these reforms are highlighted; and, it is argued that to avoid the state-trading or nonmarket economy label, which serves as a rational for the use of these discriminatory safeguards and special antidumping methodologies, and tactics, approved by the Protocol of Accession, China should disentangle government from business to convince WTO members that its enterprises are governed solely by market considerations. This disentanglement is most probable, only if China embraces the rule of law.

II. Domestic Economic Reform

The previous sections dealt with issues that are almost exclusively political and/or procedural and have nothing to do with the substantive economic and legal concerns of WTO membership. Because WTO membership impacts on so many different areas of economic activity, profound reforms are necessary to implement the delicate policy

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PNTR, see GROOMBRIDGE, M., "China's Long March to a Market Economy – The Case for Permanent Normal Trade Relations with the PRC", *Trade Policy Analysis*, 24 April 2000, No. 10 (CATO); and FAUX, J., "PNTR With China – Economic and Political Costs Greatly Outweigh Benefits", *Briefing Paper*, May 2000 (Economic Policy Institute).

[318] It should be noted that also countervailing methodologies are included, but they have not yet been employed so far.

decisions surrounding it. It should also be noted that many of these reforms take place through the law; and, that since reform began in China, law has played a very important role in the economic restructuring process. Notwithstanding this interconnection between economic and legal reform, this Chapter deals with them separately.

It is about these domestic economic and legal reforms that much controversy over China's accession exists though. China faces the daunting task to convince fellow WTO members that it can comply with WTO requirements. Much of the literature is divided on this issue with authors usually arguing along their own partisan lines. However, most Western authors agree that China is ready to join the WTO, but many make reservations to various degrees over the reform of the economy and the legal system. Significant delays have occurred in China's accession because WTO members' fact finding about Chinese domestic reform policies merged into the negotiations about how existing policies needed to be changed to ensure conformity with the WTO. Therefore some factions within major trading partners are not entirely reassured that the Chinese transition economy can comply with WTO standards. As a result the Protocol of Accession retained some of the discriminatory trade policy instruments that traditionally were used on nonmarket economies or state-trading countries. The success of China's reform policies is of great importance to instil confidence in the Chinese economy and its compliance with WTO requirements. China's continued efforts in this regard should make it possible to graduate from its nonmarket or state-trading label. Therefore China's performance in restructuring its economy is directly relevant for trading partners' use of the specially drafted trade policy safety valves in the Protocol of Accession.

Chapter One identified many of the steps economists regard as important in moving towards a full market economy including the disagreement among economists over sequencing reforms in order to be successful. It seems that many authors have formulated valuable advice for China and transition economies in general to reform their economy and legal system, but no author will ever tell when these reforms are really accomplished. In other words, all of the conditions, or prerequisites these economists have formulated and which were identified in the First Chapter, should certainly be part and parcel of an economic restructuring programme, however, as the disagreement over sequencing of these prerequisites shows, the question is – should they come first? Having too

exhaustive a list of firm preconditions before letting China graduate from its nonmarket economy or state-trading status, may make reformers balk due to the difficulty. Moreover, with such a long list of preconditions, entrenched interest groups opposed to increased competition from China or opposed to trade liberalisation will always say some prerequisites have not been met. With the fundamental question in mind of when Chinese reforms will allow the country to graduate from its nonmarket or state-trading label, this section will look at China's trade regime, and the reform of the state-enterprise sector, to allow indirect regulation through market-determined prices, and to replace direct regulation of enterprise output through the planning system[319]. It will ultimately become clear that state trading is a principle just as illusive as the rule of law and the free market. Nonetheless, the main criterion to determine graduation from the nonmarket economy label should be, whether China's state enterprises are organised along market considerations and are disentangled from government interference. However, this disentanglement will not be achieved by employing protectionist market strategies aimed at the discrimination of certain Chinese industries. Instead it should be achieved in an open dialogue and through co-operation and engagement with China. In so far as this entanglement of government and business creates obstacles to trade, negotiations should be opened to expand trade with respect for the WTO's rule orientation.

A. State Trading and Article XVII GATT

Article XVII GATT addresses the concerns that state trading raises. However, its provisions are not rigorous. Article XVII only tackles the concerns by requiring notification[320] and the supply of information[321]. It does not prevent any member from establishing or maintaining state enterprises, but it demands that such enterprises shall

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[319] That a link between state enterprise reform and China's trade regime exists, is proven by IANCHOVICHINA, E., MARTIN, W. and FUKASE, E., "Assessing the Implications of Merchandise Trade Liberalisation in China's Accession to WTO", World Bank, 23 June 2000.

[320] See § 4 (a) of Article XVII. Members must notify all the products, which are imported or exported by state enterprises. On this notification requirement, see also WTO, *Guide to GATT Law and Practice*, WTO, Geneva, 1995 (hereinafter GATT Analytical Index) p. 481-482 and the Understanding on the Interpretation of Article XVII of GATT 1994, which tries to improve notification. Notification is done through an established questionnaire.

[321] See § 4 (b), (c), (d) of Article XVII.

respect non-discriminatory treatment[322] and take into account commercial considerations[323]. The obstacles to trade, which these enterprises can create, must therefore be limited in negotiations to expand international trade[324]. China's commitment to address state trading is addressed in Section 6 of its Protocol of Accession.

Article XVII makes an important exception for government procurement,[325] which is addressed separately in the relevant plurilateral agreement[326]. The US-China Bilateral WTO Agreement, however, explicitly clarifies that purchases of goods or services by state-owned and state-invested enterprises, are not government procurement and are thus subject to Article XVII and WTO rules[327].

The central concern for WTO trading partners is that the Chinese government could act in indirect ways to influence world trade in an uneconomic direction[328]. Acting through state enterprises, it could provide protection against imports or advance exports, to the detriment of foreign producers. Bringing these state enterprises within the realm of

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[322] According to *GATT Analytical Index* this involves only MFN and no National Treatment (p. 475, referring to early Geneva discussions). Recent case law from 1984 and 1988 did not answer the issue decisively. See 1984 "Canada – Administration of the Foreign Investment Review Act", L/5504, adopted on 7 February 1984, 30S/140, 163, para. 5.16.; and 1988 "Canada – Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies", L/6304, adopted on 22 March 1988, 35S/37, 90, para. 4.27. See also DAVEY, W., "Article XVII GATT: An Overview", in COTTIER, T. and MAVROIDIS, P., *State Trading in the Twenty First Century*, Ann Arbor, The University of Michigan Press, 1991, p. 17-36, at p. 26. For further reference, see also KOSTECKI, M., *East-West Trade and the GATT System*, St. Martin's Press, New York, 1979, chapter 3; and *State-Trading Enterprises in Agriculture*, OECD, Paris, 1998.

[323] Such as price, quality, availability, marketability, transportation etc. The idea is to afford enterprises of other members to compete for participation. See § 1 (b) of Article XVII.

[324] See § 3 of Article XVII.

[325] See § 2 of Article XVII, stating that § 1 shall not apply to imports of products for immediate or ultimate consumption in governmental use.

[326] The Agreement on Government Procurement, 1994, does not come under the single package of WTO accession and applies only to parties, which explicitly have ratified the agreement. For further reference on government procurement and China, see DODDS, F., "Offsets in Chinese Government Procurement: The Partially Open Door", 26 *L. & Pol'y in Int'l Bus.*, Summer 1995, p. 1119-1145; and LINARELLI, J., "China and the GATT Agreement on Government Procurement", 8 *J. Chinese L.*, Fall 1994, p. 185-226. On government procurement in transition economies, see also LAIRD, S., "Transition Economies, Business and the WTO", WTO, May 1998.

[327] See Sino-US Bilateral WTO Agreement, 15 November 1999. It must further be noted that accession to the WTO by nonmarket economies that have State-trading practices is addressed in the US 1988 Omnibus Trade and Competitiveness Act, Pub. L. No. 100-418, 102 Stat. 1107. Section 1106 provides that before any major country with significant State-trading enterprises can enter, the US President must determine whether trade between the US and that country is significant, and if the trade unduly burdens the US. If so, WTO rules will apply only if the State trading is conducted on a commercial basis. See also § 47 of the Working Party Report, WTO/ACC/CHN/49.

[328] See § 44 and § 208ff of the Working Party Report, WTO/ACC/CHN/49.

private industry competition is therefore the main focus. In other words, State enterprises should learn how to behave as private competitive traders[329].

The most prominent negative effects of uncontrolled state trading are violations of market access obligations, and the use of proprietary directions to evade the elimination of quantitative measures. The disciplines on state trading, however, are contained in other Articles of GATT. Market access can be harmed by setting resale prices of imports at very high levels, and thus negate tariff concessions bound in WTO Schedules conforming Article II GATT[330]. The other prominent effect, the creation of quantitative restraints, is addressed in Interpretative Notes to Articles XI, XII, XIII, XIV and XVIII. Governments might abuse ownership in enterprises to give directions that limit the amount of trade and thereby protect the domestic market, without having to issue trade-distorting legislation. In doing so governments create quantitative restrictions[331]. It is therefore important that the government disentangles itself from day-to-day management in business and that corporate laws implement the necessary checks and balances with regard to state involvement.

It is a nuisance that for its purposes Article XVII does not define 'state-trading enterprises'. But it is clear from the text that various types of enterprises come within its scope: (1) a 'State enterprise' or 'any enterprise' that has been granted 'formally or in effect, exclusive or special privileges' (paragraph 1(a)); (2) 'Marketing Boards'

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[329] However, this aim may be narrower than it appears at first blush. It may mean that behaviour along commercial lines is only applicable if the action at issue falls within the scope of the general principles of non-discriminatory treatment. This interpretation obviously reduces the potential of Article XVII to prevent state-trading enterprises from engaging in market access limiting activities. See DAVEY, *o.c.*, *supra* note 322, p. 27

[330] See JACKSON, J., "State Trading and Nonmarket Economies", 23 *Int'l Law.*, Winter 1989, p. 891-908, at p. 892. Even if there is a tariff binding for the product in question, a mark up could effectively evade the tariff binding. After all the provision of Article II § 4 in case of monopolised state trading is hard to police, and furthermore many products could be unbound anyway.

[331] See LAIRD, *o.c, supra* note 326 (noting that state-trading countries and state-trading enterprises are perceived as making purchasing and sales decisions which need not be determined on the bases of the best price for equal quality of products or services, duplicating the effects of quantitative restrictions). See also JACKSON, *o.c.*, *supra* note 330, p. 892 (noting that Article XI can easily be evaded by proprietary directions from the State owner).

(interpretative note to paragraph 1); (3) 'any enterprise' under the jurisdiction of a contracting party (paragraph 1 (c)); and (4) an 'import monopoly' (paragraph 4 (b)[332].

A clarification of what is considered to be a state-trading enterprise for notification purposes is provided in the WTO Understanding on the Interpretation of Article XVII. Members shall notify state-trading enterprises in accordance with the following working definition: "Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports"[333].

Even without a clear definition of what constitutes a State enterprise[334], it is clear that Chinese SOEs could come under the umbrella of Article XVII, and be scrutinised for their uneconomic behaviour. To fully understand state trading in China some knowledge about the foreign trade system in China is required.

B. China's Foreign Trade System[335]

Although Chinese WTO accession has caused a sweeping change in China's trade system, which will continue to be liberalised, it is fair to say that the trade system is strict because Chinese law imposes limitations on the capacity of Chinese enterprises to engage in foreign trade. Only those enterprises that have permission from the government are qualified to import or export goods. The ability to enter into foreign trade contracts is proscribed by an agency system[336] and complicated procedures exist to license[337] Chinese

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[332] The Working Party on State trading has worked on an illustrative list showing the kinds of relationships between governments and State trading enterprises, and the kinds of activities engaged in by these enterprises.

[333] Citation taken from BHALA, R., *International Trade Law – Documents Supplement*, Charlottesville, Michie, 1996, p. 97.

[334] The US Draft Charter of GATT 1947 contained a definition of state enterprise in the section on state trading: "For the purposes of this Article, a State enterprise shall be understood to be any enterprise over whose operations a Member government exercises, directly or indirectly, a substantial measure of control". See for further reference *GATT Analytical Index, o.c., supra* note 320, p. 473.

[335] Substantial economic research concerning the reform of the foreign trade system was done by LARDY, N., *Foreign Trade and Economic Reform in China, 1978-1990*, Cambridge, Cambridge UP, 1991; and MAN, T., "National Legal Restructuring in Accordance with International Norms: GATT/WTO and China's Foreign Trade Reform", 4 *Ind. J. Global Legal Stud.*, Spring 1997, p. 471-507.

[336] Under this system a Foreign Trade Corporation (FTC) enters into a contractual relationship directly with a production enterprise or other entity to serve as its agent in conducting purchasing and selling in the international market. The FTC will sign on behalf of the entity and charge a commission, but the principal will bear the responsibility of all of the profits and losses of the transaction. See PRC, Foreign Trade Law

businesses to legally contract with foreigners[338]. The Chinese rationale justifying these restraints on foreign trade is the necessity to maintain order in the foreign trade system[339]. There exists a whole range of Foreign Trade Operators (FTO) permitted to conduct import and export business, but apart from Foreign-Invested Enterprises (FIE) and maybe Sino-Foreign Investment Foreign Trade Corporations (SFIFTC), the bulk of trading companies remain state-owned or involve state capital. These entities comprise National Foreign Trade Corporations (NFTC) and Local Foreign Trade Corporations (LFTC), Production Enterprises with Foreign Trade Rights (PEFTR), Commercial and Material Enterprises with Foreign Trade Rights (CMEFTR), and Science Research Institutes with Foreign Trade Rights (SRIFTR)[340].

This diversification of FTOs is a recent phenomenon and definitely indicates that China is gradually releasing its tight hold on the capacity of Chinese enterprises to engage in foreign trade. In this regard a 1984 landmark report from the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) ended the 30-year monopoly over foreign trade by NFTC and LFTC[341]. It has therefore become possible for a wider spectrum of Chinese

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(FTL), 12 May 1994, Art. 13; see also WANG, B., "China's New Foreign Trade Law: Analysis and Implications for China's GATT Bid", 28 *John Marshall L. Rev.*, Spring 1995, p. 495-538, at p. 505-506.

[337] Art. 9 FTL, *supra* note 336. See WANG, *o.c.*, *supra* note 336, p. 502 (also dealing with import and export licensing). Apart from a positive list for trading companies, there also exists a negative list for commodities that these companies can trade. The negative list is used to reserve a list of commodities for trading by specified enterprises. Firms wishing to trade in other products are required to be on a positive list of firms with trading rights for those particular goods. See IANCHOVICHINA, MARTIN and FUKASE, *o.c.*, *supra* note 319.

[338] The sanction is that parties end up with a void, thus unenforceable contract if the Chinese contracting party has no FTR. See WILLIAMS, M., and ZHONG, J., "The Capacity of Chinese Enterprises to Engage in Foreign Trade: Does Restriction Help or Hinder China's Trade Relations?", 8 *J. Trans. L. & Pol'y*, Spring 1999, p. 197-230, at p. 217ff.

[339] WILLIAMS, ZHONG, *o.c.*, *supra* note 338, p. 197-98 (further arguing that this system does not support an orderly trade system but rather sustains disorder, leading to the separation of these enterprises from international markets).

[340] See WILLIAMS, ZHONG, *o.c.*, *supra* note 338, p. 203ff.

[341] The full text appeared in *A Collection of Laws and Regulations of the People's Republic of China*, (*Zhonghua Renmin Gongheguo Fagui Huibian*), Law Department of the General Office of the State Council of the PRC, ed., 1986. The report concluded that SFTC would remain the principal force of foreign trade, they should, however, not enjoy a monopoly over foreign trade operations. MOFTEC therefore recommended that a limited number of small- and medium-sized enterprises should be allowed to enter the market as complementary traders to revitalise China's foreign trade. See WILLIAMS, ZHONG, *o.c.*, *supra* note 339, p. 201. Furthermore, it should be noted that around the same time MOFTEC had approved a profound decentralisation of foreign trade authority. In the beginning only 12 NFTC existed. By the mid 1980s national production ministries created their own FTCs, and secondly provincial governments established hundreds of FTCs. See LARDY, *o.c.*, *supra* note 335, p. 39ff (noting also that the monopoly

enterprises to get actively involved in international competition. In recent years China has begun an experimental registration system in several Special Economic Zones (SEZ). In the opinion of some authors, however, the partial replacement of the licensing system does not indicate that China's practice fully reflects the principle of free trade[342].

An important aspect of China's foreign trade system reform was the grant of Foreign Trade Rights (FTR) to individual SOEs. These SOEs were traditionally separated from international markets[343]. So neither could they directly import what they needed for their production, nor export what they produced until the 1984 MOFTEC report changed this. Nowadays large and medium SOEs are qualified to apply for FTR[344]. But the departments in charge of foreign trade will consider applications according to a certain order of priority[345]. Further, the application for FTR cannot be approved unless a number of administrative conditions are fulfilled[346]. Additional requirements exist when the applicant is a local production enterprise[347].

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position eroded slowly since 1981). On decentralisation and the two-tiered foreign trade management, see also WANG, *o.c.*, *supra* note 336, p. 497ff.

[342] WILLIAMS, ZHONG, *o.c.*, *supra* note 338, p. 198-99.

[343] While prices in international markets continue to respond to changes in supply and demand, China's price structure appears to have diverged increasingly over time from world prices. See LARDY, *o.c.*, *supra* note 335, p. 20 (who calls it an "airlock" system, *Ibidem*, p. 41).

[344] See State Council, Regulations on Transformation of the Operating Mechanism of the State-owned Industrial Enterprises (Transformation Regulations), promulgated 23 July 1992, and later that year State Council, Opinions of Granting Production Enterprises Foreign Trade Rights (FTR Opinion); see also MOFTEC and State Economic and Trade Commission (SETC), Joint Circular on Further Promoting the Work of Granting the Production Enterprises FTR (Joint Circular), 30 January 1997. Similar requirements exist for CMEFTR. See thereto State Council, Opinion on Experimentally Granting FTR to CME (CME Opinion), 4 November 1993. CMEs are differentiated because they deal either with consumer goods or extractive products, petro-chemical products, and mechanical and electrical equipment. See WILLIAMS, ZHONG, *o.c.*, *supra* note 338, p. 207-211.

[345] See Art. 1 FTR Opinion, *supra* note 344. First come priority enterprises, *i.e.* technology intensive enterprises or enterprises, which produce machinery and electrical equipment and need to provide after-sale services abroad or enterprises that produce and export machinery and electrical equipment. Second come strictly-controlled enterprises, which are enterprises mainly producing primary materials, products subject to quota control, or products with only a single market. Third are the flexibly-controlled enterprises, which are granted by evaluating the nature of demand and supply in both domestic and international markets if the enterprises do not produce machinery or electrical products but rather technology-intensive products or products with a short commercial life span. Finally there is a category of disqualified enterprises, which shall not be granted FTR, including core enterprises in an enterprise group that has been granted FTR, large SOE groups that have established a subsidiary specialising in import and export operations, or enterprises which have joined any export combine or joint export corporation.

[346] See Joint Circular § 1, *supra* note 344. An application for FTR cannot be granted unless the enterprise (a) is an independent economic entity which enjoys the autonomy to manage, and has separated its business from administration by government; (b) has its own premises and facilities for operations, funds, and other materials necessary for import and export operations; (c) has personnel qualified for foreign trade operations; and (d) produces its own products for export and meets the set export value. However, as of

The reform process gradually increased both the numbers of firms allowed to trade and the different types of firms eligible for trading rights. Moreover the traditional State-trading enterprises or FTCs have been awarded independent legal status and SOEs of this type now appear to operate very strongly along commercial lines[348]. Consumers and producers wishing to purchase imports or sell exports will typically have a range of enterprises through which they can undertake these transactions, because China has dismantled most of its national foreign trade monopolies as part of its WTO commitment[349].

However, according to Article XVII state trading goes beyond the operation of traditional FTC monopolised trade. It could well encompass the production and commercial SOEs, either because the Chinese government directly controls the enterprise through ownership and, in so doing, influences the level or direction of imports or exports, or because the FTR it grants through a complex administrative licensing system, might be considered a special privilege, a statutory power[350]. Therefore SOEs, which have been granted FTR, could fall within the realm of Article XVII GATT. As a result it is important that the Chinese government can convince its trading partners that these enterprises operate along commercial lines as specified by Article XVII.

According to some authors the administrative licensing of the capacity to engage in foreign trade, still has the potential to seal off SOEs from international markets and competition, in so far the commercial decision making is preoccupied by administrative decision making[351]. They argue that the licensing of FTR might also be regarded as a

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January 1997 the set export value requirement no longer applies to large SOEs, see WILLIAMS, ZHONG, *o.c.*, *supra* note 339, p. 209.

[347] See FTR Opinion, *supra* note 344, Arts. 3 and 4.

[348] IANCHOVICHINA, MARTIN and FUKASE, *o.c.*, *supra* note 319.

[349] Products still subject to state trading are listed in Annex 2A1 of the Protocol of Accession with regard to imports, and Annex 2A2 with regard to exports. Products subject to designated state trading are listed in Annex 2B of the Protocol and will be liberalised three years after accession.

[350] It is considered that the government conferring the exclusive or special privileges assumes the responsibility of exercising effective control over operations affecting the external trade of such enterprise. See *GATT Analytical Index*, *o.c.*, *supra* note 320, p. 473 (based on the London report of the Preparatory Committee).

[351] WILLIAMS, ZHONG, *o.c.*, *supra* note 338, p. 228. The strict control on the capacity of enterprises to engage in foreign trade has led to the separation of enterprises from international markets, and, consequently, their ignorance of international practices and rules.

form of quantitative trade restriction in so far it still can restrict the number of FTOs[352]. These authors also believe that the numerical surge of FTOs and the differential treatment amongst them erodes the uniformity in which foreign trade should be administered[353]. However, as a result of WTO accession, China is stepping up reforms of its Foreign Trade regime[354] and further liberalisation thereof is expected for the years to come. Section 5 of China's Protocol of Accession stipulates that the country will progressively liberalise the availability and scope of the right to trade in all goods, except for the goods explicitly listed to be subject to state trading. The same Section affirms the commitment to accord National Treatment with regard to the right to trade.

For these SOEs with FTR to be really capable of independent commercial decision-making in view of Article XVII GATT, the following section will explore whether they are independent economic entities as required by the FTR Joint Circular[355].

C. State-owned Enterprise Reform

Although statistics and figures may vary, SOEs are, in belief and fact, still the backbone of the Chinese economy. These enterprises produce a variety of products and do involve more than heavy industry. The state sector is a major institution affecting millions directly and the entire population indirectly. The SOEs traditionally feed, clothe, and tend from cradle to grave a large portion of the population, and its products and revenues provided to the state benefit the entire population. Therefore the function of these SOEs traditionally has been welfare enhancement instead of profit maximisation.

The qualification of China as a state-trading or nonmarket economy is inextricably linked with the success of China's profound domestic SOE reform and the question whether Chinese SOEs are capable of independent commercial decision-making to satisfy WTO trading partners' concerns, or whether these SOEs are merely instruments of government policy. In this regard, China should convince trading partners that its government is sufficiently disentangled from day-to-day enterprise management. It appears that scholarly opinion is still divided concerning this issue.

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[352] WANG, *o.c.*, *supra* note 336, p. 504-05.
[353] WANG, *o.c.*, *supra* note 336, p. 521-22.
[354] See, *e.g.*, "Guangdong steps up development of foreign-trade-related private enterprises", www.chinaonline.com, 12 September 2000.

a. Initial Reform

From the foundation of the People's Republic in 1949 to the inauguration of the "Economic Reform and Open Door policy" in 1978, the economy was based on public ownership[356]. Apart from state ownership, there was also state management regulating all personnel, finance, physical assets, production, supply and marketing affairs under the guidance of centralised state plans[357]. Therefore the enterprises did not enjoy independent legal status nor did they have any autonomous decision-making power[358]. It should be noted, however, that China's highly centralised command economy was not as rigid as its supermodel in the neighbouring Soviet Union[359]. Whilst the plan played a major role in the national economy, the state had begun to supplement it by market adjustments at the end of the 1970s.

The liberalisation of the agricultural economy was the first systematic effort to incorporate market forces into the Chinese economy[360]. It allowed farmers to provide food products that the agricultural markets were demanding. In addition, the first step for enterprise reform had to readjust the management relationship between the state and the

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[355] See § 1 of FTR Joint Circular, note 346.

[356] See JIANG, Q., "Like Wading Across a Stream: Law, Reform and the State Enterprise", in BACHNER, B. and FU, H. (Eds.), *Commercial Law in the People's Republic of China: Regulation and Reform Affecting the Market*, Hong Kong, Butterworths, 1995, p. 1. By 1978 the public sector was responsible for 98% of the GNP and accounted for almost 100% of the industrial output, of which 77.6 % was produced by SOEs and 22.4 % by other Collectively-Owned Enterprises (COE) in the economy.

[357] In a traditional command economy the state is viewed as one giant vertically integrated productive firm: "China Inc". See CLARKE, D., "Regulation and its Discontents: Understanding Economic Law in China", 28 *Stan. J. Int'l L.*, Spring 1992, p. 287. At the top of the system stood the State Planning Commission (SPC). The SPC set initial rough targets, then sent to various industrial ministries under the State Council and to provincial planning commissions. The ministries and provinces then disaggregated these targets and added requirements of their own before passing them on to particular enterprises. See CLARKE, D., "What's Law Got to Do With It? Legal Institutions and Economic Reform in China", 10 *UCLA Pac. Basin L.J.*, Fall 1991, 1-76, at p. 5. See also DODDS, R., "State Enterprise Reform in China: Managing the Transition to a Market Economy", 27 *Law & Pol'y Int'l Bus.*, Spring 1996, p. 695-753, at p. 704-705.

[358] See JIANG, *o.c.*, *supra* note 356, p. 2; and ART, R. and GU, M., "China Incorporated: The First Corporation Law of the People's Republic of China", 20 *Yale J. Int'l. L*, 1995, p. 273-308, at p. 277. Decision power rested with the Department in Charge, the so-called mother-in-law of the enterprise. Factory managers were responsible to the relevant ministry's bureaucracy. According to enterprise guidelines set out in the *Seventy Policy Points for State Industries*, Promulgated September 1961, the duty of the enterprise was strictly limited to the fulfilment of the task quotas stipulated by the state plans.

[359] See CLARKE, *o.c.*, *supra* note 357, 1992, p. 287 and CLARKE, *o.c.*, *supra* note 357, 1991, p. 6.

[360] See JIANG, *o.c.*, *supra* note 356, p. 2; and BLUMENTAL, D., "'Reform' or 'Opening'? Reform of China's State-owned Enterprises and WTO Accession – The Dilemma of Applying GATT to Marketizing Economies", 16 *UCLA Pac. Basin L.J.*, Spring 1998, p. 198-262, at p. 228. Reform spread rapidly from the few areas in Anhui and Sichuan provinces, the Party leaders from those provinces, Wan Li and Zhao Ziyang, were soon thereafter promoted to central leadership positions.

enterprise by delegating independent management authority to, and sharing profits with, the enterprise[361].

b. Main Approaches

The reform strategy that has been implemented is best described as a gradual dual-track approach[362] (*shuang gui zhi*), characterised by the coexistence of a 'new' market track[363] and 'old' plan track[364]. It caused some ideological difficulty to legitimise profit-seeking private enterprises[365]. But as a result of the reforms, the private, new track economy soon started to supplement the state industry. Today large numbers of private medium and small businesses operate in China's economy, such as the Township and Village Enterprises (TVEs)[366]. The Chinese government now even encourages individuals and private firms to buy smaller SOEs to become full owners. Usually it concerns enterprises the government deems itself unable to manage[367]. This obviously has an impact on

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[361] Agriculture was essentially decollectivised, with each household making its own decisions on production. See CLARKE, *o.c.*, *supra* note 357, 1992, p. 285-286. About rural collectives, see DODDS, *supra* note 357, p. 701, and about agricultural reform at p.706.

[362] See CAO, Y., FAN, G. and WOO, W., "Chinese Economic Reforms: Past Successes and Future Challenges", in WOO, W., PARKER, S. and SACHS, J. (Eds.), *Economies in Transition – Comparing Asia and Europe*, Cambridge, MIT Press, 1997, p. 20. This dual-track approach pervades almost every aspect of policy making. One encounters it in sectoral reform, price deregulation, enterprise restructuring, regional development, trade promotion, foreign exchange management, central-local fiscal arrangements, and domestic currency issuance. See also LARDY, N., *China's Unfinished Economic Revolution*, Brookings Institution Press, Washington DC, 1998, p. 1ff (about China's Economic Reform Strategy).

[363] The 'new' track is the non-state sector, which consists of private and semi-private enterprises, community-owned rural industrial enterprises (often referred to as township and village enterprises, TVEs), and foreign joint ventures or wholly foreign-owned enterprises.

[364] The 'old' track consists of the state sector.

[365] Because private business conflicts with socialist ideology, it was resolved by distinguishing at first between "individual" enterprises (*geti jingji*) and "private" enterprises (*siying jingji*). The former are essentially based on a person's own labour and may employ a few workers without really changing its nature, the latter, however, relied on hired labour and hence raised issues of worker exploitation. In 1987, the then General Secretary of the party, Zhao Ziyang, advanced the notion that China was in the "primary stage of socialism". This means that in a predominant public sector, the private sector may contribute production and employment. See ART and GU, *o.c.*, *supra* note 358, p. 286; and BLUMENTAL, *o.c.*, *supra* note 360, p. 221. Last author therefore calls China "a strange hybrid in which diverse forms of ownership coexist, often in tension with each other." See also DODDS, *o.c.*, *supra* note 356, p. 703-704.

[366] See "Most of China economy not state-owned, International Finance Corp. says", www.chinaonline.com, 26 October 2000. This requires also new law reforms, see "One size does not fit all: New laws tailored for private sector", www.chinaonline.com, 18 October 2000, noting that China will draft new business laws to fit private enterprises.

[367] These enterprises mainly fall into three categories: enterprises that are insolvent or near bankruptcy; businesses suffering from losses or earning only minimal profits over an extended term; or those selected for sale "to perfect the structure of industry". See ART and GU, *o.c.*, *supra* note 358, p. 287. See also

competition with private companies competing with SOEs causing the latter's profits to decline[368].

As some authors point out, a gradual reform was adopted, not because there were no proposals for more radical reforms, but because at the end of the 1970s most ordinary people had not yet totally lost their trust in the old system[369]. It was popularly believed that the economic problems came from the implementation of the political struggle[370] and not from the defects of the central planning system. Gradualism was more of an *ex post facto* description of an unintended evolutionary process[371].

To many authors, politics still is at the centre of gradualism. The transition to a market-oriented economy invariably produces dislocation and social stress, causing uncertainty and discontent. The possibility of unrest[372] is a political problem for the Chinese government, which fears massive restructuring will have devastating political consequences for the Party bureaucracy[373]. The lack of political willingness to carry out

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ZHANG, L., "Forms and Legal Application of Chinese State-Owned Enterprises Restructuring and Merger & Acquisition by Foreign Investors", *China Law,* February 2001, p. 97.

[368] About the structure of the market in China, see SONG, B., "Competition Policy in a Transitional Economy: The Case of China", 31 *Stan. J. Int'l L.*, Summer 1995, p. 387-422. See also DODDS, *idem* note 361, who notes that large numbers of rural workers were able to leave farming to set up small private businesses and to work in township and village enterprises. They began to compete with the SOEs for investment, goods and funds, which caused the latter's profits to decline. The increase in agricultural prices also eroded SOE profits and caused the urban costs of living to rise.

[369] CAO, FAN, WOO, *o.c.*, *supra* note 362, p. 31. Authors note that the majority of the society and the leadership in 1978 were not in favour of a radical reform package because the economic situation then was improving rapidly.

[370] Crucial here was the end of the decade-long Cultural Revolution. Deng Xiaoping returned quickly to power after the ultra-leftist Gang of Four was arrested by Mao's would-be successor Hua Guofeng, hereby ending the Cultural Revolution. Groundbreaking herein was the Communiqué of the Third Plenary Session in late December 1978. See also BLUMENTAL, *o.c.*, *supra* note 360, p. 226.

[371] CAO, FAN, WOO, *o.c.*, *supra* note 362, p. 31. Authors note that very few people knew what to do in 1978. Participants might have known what the first "piece" should be, but might not know what the next one should be. They also note the absence of a common vision at the elite level. China's gradual reform has been characterised by gradual changing of its reform objectives. China has proceeded through a lengthy path of readjusting its reform objectives from "a planned economy with some market adjustment", to "a combination of plan and market" and now to "a socialist market economy with Chinese characteristics". The last vision has apparently resolved the issue. See also YANG, D., *Calamity and Reform in China – State, Rural Society, and Institutional Change Since the Great Leap Famine*, Stanford, Stanford UP, 1996 (arguing that next to the role of plans by revisionist leadership and the Cultural Revolution rural reforms incubating later reforms, are also due to the Great Leap Famine).

[372] *E.g.* after a trial bankruptcy experiment of a large state-owned knitting mill in Chongqing, 2000 laid-off workers marched on city hall in protest and government leaders were only able to avoid riots by going to extraordinary lengths to reassign workers to other jobs. See DODDS, *o.c.*, *supra* note 356, p. 723. See also AUGUST, O., "5,000 Chinese protest over unpaid wages", *The Times*, 18 May 2000.

[373] See BLUMENTAL, *o.c.*, *supra* note 360, p. 202.

painful reforms of inefficient, unprofitable enterprises is believed by these authors to cause China's marketisation efforts to stagnate[374].

This view is reinforced by words of Chinese President Jiang Zemin, who emphasised that maintaining political stability is of primary importance[375]. Because of the political risks[376] involved, China may hesitate to implement far-reaching and necessary economic reforms[377]. Seemingly a considerable number of reformers in the PRC still believe in the old track economy, and that it should be revitalised.

Apart from these political consequences, gradualism raises the issue among economists, whether the two tracks, state and private, should be merged as rapidly as possible[378]. The state has used the revenue from the more productive new sectors not only to cover the losses of the SOEs in the old sector but also to upgrade these SOEs. Some authors therefore regret that the old track has not shrunk proportionately as rapidly as it should have. The most important challenge for these authors is not how to speed up the growth of the new track, but how to ensure that the old track does not grow as well.

c. Management Responsibility System

At the end of 1986, China adopted a management responsibility system (MRS), which enabled the management to contract out state assets, and to keep the earnings above the

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[374] BLUMENTAL, *o.c.*, *supra* note 360, p. 209.

[375] At the 15th Party Congress, Jiang stated that "[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 jeopardising stability, and guard against (...) subversive (...) domestic hostile forces." Cited by BLUMENTAL, *o.c.*, *supra* note 360, p. 216.

[376] See CHAN, V., "Exterminate foes of reform: Jiang – President tries to balance 'leftists' and rightists'", *South China Morning Post*, 23 August 2000; and JOUNG, J., "Zhu Rongji Pushes China to an East European-style Moment of Truth", www.chinaonline.com; both noting a dangerous political conflict in China between pro-reform and conservative forces.

[377] Such as implementing the Bankruptcy Law. See *infra* note 381.

[378] See CAO, FAN, WOO, *o.c.*, *supra* note 362, p. 32. LARDY, *o.c.*, *supra* note 362, p. 3. He notes that the economic cost of postponing fundamental transformation of the state sector is overlooked. On the pace of reforms, see also THOMAS, V. and WANG, Y., "East Asian Lessons from Economic Reforms", in WOO, PARKER, SACHS (Eds.), *l.c.*, *supra* note 362, p. 217-241; and CASS, R., "Macro-Economic Changes from Centralized to Market Economies: Big Bang v. Gradual Change: The Optimal Pace of Privatisation", 13 *B.U. Int'l L.J.*, Fall 1995, p. 413ff. On the issue of privatisation, see further BAKER, M., "Privatisation in the Developing World: Panacea for the Economic Ills of the Third World or Prescription Overused", 18 *N.Y.L. Sch. J. Int'l & Comp. L.*, 1999, p. 233ff; and HAVRYLYSHYN, O. and McGETTIGAN, D., "Privatization in Transition Countries: Lessons of the First Decade", IMF, August 1999. See also note 392.

level it contractually owed the state, in order to provide money for expansion, reinvestment, higher wages and more fringe benefits for the employees[379].

This resulted from the growing intention in the 1980s to create an enterprise that was relatively independent, a socialist commodity producer, and an independent business manager[380]. If such an enterprise conducts its own business, it would be responsible for its own profits and losses[381], and be capable of reforming and developing itself according to law.

To succeed, power had to be delegated to the management of the enterprises to determine production schedules, purchase supplies, marketing strategies, investment decisions, hiring, firing, rewarding, and pricing, on the condition that the enterprises respect the state plans and regulations[382]. It also enhanced the recognition that SOEs, like other enterprises, should have the status of legal person[383]. Gradually, planning decreased while pricing for commodities was liberalised.

To make enterprises sensitive to the difference between costs and revenues, the government required since 1981 that capital construction projects for SOEs had to obtain

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[379] This is sometimes also referred to as "contract responsibility system" (CRS). See JIANG, *o.c.*, *supra* note 356, p. 4. ART and GU, *o.c.*, *supra* note 358, p. 279. See also DODDS, *o.c.*, *supra* note 357, p. 707-708 and 724ff. In 1979 the government began allowing some firms to retain a portion of their profits after meeting their obligations under the state plan, by 1980 it had implemented profit retention plans nationwide, and it began introducing work-related pay and bonuses. After meeting their plan targets, SOEs could make purchases and sales on the market. A dual track system emerged under which most goods had a plan price and a market price. See further also XU, L., "Determinants of the Re-partitioning of Property Rights between the Government and State Enterprises", World Bank, March 1997.

[380] JIANG, *o.c.*, *supra* note 356, p. 3; ART and GU, *o.c.*, *supra* note 358, p. 278-279.

[381] An example is the introduction of the PRC Bankruptcy Law, enacted by the 6th NPC on 2 December 1986. See in this regard MONTFORT, M., "Reform of the State-owned Enterprise and the Bankruptcy Law in the People's Republic of China", 22 *Oklahoma City U. L. Rev.*, Fall 1997, p. 1067-1123.

[382] Decision by the Central Committee of the Communist Party of china on the Reform of the Economic System ('1984 Decision'), passed on 20 October 1984. Another milestone, the State-Owned Industrial Enterprise Law of the PRC (SOIEL) was enacted on 13 April 1988, by the First Session of the 7th NPC. It formally restricted many of the powers of the Department in Charge (See note 358), but it provided these rights only subject to "regulations of the State Council". This left the limits of SOE autonomy vague and open to official arbitrariness. See JIANG, *o.c.*, *supra* note 356, p. 3-4. See also BLUMENTAL, *o.c.*, *supra* note 360, p. 229-230 and ZHENG, H., "Business Organization and Securities Laws of the People's Republic of China", 42 *Bus. Law.*, February 1988, p. 549-619, at p. 558ff.

[383] Article 41, General Principles of the Civil Law of the PRC (GPCL), 12 July 1986, Effective 1 January 1987. Article 48 sets forth that the enterprise must meet its civil obligations and Article 82 states that the enterprise enjoys the right to manage the assets as authorised by the State. See also ZHENG, *o.c.*, *supra* note 382, p. 553ff.

their funds through interest-bearing bank loans instead of from government sponsored interest-free capital appropriations[384].

The management responsibility system had its shortcomings, though[385]. The management contracts encouraged short-term behaviour and neglected long-term investments in order to maximise profits during the contract period. Managers were not always punished for failure. The contract system was also too rigid for China's rapidly changing economic environment, causing the government to adopt a policy of lowering contract targets when external events made it difficult for enterprises to fulfil their contractual obligations. It made the enforcement of contracts discretionary and weakened their incentive effects. So in January 1994 the government stopped initiating responsibility contracts, with existing contracts expiring in 1996-97. The new system that would have to establish independent enterprise management was *corporatisation.*

d. Corporatisation

In the early 1990s, the southern tour by Deng Xiaoping and his remark that the "planned economy is not equivalent to socialism, nor is the market economy equivalent to capitalism" reaffirmed the commitment of the state to economic reform. In October 1992, the 14th Chinese Communist Congress declared that the party would strive to establish a "socialist market economy"[386]. Around the same time new laws tried to radically reshape the financial composition of the state enterprise as a budgetary unit of the state's financial plan, with the objective of course to achieve a balance of enterprise funds rather than to

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[384] CLARKE, *o.c.*, *supra* note 357, 1992, p. 296.

[385] See in this regard XU, L., "The Productivity Effects of Decentralized Reforms: An Analysis of the Chinese Industrial Reforms", World Bank, *s.d.* (noting p. 30 that adopting the Management Responsibility System and raising profit retention rates, probably the most important reforms as viewed by the Chinese government and many scholars, did not improve productivity much; in fact, there is weak evidence that MRS even might have reduced productivity growth).

[386] JIANG, *o.c.*, *supra* note 356, p. 5. These reforms were legally consolidated in *inter alia* the 1992 Regulations, which redefined the SOIEL (*supra* note 382) in terms of meeting the needs of the market. See State Council, Regulations for the Transformation of Management Mechanisms of the State Industrial Enterprises (1992 Regulations), Promulgated on 23 July 1992. The decrease in government intervention impacted areas such as product pricing, mandatory planning, business operations, technical innovations, labour and personnel affairs and the internal income distribution. See also BLUMENTAL, *o.c.*, *supra* note 360, p. 231. Only the right to negotiate foreign trade contracts had not been delegated to the enterprises.

reimburse costs to the state. Accountancy laws improved, to some degree, the fiscal responsibility and accounting of assets and capital[387].

To clarify the separation of the right to own from the right to manage in the public economic sector the constitution was changed[388]. The 1993 Communist Party Decision[389] called for further renovations of the state enterprise system to effectively separate the government administration from enterprise management, and to end the dependency by state enterprises on bureaucratic government agencies[390]. This policy document inspired the 1993 Company Law[391].

The Company Law reaffirms China's commitment to socialism, and China's reform programme therefore is different from the kind of privatisation experienced by the nations of Eastern Europe[392]. What has happened in China is preferably called

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[387] See, *e.g.*, Ministry of Finance, General Provisions for Enterprise Finance (GPEF), and the Regulations for Enterprise Accounting (REA), Promulgated with the approval of the State Council, on 30 November 1992, Effective 1 July 1993. See also JIANG, *o.c.*, *supra* note 356, p. 6. For further reference, see YANG, J. and YANG, J., *Handbook of Chinese Accounting*, Hong Kong, Hong Kong UP, 1999 and TANG, Y., CHOW, L. and COOPER, B., *Accounting and Finance in China*, Hong Kong, Pearson, 3rd ed., 1996. China is apparently planning to bring its accounting systems in line with international practice, see "China to overhaul accounting system", www.chinaonline.com, 14 November 2000.

[388] The First Session of the 8th NPC amended Article 16 to change "state-run enterprise" into "state-owned enterprise". See also JIANG, *o.c.*, *supra* note 356, p. 8.

[389] Decision by the Central Committee of the Communist Party of China on a Few Issues in Establishing the Socialist Market Economic System, adopted at the Third Plenary Session of the 14th Chinese Communist Party Congress ('1993 Decision'), on 14 November 1993. See JIANG, *o.c.*, *supra* note 356, p. 8-9. The 1993 Decision goes further than the 1984 Decision (*supra* note382), which only assured the separation of the right to own an enterprise from the right to manage one. According to the 1993 Decision the state changes its role from the administrative authority in charge of the enterprise to the investor, or shareholder of the company. The State is only entitled to normal shareholder rights and cannot interfere directly in the management. The enterprise acquires the legal rights to dispose of the assets of the enterprise, which it must manage independently and assume sole responsibility for profits and losses. Shareholders are only responsible for the liabilities to the extent of their investment. See also DODDS, *o.c.*, *supra* note 357, p. 710-711.

[390] For a clear picture of initial bureaucratic involvement and Communist Party involvement in these enterprises, see ZHENG, *o.c.*, *supra* note 382, p. 559ff.

[391] PRC, Company Law, adopted at the 5th Session of the Standing Committee of the 8th NPC, on 29 December 1993, Effective 1 July 1994. See ART and GU, *o.c.*, *supra* note 358, p. 280; and HAN, A., "China's Company Law: Practising Capitalism in a Transitional Economy", 5 *Pac. Rim L. & Pol'y J.*, July 1996, p. 457-507.

[392] These economies, together with the former Soviet Union, experienced shock treatment economic programmes in which transfer of ownership stood central. To date some members of the Chinese leadership are still convinced that expanding the autonomy of SOE 's without changing ownership is the way to solve the current problems in SOE 's. For a comparative view with China, see DODDS, *o.c.*, *supra* note 357, p. 746ff, see generally also WOO, W., PARKER, S. and SACHS, J. (Eds.), *Economies in Transition – Comparing Asia and Europe, l.c., supra* note 362. It is generally argued that China has achieved its economic boom by applying a policy of gradual reform, rather than large-scale privatisation. Gradual reforms have provided a stable environment for investment and allow time for the development of laws and

corporatisation or *stockification,* which entails the restructuring of enterprises, adopting the corporate form, and instituting stock ownership, and, consequently, stock trading without necessarily relinquishing the state's controlling interest in the means of production[393]. The idea is still that the state continues to regulate the economy, but as a sovereign implementing policies of general application rather than as an owner micro-managing individual enterprises[394]. Most authors agree that China's stock markets, however, have not replaced the role of the state with a capital market system[395]. They facilitate financing, however, by channelling consumer savings into productive enterprises.

Since the 1993 Decision, the Chinese government has encouraged break ups and mergers to reshuffle enterprises to conform them to required norms[396]. This was done in the first place to avoid major bankruptcies. Other SOEs have been put together to form groups to organise strategic alliances meant to create economies of scale[397].

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institutions essential to both a properly functioning market economy and a privatisation programme. On the importance of institution building see KOLODKO, G., "Ten Years of Postsocialist Transition: the Lessons for Policy Reforms", World Bank, April 1999. According to CAO, FAN, WOO five factors generated growth in China: 1) initial economic structures, 2) integration into the global economy, 3) saving behaviour, 4) two disastrous leftist campaigns, and 5) overseas investment. See CAO, FAN, WOO, *o.c.*, *supra* note 362, p. 28ff.

[393] The opening of securities exchanges in Shanghai in December 1990, and Shenzhen in June 1991, may have created a structure, whereby state agencies no longer manage the details of day-to-day operations, but government administrative agencies have retained controlling rights through ownership of key state and legal person shares. See hereto BLUMENTAL, *o.c.*, *supra* note 360, p. 223. See also DODDS, *o.c.*, *supra* note 357, p. 712. He calls the Chinese strategy a strategy of marketisation, introducing markets and competition without relinquishing control over SOEs. On the explanation of corporatisation, see also p. 727ff.

[394] See in this regard CLARKE, D., *o.c.*, *supra* note 357, 1992, p. 289.

[395] See DODDS, *o.c.*, *supra* note 357, p. 709. He writes that already in the mid 1980s local authorities and entrepreneurs set up small, unofficial securities markets in a number of cities around the country. On capital markets in China, see further, *e.g.*, ZHANG, J., "Securities Markets and Securities Regulation in China", 22 *N.C.J. Int'l L. Com. Reg.*, Winter 1997, p. 557-630; DALY, B., "Of Shares, Securities, and Stakes: The Chinese Insider Trading Law and The Stakeholder Theory of Legal Analysis", 11 *Am. U. J. Int'l L. & Pol'y*, 1996, p. 971-1026; QIAN, A., "Why Does Not the Rising Water Lift the Boat? Internationalization of the Stock Markets and the Securities Regulatory Regime in China", 29 *Int'l Lawyer*, Fall 1995, p. 615-632; HOLMES, W., "China's Financial Reforms in the Global Market", 28 *L. & Pol'y in Int'l Bus.*, Spring 1997, p. 715-777; KONG, K., "Prospects for Asset Securitization Within China's Legal Framework: The Two-tiered Model", 32 *Cornell Int'l L. J.*, 1998, p. 237-271; and YAO, C., *China's Financial System under Transition*, Basingstoke, Macmillan, 1998. See also PRC, Securities Law, Adopted by the Sixth Session of the Ninth National People's Congress Standing Committee on 29 December 1998.

[396] See, *e.g.*, "International mergers and acquisitions will attract foreign capital, says MOFTEC", www.chinaonline.com, 11 October 2000 (noting that M&A has been an important focus of research).

[397] See DODDS, *o.c.*, *supra* note 356, p. 735-737. See also HUCHET, J., "The Hidden Aspect of Public Sector Reforms in China", 32 *China Perspectives*, November-December 2000, p. 37-48.

e. Social Costs

Despite these reforms, the state-run system has suffered chronically from losses, inefficiency, and insufficient productivity. A substantial portion of workers is *xia gang*[398]. According to some economists, the government's use of state enterprises, for both production and delivery of welfare services, constitutes a further structural impediment[399].

Many of the difficulties in creating a market economy by downsizing the SOE track are associated with accounting for the irrational debt liabilities, employees' support programmes, and extensive social commitments. Because the state's social security reform[400] lags behind enterprise reform, the insurance funds for retirement, unemployment[401], medical care and labour casualties must be generated from diminishing enterprise resources and state funds[402]. The Chinese government recognises these problems, and agrees to make additional investments in a social safety net independent from SOEs. The absence of a proper social safety net eventually leads to the postponement of fundamental reforms causing in turn severe damage to the Chinese financial system as one renowned China observer has noted[403].

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[398] See ART and GU, *o.c.*, *supra* note 358, p. 277. *Xia gang* or off-post is a euphemism for workers who are employed on paper but are not expected to report for work and thus are paid only a fraction of their previous income.

[399] Chinese enterprises routinely provide their workers with housing, medical care, pensions and a host of other social services as part of the "iron rice-bowl" or lifetime employment and social benefits. See ART and GU, *o.c.*, *supra* note 358, p. 278. This is an important reason why bankruptcies of inefficient enterprises are so few.

[400] See, *e.g.*, LEE, P., "Reforming the Social Security System in China", in NAGEL, S. and MILLS, M. (Eds.), *Public Policy in China*, London, Greenwood Press, 1993, p. 33-52; and SUN, G., "Health Care Administration in China", *Ibidem*, p. 53-62.

[401] See, *e.g.*, "Bank of China to layoff 15,000 employees", www.chinaonline.com, 19 October 2000. Nevertheless WTO is generally believed to create new jobs in the private sector, see MARLOW, K., "WTO Deal to Bring China Jobs, Says Economist", www.chinaonline.com, 16 November 1999.

[402] JIANG, *o.c.*, *supra* note 356, p. 12-13. On the social costs of market reform, see GRAHAM, C., "Strategies for Addressing the Social Costs of Market Reforms: Lessons for Transition Economies in East Asia and Eastern Europe", in WOO, PARKER and SACHS, *o.c.*, *supra* note 362, p. 325-355. China is apparently serious about beefing up its social security programmes; see "China earmarks US$ 652 million for social security", www.chinaonline.com, 1 August 2000.

[403] See especially LARDY, *o.c.*, *supra* note 362, p. 4-5. Unwilling to tolerate urban employment that would accompany the widespread bankruptcy of loss-making firms, the state assumed the burden of subsidising growing losses through fiscal subsidies and, increasingly, through so-called policy loans from the state-owned banks. This resulted in huge financial liabilities on the part of Chinese firms. The reason for borrowing such large sums is that they are obligated to provide a broad range of social services that should be financed from the government budget. On financial reform, see also YANG, H., *Banking and Financial Control in Reforming Planned Economies*, Macmillan Press, London, 1996.

D. Compliance with Article XVII GATT

Let us now return to the main concern of Article XVII GATT, *viz.* that maintaining China's large State-owned economic presence could enable the country to evade the effective responsibilities and policies of GATT/WTO even though such an economy can be in complete conformity with the technical rules of GATT[404]. It appears that scholarly opinion is divided on the question whether Chinese SOEs can operate according to commercial business practice. Some scholars doubt that China's corporatisation efforts have disentangled the government from business, whereas others argue that there is a lack of transparency regarding government involvement, which makes it difficult to gauge the effects.

a. Transparency and State Trading

As was discussed earlier, China has thoroughly decentralised foreign trade beyond the original handful of centrally controlled FTC[405]. And China has made further commitments to liberalise foreign trade in its Protocol of Accession. The large number of existing trading firms engaging in import and export make it therefore very difficult to subject these FTC to deliberate government policies preventing them from operation along commercial business practice. Besides, these FTC are subject to competition from FIE and other private-invested FTC, which forces them to adjust for their own survival. Broadly there are only two groups of commodities for which the number of firms entitled to engage in trade is tightly restricted[406]. These products are typically handled by one or a few designated FTO, making direct control of the quantities imported and exported very practical. This regime is an important special feature of the Chinese trade system, but very much a minority part of the overall system. Furthermore, it should be stressed that

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[404] JACKSON, *o.c.*, *supra* note 330, p. 892.

[405] In mid 1999, MOFTEC reported that there were around 9,000 FTC. The number of SOEs and private firms with trading rights for their own products had risen to 12,000 and around 300,000 FIEs had trading rights for their own products. See IANCHOVICHINA, E., MARTIN, W. and FUKASE, E., *o.c.*, *supra* note 319.

[406] These involve on the one hand grain, vegetable oils, sugar, tobacco, crude oil, refined oil, chemical fertiliser, cotton and on the other hand rubber, timber, plywood, wool, acrylics, and steel products. See Annexes 2A and 2B of the Chinese Protocol of Accession.

China is not the only WTO member employing state trading. The heavy reliance on it for agricultural trade in many major trading partners raises general concerns[407].

The main problem with state trading, however, seems to be Article XVII GATT itself. This Article calls for transparency without exactly defining the scope of what is considered to be state trading, except for notification purposes. Depending on how wide one interprets its scope, the broader the concern will be. Because Article XVII is rather open-ended, state trading runs the risk of becoming a stopgap for all the sins of China's enterprise reform. Critics and opponents of China's WTO accession might use the state-trading label for all what they see as flaws in the process of domestic reform and lacks private initiative. Notwithstanding the mystery that surrounds Article XVII GATT, it should be argued that China, in order to let its SOEs make decisions along the lines of normal commercial business behaviour, should continue its efforts, especially in the field of corporate governance.

b. Corporate Governance

Many authors agree that getting the government out of business has proven to be a persistent problem from the outset of SOE reform[408], despite clear language in the 1993 Decision, inspiring the Company Law, that the state is only entitled to normal shareholder rights and cannot interfere directly in the management[409]. The Company Law may be a legal milestone to *corporatise* SOEs by converting them into shareholding companies, the changes it specifies, however, are cosmetic according to some scholars, who especially criticise Articles 4 and 58 of the PRC Company Law[410]. They would argue the law falls

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[407] See generally State Trading Enterprises in Agriculture, OECD, Paris, 2001.

[408] BLUMENTAL, *o.c.*, *supra* note 360, p. 228, but see also SUN, X., "Reform of China's State-Owned Enterprises: A Legal Perspective", 31 *St. Mary's L. J.*,1999, p. 19-47; and WANG, W., "Reforming State Enterprises in China: The Case for Redefining Enterprise Operating Rights", 6 *J. Chin. L.*, Fall, 1992, p. 89-135.

[409] See note 389.

[410] Article 58 unambiguously holds that "any government official may not hold the position of chairman of the board of directors, or supervisor or president of a company". SUN, *o.c.*, *supra* note 408, p. 31-32, argues that, through packing and restructuring, many SOEs have changed only in name and that in the list of company management, one still finds the names of government officials. Article 4 is criticised for contradicting international practice, for it states, "the ownership of state property in a company is vested in the state". An investor who contributes his property to the company conveys ownership rights over the particular property to the company; in return, the investor receives an equity interest. If an investor, such as the government, is allowed to retain ownership rights over the property already invested into the company,

short of providing enterprises and managers with the corporate tools they need to build modern companies and maximise efficiency, because administrative agencies holding controlling shares can still interfere directly in the day-to-day management and affairs of the company[411] - a feature earlier reforms already tried to bring to extinction without success.

Another scholar notes that, under the Company Law, the state and the company (with its investors) receive certain legal rights that are ambiguous and at odds[412]. While enterprises obtain the right of autonomous operations, the state retains legal ownership of state-owned assets, according to Article 4 Company Law, and the internal governance system causes to raise conflicting interests and rights between the state, the company, private shareholders, and labour representatives. Of concern is the notion that enterprises must operate under government and CCP supervision[413].

Corporatisation can only be called a success if it achieves two levels of separation, *viz.* first, when the state's regulatory and administrative powers would be separated from its enterprise ownership rights; and, second, when ownership and management rights would be separated[414]. The critics contend that the State with its highly concentrated ownership is unlikely to play the role of a passive investor and with the continued fears of social unrest will continue to intervene in SOE operations. A proper separation between, and balance of, ownership and control is by no means determined by law directly. It is rather achieved through the owner's voluntary avoidance of interfering in the exercise of ownership functions[415].

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that ownership will conflict with the company's ownership of its own property. SUN at p. 33 rightly believes that this prevents a clear definition of ownership rights in the company.

[411] Articles 66 and 67, PRC Company Law. It should be noted, however, that it concerns only wholly state-owned enterprises.

[412] NIKKEL, M., "'Chinese Characteristics' in Corporate Clothing: Questions of Fiduciary Duty in China's Company Law", 80 *Minn. L. Rev.*, December 1995, p. 503-542.

[413] See in this regard the excellent study of the tension between the enterprise's right of autonomous operations and the government's right of supervision, by MATIAS, J., "From Work-Units to Corporations: The Role of Chinese Corporate Governance in a Transitional Market Economy", 12 *NY Int'l L. Rev.*, Winter 1999, p. 1-54.

[414] DODDS, *o.c.*, *supra* note 357, p. 730ff.

[415] DODDS, *o.c.*, *supra* note 357, p. 731-733 (noting that many questions in the Company Law remain unanswered, such as, what percentage of ownership the state reserves, who will represent the State, or how will the ownership claims of multiple supervisory government units be handled. The law does not explain how a conflict between State and private shareholders should be handled, and does not protect minority shareholders. Finally, not much is known about fiduciary duties).

Many authors therefore believe that only privatisation can save SOE reform, and it should be noted that the Chinese government has acknowledged these calls for the divestiture of state-owned assets. On September 22, 1999, the Chinese Communist Party Central Committee reaffirmed the goal of state-owned enterprise reform in its Decision on Major Issues Concerning State-Owned Enterprise Reform and Development. The decision indicated that various reforms should be adopted for medium and small enterprises, which basically mean their privatisation, but also allows for the government to sell off more state shares in large SOEs[416].

Despite the criticism from Western as well as Chinese scholars, who point out some weaknesses in Chinese corporate governance, to the extent that proprietary directions by the government meddling with business are possible, it should be concluded that, for the purposes of Article XVII, it is unlikely that unwanted government interference on the microeconomic level will amount to concerted policy action by the central Chinese government on the macroeconomic level, simply because China's economy is far too decentralised. As far as corporate governance is concerned, and the fine-tuning of its Company Law, I believe that China's efforts to create a transparent legal system will also pay off its company reforms, and will contribute to the government's disentanglement from business.

III. Domestic Legal Reform

Chapter One mentioned the importance of building a legal system to accommodate free market principles and economic reforms in this regard. The instrumental approach China takes in view of the law means that much of its economic reforms have been initiated through legislation. As with creating a free market, building a legal system according to the rule of law encounters a list of preconditions, which the previous Chapter tried to identify as the separation of powers, judges' independence, respect for individual fundamental rights and freedoms, the legality of administrative action, control of legislation and administration by the independent judiciary, and other legal professions. However, the rule of law as well as the free market economy are illusive principles and remain Western philosophical concepts from which China stands culturally remote.

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[416] See, *e.g.*, ZHANG, *o.c.*, *supra* note 397.

China's WTO membership, nonetheless, requires the country to apply and administer in a uniform, impartial and reasonable manner all its laws, regulations and other measures of the central and local governments. China also has to maintain impartial and independent tribunals, contact points and procedures for the prompt review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application[417]. In this regard China's Protocol of Accession provides for a number of detailed clauses. A linchpin article as far as legal system requirements are concerned is Article X GATT[418], which is sometimes referred to as the "transparency clause".

At the time Article X GATT was drafted, transparency had not the 'veil dropping' meaning it has in the present WTO, but replicated very much the American approach to emerging administrative law in the 1920s and 1930s[419]. Since the establishment of the WTO, however, transparency of the legal system has become a vastly expanded concept and now requires *e.g.* publication of laws, regulations, and the mode of administration in tradable services or, to a more limited extent, investment regimes[420].

To satisfy the transparency requirement China's accession to the WTO obliges the Chinese government to make China a more rule-based society than it has ever been. Significant efforts in the last decade have improved China's situation greatly[421], and more reforms are still underway.

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[417] See Article 2(A), 2(C) and 2(D) of the Protocol of Accession.

[418] The need for legal institutions can be found in several articles of different WTO texts. The WTO Agreements cover a large number of provisions requiring the availability of judicial, arbitral or administrative tribunals and independent domestic review procedures, such as in Article 13 Antidumping Agreement, Article 11 Agreement on Custom Valuation, Article 2 (j) Agreement on Rules of Origin, Article 4 Agreement Pre-shipment Inspection, Article 23 Subsidies Agreement, Article VI GATS, Article 41-50 and Article 59 TRIPS, and Article XX Government Procurement.

[419] See OSTRY, S., "China and the WTO: The Transparency Issue", 3 *UCLA J. Int'l L. & For. Aff.*, Summer 1998, p. 1-19, at p. 4-5.

[420] *Idem*, p. 9-10.

[421] See Art. 1 Memorandum of Understanding Concerning Market Access, 10 October 1992, 31 I.L.M. 1274 (hereafter MOU). The 1992 MOU substantially improved the transparency of China's foreign trade regime and the full implementation of it should bring China in conformity with GATT Article X. See HU, P., "The China 301 on Market Access: A Prelude to GATT Membership?", 3 *Minn. J. Global Trade*, Spring 1994, 132-158, at p. 144-45. One of the major improvements was the adoption of the PRC, Foreign Trade Law (FTL), enacted by the 8th NPC on 12 May 1994. This law prescribes that foreign trade policy and regulations must be published freely and bans or restrictions on imports and exports must conform to GATT rules and be transparent. The FTL addresses the issues of unified national trade policy, transparency and conformity with GATT principles and international practices with respect to NTBs, market access,

Yet a number of legal scholars have pointed out some remaining concerns as well[422]. These concerns comprise the unpredictability of the legal system through policy laws, the lack of transparency due to the bureaucratic heavy hand, and the problems surrounding judicial review and lack of enforcement. According to these authors these shortcomings may undermine Chinese market access obligations, because foreign traders and investors must struggle their way through administrative regulations, and find it hard to seek legal redress. It should be noted, however, that in the Protocol of Accession China has renewed its commitment to alleviating these concerns. The issues addressed in Article X GATT, and the relevant provisions in the Protocol, go to the very heart of China's legal infrastructure, and more precisely to the nature and enforcement of its administrative law regime[423].

A. Policy *versus* Law

Several authors contend that, in order to understand the position of the law in China, it is necessary to understand the position of the Chinese Communist Party (CCP)[424]. Despite the erosion of the ruling ideology, which caused the discipline and the cohesion of the CCP to decline[425], legislation remains according to many observers dependent on the Chinese Communist Party's (CCP) formulation of specific policies[426]. Sometimes,

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antidumping, subsidies and safeguard issues. On these improvements, see MAN, *o.c.*, *supra* note 335, p. 493 and WANG, *o.c.*, *supra* note 336.

[422] For a recent account of such criticism, see, *e.g.*, MASTEL, G., "China and the WTO: Moving Forward Without Sliding Backward", 31 *Law & Pol'y Int'l Bus.*, Spring, 2000, p. 981-997 (noting compliance problems).

[423] OSTRY, *o.c.*, *supra* note 419, at p. 2.

[424] On the role of the CCP in law and society, see, *e.g.*, CHEN, A., *An Introduction to the Legal System of the People's Republic of China*, Hong Kong, Butterworths, 1998.

[425] See in this regard ZHENG, S., *Party vs. State in Post-1949 China*, Cambridge, Cambridge UP, 1997, p. 4 (noting that China is facing a deep institutional crisis because of the disarray in the CCP, and that the country is faced with the challenge of providing an alternative). On the erosion of Party control over lawmaking see, TANNER, M., *The Politics of Lawmaking in Post-Mao China: Institutions, Processes, and Democratic Prospects*, Oxford, Clarendon, 1999, p. 51ff.

[426] LUBMAN, S., "Dispute Resolution in China after Deng Xiaoping: 'Mao and Mediation' Revisited", 11 *Colum. J. Asian L.*, Fall 1997, p. 229-391, at p. 257. Or more extensively, see the same author's book, *Bird in a Cage: Legal Reform in China after Mao*, Stanford, Stanford UP, 1999. See further CLARKE, *o.c.*, *supra* note 357, 1991, p. 17-18. Although the National People's Congress (NPC) is a weak parliamentary body, it is no longer a rubber stamp and is constitutionally the supreme sovereign body of the PRC. The NPC elects a Standing Committee, which exercises the authority of the NPC when the NPC is not in session. However, major pieces of legislation must still receive prior Party approval and much of their content is decided before the NPC becomes involved. On the rise of the NPC system, see TANNER, *o.c.*, *supra* note 425, p. 72ff.

important policies are announced in laws that are accompanied by statements by the CCP, and CCP directives are still used to modify policies, previously given legislative expression[427]. Therefore these authors argue that the distinction between law and policy in China is blurred, and the result is a gap between the law on its face and the norms that are actually applied.

The Party regime can thus revise legal policy anytime according to practical experience, and can still intervene and resume total control whenever it deems the foundation of the regime as under threat[428]. In this line of argument the supremacy of party policy over the law cannot guarantee a stable legislative environment to deal with foreign trade issues involving investment, banking, finance, tax, *etc.*, as long as foreign investors and China traders remain exposed to the "legendary" arbitrariness of Chinese policy makers. Moreover, as some authors point out, laws are drafted in vague terms so their interpretation can change overnight to suit any sudden policy change[429]. It is further argued that the importance attached to underlying policies creates a legal system that is fluid and very changeable, and hence not reliable. It allows the current regime to maintain the appearance of a viable legal system while retaining within its actual operation many facets of policy implementation, namely, changeability and adaptation to local normative structures and conditions[430]. As professor Chen notes, many Chinese scholars explain that the rule of law does not detract from the principle of Party leadership in the state[431]. It is the Party's role to organise and lead the people in forming their common will, and then elevating such will into law through the democratic procedure of legislation. It is also the Party to lead the people in observing the law and in supervising the exercise of legal powers by state organs[432]. However, even at the theoretical level not all Chinese scholars believe that the issue of the relationship between the Party and the law has been completely resolved. Chen continues that it has been pointed out that, although the

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[427] LUBMAN, *o.c.*, *supra* note 426, p. 244.
[428] *Ibidem.*
[429] See CORNE, P., "Lateral Movements: Legal Flexibility and Foreign Investment Regulation in China", 27 *Case W. Res. J. Int'l L.*, Spring/Summer 1995, p. 247-299. On legislative drafting, see SEIDMAN, A. and SEIDMAN, R. (Eds.), *Legislative Drafting for Market Reform: Some Lessons from China*, Basingstoke, Macmillan, 1997.
[430] CORNE, *o.c.*, *supra* note 429, at p. 263.
[431] See CHEN, A., "Toward a Legal Enlightenment: Discussion in Contemporary China on the Rule of Law", 17 *UCLA Pacific Basin L.J.*, Fall 1999/Spring 2000, p. 125-165, at p. 148.

personnel and operations of Party organs are financed by the state budget, these organs are not regulated by state law[433].

Although Western scholars may have concerns about the position of the CCP in law and fact as far as they understand the rule of law, it is also hard to expect from China's WTO membership that it will change its governing and political institutions overnight. Continued conceptual or ideological renewal by Chinese reformers to win widespread acceptance of the doctrines, values and culture of the rule of law among officials, will most probably lead to institutional innovation to alleviate the concerns in future. For the time being, Western trading partners will have to content themselves with China's obligation to apply and administer all its laws, regulations, and other measures in a uniform, impartial and reasonable manner[434].

B. Administrative System

The administrative nature of the Chinese legal system has also caught the attention of the literature. The executive centred state apparatus headed by the State Council[435] supervises many departments including ministries, commissions, administrations and offices[436]. These central administrative agencies all possess authority to issue regulations to implement specific legislation under a grant of such power by a legislative body, and also a technically distinct type of authority to execute their general administrative responsibilities to issue any rule that is necessary to carry out their functions[437]. Until recently, no procedural rules existed to govern the enactment of these important rules[438].

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[432] *Ibidem.*
[433] *Ibidem.*
[434] Art. 2(A) of the Protocol of Accession.
[435] The State Council is considered to be an administrative organ, not a legislative, and hence can pass only administrative rules (*xingzheng fagui*). See CLARKE, *o.c.*, *supra* note 357, 1991, p. 18.
[436] LUBMAN, *o.c.*, *supra* note 426, p. 254 and 257. Most legislation originates in the State Council and those ministries, commissions and bureaux which are subordinate to it. The boundary between administrative legislation that is the proper subject of the executive branch, the State Council, and the pure legislative activity that is reserved to the NPC, is often obscured. In its legally mandated role, the State Council enjoys too much power.
[437] On the State Council lawmaking system, see TANNER, *o.c.*, *supra* note 425, p. 120ff.
[438] This has recently changed somewhat under the PRC, Lawmaking Law, 15 March 2000, enacted by the 3rd plenary meeting of the 9th NPC. See also LI, Y., "The Law-making Law: A Solution to the Problems in the Chinese Legislative System?", 30 *HKLJ*, 2000, p. 120-140.

Although a formal hierarchy of norms exists[439], several observers conclude that the confusing range of documents and the blurred distinction between primary and secondary, implementing, legislation create a disorderly hierarchy of rules[440].

China has therefore agreed to set up an enquiry point where, upon request, information relating to measures affecting WTO trade may be obtained. Replies to WTO members will represent the authoritative view of the Chinese government[441]. Next to the other transparency commitments, this should definitely advance the situation of foreign traders and investors in China.

C. Legal Redress and Law Enforcement

Article X GATT, which, as mentioned above, goes to the heart of a country's legal infrastructure[442], as well as the Sino-US Bilateral WTO Agreement and China's Accession Protocol mention the importance of legal redress and law enforcement[443]. This is particularly relevant in the Chinese context where 'bureaucratic overreaching' may cause administrative interference with foreign investors' business[444].

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[439] CLARKE, *o.c.*, *supra* note 357, 1991, p. 26 notes that rules promulgated by hierarchical bodies have corresponding degrees of authority, but the Chinese legal system still has to come up with a definitive hierarchy that would enable rules to be ranked according to such features as label and promulgating body. See also note 440.

[440] LUBMAN, *o.c.*, *supra* note 426, p. 258. CLARKE, *o.c.*, *supra* note 357, 1991, p. 26-27 (noting that regulations issued by the State Council or one of its ministries may be given greater weight than laws issued by the NPC, because the latter are often vague statements of general principle that explicitly contemplate subsequent implementing rules). See also LI, *o.c.*, *supra* note 438, p. 122. CORNE, *o.c.*, *supra* note 429, p. 252 (according to whom the hierarchy goes as follows: The NPC and its Standing Committee issues various enactments that can loosely be categorised as 'law'; the State Council issues administrative regulations (*xinzheng fagui*), the organs under the State Council, on the other hand, issue what are known as administrative rules (*xingzheng guizhang*); local people's congresses issue local administrative regulations (*difang xingzheng fagui*), and local people's government of provinces, municipalities, and quite big cities may issue local administrative rules (*difang xinzheng guizhang*); other normative documents (*qita de guifanxing wenjian*), formulated by national or local administrative organs, for the purpose of regulation, are not enforceable as law).

[441] Art. 2(C) of the Protocol of Accession.

[442] OSTRY, *o.c.*, *supra* note 423, p. 2.

[443] Art. 2(D) of the Protocol of Accession.

[444] See WELLER, D., "The Bureaucratic Heavy Hand in China: Legal Means for Foreign Investors to Challenge Agency Action", 98 *Colum. L. Rev.*, June 1998, p. 1238-1282.

a. Legal Redress

The principles set forth in Article 41 of the PRC Constitution,[445] as reaffirmed in Article 121 of the PRC General Principles of Civil Law (GPCL),[446] as well as the 1989 Administrative Litigation Law (ALL),[447] are among the legal milestones dealing with the requirement of legal redress. Moreover, many Chinese laws and regulations specifically provide for the right to appeal against administrative agencies and to call on People's Courts[448].

The GPCL assert the basic tenet that the State can incur liability to citizens or entities as is recognised in the PRC Constitution[449]. But it is the passage of the ALL that rendered these rights more concrete. It both strengthens general checks against governmental control in China and offers foreign investors a legal means to challenge intrusive agency action[450].

The ALL does impose two explicit limits, however. First, it does not permit a plaintiff to challenge the inherent validity of abstract regulations and rules under which a particular administrative act is implemented, instead, it only allows reviewing the lawfulness of concrete acts[451]. Hence a court can *e.g.* only refuse to apply a conflicting lower-level regulation, if it conflicts with say the Constitution, national law, or a State Council regulation. It may not strike down such abstract rule, but will refer the matter for resolution to the State Council. Alternatively, an injured party may seek administrative reconsideration, through which the applicable agency may modify, or declare void, a concrete administrative act. However, the agency reconsidering the administrative act and

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[445] See PRC, Constitution, 1982, Article 41.
[446] See General Principles of the Civil Law of the PRC (GPCL), 12 July 1986, effective 1 January 1987, Art. 121.
[447] See PRC, Administrative Litigation Law, 1989, effective 1 October 1990. On Administrative Law in China, see generally FENG, L., *Administrative Law – Procedures and Remedies in China*, Hong Kong, Sweet & Maxwell, 1996. See also WANG, X., "Administrative Procedure Reforms in China's Rule of Law Context", 12 *Colum. J. Asian L.*, Fall 1998, p. 251-277.
[448] This is *e.g.* the case in the PRC, Customs Law.
[449] WELLER, *o.c.*, *supra* note 444, p. 1255-1256.
[450] *Idem*, p. 1257.
[451] Article 12 ALL. "Concrete acts" have been construed by the Supreme People's Court as "unilateral acts or conduct, relating to specific matters and the rights and interests of specific citizens or legal persons". The general regulation itself, however, may not be struck down. See WELLER, *o.c.*, *supra* note 444, p. 1259-1260.

relevant regulation may be in the same hierarchy as the original deciding agency and may have drafted the regulation itself[452].

The second limitation on causes of action in Article 12 ALL permits certain concrete acts to be immunised from judicial challenge[453]. This limitation is understandable, because it immunises laws and regulations promulgated by the legislative branch of the government only as distinct from the administrative branch.

Apart from these limits, however, some critics of China's legal system argue that an injured party's frustration may arise from other deficiencies in the Chinese legal system, such as insufficiently developed procedural law and the general inefficacy of the courts[454]. Although the law permits a challenge of administrative actions, these critics say its effectiveness is limited by constraints on the power of the courts. Since 1979 the court system has been extensively rebuilt,[455] but as some scholars point out, the usefulness is restrained by some systemic weaknesses of the Chinese legal system, as is shown further below.

b. Law Enforcement

Law enforcement appears to be a serious concern in China[456]. Official statistics indicate significant problems with the enforcement of verdicts[457].

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[452] WELLER, *o.c.*, *supra* note 444, p. 1260-1261.
[453] *Idem*, p. 1261.
[454] *Idem*, p. 1262.
[455] On the Chinese judicial system, see, *e.g.*, CLARKE, *o.c.*, *supra* note 357, 1991, p. 19ff; and LUBMAN, *o.c.*, p. 306ff. There exist courts of general jurisdiction as well as specialised courts like railway, forestry, maritime and military courts. The latter type's jurisdiction is not limited by administrative territorial boundaries like the former type. General jurisdiction courts are organised hierarchically. At the top stands the Supreme People's Court, followed by Higher Level People's Courts (Provincially and in Municipals directly under the Central Government, as well as in Autonomous Regions like Tibet), Intermediate Level People's Courts (Prefectural Levels, as well as provincially larger cities directly beneath the Provincial Government), and Basic Level People's Courts (rural and urban counties or districts). The pyramid is not very neat, because higher courts sometimes exercise primary jurisdiction over cases that would have an "influence" on their territory. Courts of general jurisdiction have separate divisions for criminal, administrative, civil and economic matters, and enforcement.
[456] See CLARKE, D., "Power and Politics in the Chinese Court System: The Enforcement of Civil Judgements", 10 *Col. J. Asian L.*, 1996, p. 1-93; CLARKE, D., "The Execution of Civil Judgements in China", *China Quarterly*, n° 143, 1995, p. 65-81; and more recently YANG, D., "Can China Overcome Legal Balkanisation?", www.chinaonline.com, 24 March 2000.
[457] According to YANG, *o.c.*, *supra* note 456, who quotes the vice-president of the Supreme People's Court, Li Guoguang, between 1995 and 1998 higher provincial, prefectural and municipal people's courts reported 3,473 serious cases of refusing to comply with court rulings.

There are a variety of reasons why judgements may be unenforceable. There are factors within the judicial system itself that make enforcement of decisions unlikely. For example, Chinese courts in general are reluctant to use coercive means to enforce; instead, traditional Chinese society emphasises and prefers mediation[458]. Another societal and judicial factor is that courts traditionally were considered to involve in predominantly criminal adjudication and sentencing[459]. An important factor is also the lack of finality of the judgement[460].

The most important reason for judgements being unenforceable, however, is "local protectionism", which testifies so strongly to the fragmentation of the legal system[461]. Courts are extremely reluctant to enforce judgements against local enterprises, local citizens or authorities, because local governments depend on local enterprises and local banks for income and employment and courts depend on these governments as well. They

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[458] See, on this topic, LUBMAN, S., "International Commercial Dispute Resolution in China: A Practical Assessment", 4 *The American Review of International Arbitration*, 1993, p. 107-177. Among the masses education and persuasion is to be used whereas coercion in Maoist view is reserved for the enemy. See excerpts from "Analysis of the Classes in Chinese Society", "On the People's Democratic Dictatorship", and "On the Correct Handling of Contradictions Among the People", in MAO, Z., *Selected Works*, Vol. 1, 4 and 5, Beijing, Langs Press, 1965, 1969, and 1977.

[459] See CLARKE, "Power and Politics...", *l.c.*, *supra* note 456, p. 37. Apart from divorces there was not much civil work to do in a planned economy. This used to be reflected in the court's hierarchy where the president was involved in criminal adjudication, the vice-president in civil adjudication, and the assistant vice-presidents monitored the execution.

[460] See also CLARKE, "Power and Politics...", *l.c.*, *supra* note 456, p. 38. A judgement should be final to be legally effective, defendants have in fact numerous opportunities to relitigate the merits of the case, or at least to pose further procedural obstacles in the way of execution. Similar thoughts can be found in LIU, N., "A Vulnerable Justice: Finality of Civil Judgments in China", 13 *Colum. J. Asian L.*, Spring 1999, p. 35-98.

[461] See CLARKE, "Power and Politics...", *l.c.*, *supra* note 456, p. 41-42 on local protectionism, or *difang boahuzhuyi*. But not only courts reason that way, also other institutions in Chinese society, such as local banks think in the same pattern. If an outside court demands a bank to freeze an account it is very likely the bank will refuse to do so until a local court has authorised it to do so. An often-secret contact between local courts and the debtor make it possible for that party to shift funds and property because is was warned. In Shenzhen internal rules of the bank may require this, although such requirements are prohibited in notices by the Supreme People's Court and the People's Bank of China (Supreme People's Court, People's Bank of China, Joint Notice on Investigating, Freezing and Levying on Bank Accounts of Enterprises, Institutions, Organs and Organisations, Dec. 28, 1983; and, Supreme People's Court, People's Bank of China, Supreme People's Procuratorate and Ministry of Public Security, Notice on Investigation, Freezing, and Levying on Bank Accounts of Enterprises, Institutions, Organs and Organisations, Dec. 11, 1993). Banks are forbidden to transfer or unfreeze frozen funds, or to warn the depositor in advance of freezing, while courts for their part are told that, when there is a difference of opinion with a bank, the matter should be resolved through consultation between the superiors of both court and bank, instead of *detaining bank personnel*. In one case a judge entrusted with enforcement replied that the government would not let him finish the construction of his house if he executed what was demanded. In another case the daughter of a judge was transferred to a remote place after her father executed a judgement.

are all part of the same bureaucratic family, and every member must respect its local relatives.

As Dali Yang notes, the Chinese government acknowledges the problems, and the situation has changed after the Fifteenth Party Congress in 1997, where judicial fairness received far more attention than before[462]. To this end, a variety of initiatives were launched, including important institutional reforms. First, all law enforcement departments were asked, along with the military and the armed policy, to divest themselves of commercial operations in 1998-99. Second, the Supreme People's Court (SPC) directed local courts to thoroughly investigate major cases of local protectionism, and to review local regulations that affect law enforcement; those regulations that conflict with national law are to be declared null and void. The Ministry of Justice, in 1999, launched a three-year programme to retrain all staff in China's judicial administrations, and also introduced entrance exams for new recruits. Third, to reduce the backlog of rulings awaiting enforcement, the SPC carried out a campaign to enforce court rulings in the last four months of 1998, and then made 1999 the year of enforcement. Nevertheless, more than 850,000 court rulings involving 259 billion yuan were still awaiting enforcement as of June 1999, which prompted the Party leadership to marshal the Party's disciplinary mechanisms to promote enforcement[463]. Fourth, the government, especially since 1998, has placed much more emphasis on judicial fairness. These efforts have included opening most court trials to public scrutiny, tightening restrictions on admissible evidence and court procedures. Fifth, the SPC now authorises higher courts (*gaoji fayuan*) to provide unified management and co-ordination over enforcement. Sixth, co-operative pacts between legal aid centres across provinces were signed, so that those who need legal services outside their native places can be assisted.

Although Western trading partners may wish to conclude with China observers that there are still flaws in the rule of law as they understand it should ideally operate, it is important to acknowledge also that China is still making efforts to comply with high demands. These efforts comprise also the possibility to allow foreign investors judicial

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[462] YANG, *o.c.*, *supra* note 456.

[463] YANG, *o.c.*, *supra* note 456, notes that in October 1999, the Central Discipline Inspection Commission and the Ministry of Supervision directed officials to make the enforcement of verdicts an "urgent political task" and investigate cases of administrative interference in and obstruction of court enforcement.

review in the form of a "just, open, efficient, and clean and honest judicial system that ensures fair and independent trials"[464]. One should remember that lofty goals just might take considerable time to implement.

IV. Final Observations

In order for China to accede to the WTO, it is generally accepted that the country should comply with rules, formulated with a particular economic and legal structure in mind. According to many Western, but also some Chinese scholars, China's economic, legal and political structures do not seem to operate as yet in a manner the WTO contemplates how a country's economic, legal and political institutions should ideally operate. To the disappointment of some authors, the 'old' state-track economy has not withered entirely away to create an entirely private economy due to the heavy social costs involved and the danger of creating political instability in such a process. Nonetheless, in its continued efforts to create a socialist market economy, the Chinese government tries hard to rationalise the remains of its state economy. Numerous legal measures try to establish financially autonomous and competitive SOEs, independent from bureaucratic overreaching, and which must make commercial decisions in line with market considerations as required by Article XVII GATT. In this process it was pointed out that some weaknesses in China's corporate governance remain, but that because of the decentralisation in the Chinese economy there no longer exists a danger for concerted economic policy action to undermine GATT/WTO obligations in view of Article XVII GATT. This does not mean, however, that bureaucratic interference is rooted out on the micro-economic level, because various levels of government still have vested business interests. For the divestiture of state assets and to disentangle the government bureaucracy from business interests China should embrace the rule of law.

As far as the implementation of the rule of law in China is concerned, a review of Western authors has revealed that it is necessary to remain vigilant. In Chapter One it was already argued that creating a legal system is more than legislative activity; it should also permeate the legal consciousness of the people living in the region under transition.

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[464] Words of SPC President Xiao Yang commenting on the five-year plan (1999-2003) for comprehensive court reforms, and quoted by YANG, *o.c.*, *supra* note 456.

Moreover, economic troubles often compound the problem of popular acceptance of the rule of law. And Western influence on this point also raises the concern of "transplantability" of Western social and political institutions in post-communist state building. Likewise, WTO integration is not just about the formulation of international economic law and the acceptance of international, liberal trade policies, but it is for China enormously important to cast the foundations suitable to implement, monitor and possibly enforce the WTO standards. In this sense Article X GATT and related WTO provisions are important to show the way for China's implementation process.

International norms, like those created in the WTO framework, have played a tremendously important role in guiding the remodelling of the legal and economic system in China. The question remains, however, when and how the country is going to mark the end of its transition. This is directly relevant for the discriminatory treatment of China under the Protocol of Accession, which allows for special safeguard actions and nonmarket economy methodologies as a result of China's unique economic status. There are no clear criteria to let China graduate from this discriminatory treatment other than the limited duration of these discriminatory measures. Nonetheless, the success of China's reforms is directly relevant for the application of these special trade policies. It would be wrong for WTO members to apply nonmarket or state-trading methodologies to China over the next decade, if the country has completed its transition in the meantime. The absence of such clear criteria should not mean that the employment of such trade policies could happen light-heartedly. The next Chapters will be a closer study of the use of these special trade policies as a response to China's unique economic position.

Chapter Three: EC Trade Policy Response – Safeguards and Market Disruption

So far previous Chapters have dealt with the Bretton Woods institutions and have identified the two, all be it illusive, principles, a 'free market economy' and 'rule of law', which these institutions assume to be in place. In order for transition economies to become successfully integrated into these international organisations, and especially the WTO, it is believed that these countries have to undertake profound reforms to move in the direction of these principles. In applying this development process to China and its

much-debated WTO accession, it was revealed that building market and legal institutions in China should be considered an important condition for that country to be able to comply with the standards of the WTO multilateral trading rules. However, the Chinese adaptation of these reforms, earmarked by gradualism and administrative involvement, has presented the country with difficulties in losing its state trading or nonmarket economy label. These difficulties are reinforced, in turn, because there are no clear graduation criteria with which China has to comply to claim overall market economy status. State trading and nonmarket economy status are, after all, principles as illusive as the preconditions of establishing a market economy.

In their belief that China, despite its massive two decades of reform, still should be treated as a nonmarket economy, and to cabin the externalities this may cause, WTO members have opted to allow special trade policy instruments to be employed selectively against China. The use of these instruments is limited in time, supposedly until China is ready with its process of implementing economic and legal reforms. It is the focus of this Chapter to discuss the trade policy instruments that market economies have adopted under the WTO framework in the belief that China's unfinished reforms, may challenge their markets.

The first section of this Chapter addresses the possible reasons for concern that mature economies have raised over transition economies, and China in particular, joining the WTO. These concerns are incarnated by the huge trade deficit that these economies, the EC and the US, have developed with China and the fear of being inundated with cheap Chinese products, which in turn may disrupt markets. The second part will subsequently deal with the safeguard mechanisms, and as a part thereof the quantitative restrictions, employed against transition economies and China in particular. Many of those restrictions will have to be phased out *vis-à-vis* China. The third part exclusively deals with the Sino-European textiles trade, and the integration of Chinese textiles and its safeguard provisions.

Despite the welcome trade liberalisation, the Chinese Protocol of Accession approves of the use by WTO members of a transitional product-specific safeguard mechanism. This selective safeguard mechanism is based on the notion of "market disruption"; a term coined by US trade law with a Cold War connotation. It will be argued here that the legal

notion of market disruption has lost its relevance, because it is highly unlikely that WTO members will suffer from a concerted central policy action to target their industrial markets, because state-owned enterprises (SOE) in China are too decentralised. Instead, it would have been far better if the Protocol of Accession had expanded Article 5(2)(b) of the Safeguards Agreement and allowed for specific quota modulation with regard to China.

The second argument this Chapter wishes to make is that China faces the burden of stepping up its reform policies to meet WTO standards and to shed its state-trading label, but that developed countries too, will have to adjust and accept their share of the burden in a globalised economy. European industries in particular should therefore not count too much on the employment of market disruption or other safeguard mechanisms. These safeguards are to be invoked only in rare cases of emergency. The EC therefore rightly shows restraint in applying safeguard measures, but there still exist provisions in some Regulations, which should be adjusted in light of China's accession.

I further wish to note that this Chapter very much narrows its focus on the trade policy instruments as they are currently in use by the EC. Reference to US practice will be made when thought relevant. This Chapter is not concerned with coal and steel products and neither with agricultural products, but there are some useful references towards the end of the Chapter.

I. Reasons for Concern

The integration of transition economies, and in particular China, raises many concerns among more mature WTO members, such as the EC and the US. These concerns include also a number of non-trade issues impacted by trade policy, such as the environment, poverty, labour rights, and human rights[465]. Notwithstanding that trade is unmistakably linked with sustainable development, it would, however, require a different thesis to deal with all these issues. For our purposes it suffices to focus on the Chinese trade surplus that resulted in serious trade deficits with the US and the EC. China, like other emerging

[465] Useful in this regard is the EC Directorate General for Trade's informal discussion paper, "The Non-Trade Impacts of Trade Policy – Asking Questions, Seeking Sustainable Development", 8 January 2001.

economies[466], has embraced an export-oriented growth policy[467]. It is possibly this development strategy that set China on a collision course with the international markets. Because, as some view it, China seems to be eager to target international markets to amass foreign exchange to pay for its further development, and at the same time to seal off its domestic market[468]. The trade surplus that China now runs with the EC[469] and the US is often criticised as the result of a mercantilist and expansionist export-oriented growth policy[470].

The Chinese government support for export development can cause externalities[471]. And the question remains whether developed countries can still absorb a major expansion of

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[466] Often similarities between China and the high performing emerging economies of East Asia are drawn. But there are important differences as to the extent public ownership plays a role in the economy. Further, China has been far more dependent on foreign capital to generate exports, which are generally produced by FIE, or Chinese firms with close ties to foreign firms, or which engage in export processing. See LARDY, N., *China in the World Economy*, Institute for International Economics, Washington D.C., 1994, p. 23.

[467] See generally WORLD BANK, *The East Asian Miracle – Economic Growth and Public Policy,* New York, Oxford University Press, 1993; WORLD BANK, *World Development Report*, World Bank, Washington D.C., 1991, Chapter 2; DRABEK, Z. and LAIRD, S., "The New Liberalism – Trade Policy Developments in Emerging Markets", 32 *J. World Trade*, n° 5, 1998, p. 241-269; and TRUBEK, D., "Protectionism and Development: Time for a New Dialogue?", 25 *N.Y.U. J. Int'l L. & Pol.*, 1992, p. 345-366. About earlier Chinese development attempts, especially China's self-reliance strategy and import substitution industrialisation, see ECKSTEIN, A., "The Chinese Development Model", in JOINT ECONOMIC COMMITTEE, *Chinese Economy Post-Mao*, Congress of the United States, Washington D.C., 1978, p. 80-114.

[468] See WALL, D., JIANG, B. and YIN, X., *China's Opening Door*, London, The Royal Institute of International Affairs, 1996, p. 103 (noting that foreign exchange earnings to be remitted to the government was one of the main targets of reform in China). For further discussion of Chinese trade barriers, see MASTEL, G., *The Rise of the Chinese Economy – The Middle Kingdom* Emerges, New York, M.E. Sharpe, 1997, p. 103ff. Accounts of how China seals off its domestic market can be found in: INDUSTRIAL STRUCTURE COUNCIL, *2000 Report on the WTO Consistency of Trade Policies by Major Trading Partners*, MITI, Japan, 2001, p. 289ff; UNITED STATES TRADE REPRESENTATIVE, *2001 National Trade Estimate Report on Foreign Trade Barriers*, USTR, Washington D.C., 2001, p. 42ff.; and see also http://mkaccdb.eu.int following Council Decision 98/552/EC of 24 September 1998 on the implementation by the Commission of activities relating to the Community access strategy, OJ L265, 30 September 1998, p. 31.

[469] Estimated by Eurostat at 44.7 bn EUR in 2001, 44.6 bn EUR in 2000, and 30.3 bn EUR in 1999.

[470] China is often accused of vigorous export promotion in combination with restricting access to its own markets. See LARDY, *o.c.*, *supra* note 466, p. 35. The author continues p. 110ff with examining the openness of the Chinese economy. The World Bank notes that China has developed a very sophisticated system of producer protection. See WORLD BANK, *China – Internal Market Development and Regulation*, World Bank, Washington D.C., 1994, p. 155. See also *supra* note 468.

[471] WORLD BANK, *China – Foreign Trade Reform*, World Bank, Washington D.C., 1994, p. 110ff. Such government support creates an export growth dynamic and may offset disincentives to exports. The study continues to discuss the various forms of public support for export marketing and the less healthy effects it may have. Bottom line is that, if the government does not support export industries along comparative advantage, its support will end in a misallocation of resources.

developing country exports, such as the Chinese[472]. Although authoritative sources see no reason for a general protectionist response[473], except perhaps for export development in specific industries where the import penetration is very high[474], a protectionist backlash depends on the industrial countries' willingness and ability to provide supporting adjustment measures in the regions or industries affected[475]. China's exports are vulnerable to trade barriers in developed countries, and the conditions of access to international markets are in a state of flux. To reduce its vulnerability to trade barriers, China will have to diversify export markets along its comparative advantage[476]. According to some, China does not seem to be ready yet to develop a comparative advantage in heavy industrial equipment or in high technology products that cannot easily be assembled[477], though others have argued there exists reasonable potential for upgrading China's exports[478].

Although China's level of output is uncertain and controversial, it should be said that China has transformed, as a result of the change in its development strategy, since the late 1970s[479]. And different prognoses are made by economists as to where this may leave the

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[472] Analysis of the World Bank addresses fears that exist over the achievement of rapid growth and integration into the world economy by Brazil, China, India, Indonesia and Russia as a result of policy reforms undertaken in recent years. These research results are summarised in WORLD BANK, *Global Economic Prospects and the Developing Countries*, World Bank, Washington D.C., 1997. It should further be noted that, whether China really should be considered a developing country is a debated issue. See, *e.g.*, BROOKS ROSEN, J., "Twenty-Eighth Annual Administrative Law Issue: Note: China, Emerging Economies, and the World Trade Order", 46 *Duke L. J.*, April 1997, p. 1519-1564.

[473] WORLD BANK, *o.c.*, *supra* note 471, p. 143; and OECD, *China in the 21st Century – Long-term Global Implications*, OECD, Paris, 1996, p. 23.

[474] There still seems to be ample room for export development, but specific industries in which import penetration is high include footwear, toys and clothing. See WORLD BANK, *o.c.*, *supra* note 471, p. 144-146.

[475] *Idem*, p. 146. China's exports of clothing, footwear, and textile yarns and fabrics are vulnerable to trade barriers in developed countries, because they account for more than 25% of Chinese exports, a "disproportionately large share" (*Idem*, p. 148).

[476] *Idem*, p. 158. A similar conclusion is reached by the OECD, *o.c.*, *supra* note 473, p. 23 (noting that China's expanding economy cannot succeed by churning out more textiles, toys and the like).

[477] *Idem,* p. 161-163. According to the World Bank, China's export performance depends largely on its low-cost labour force and the reasonable skills levels it has developed. Electrical equipment exports therefore depend on assembly operations of products, such as radio receivers, telecom equipment, electric space heaters, and domestic electric appliances.

[478] See LARDY, *o.c.*, *supra* note 466, p. 40 (noting that China has demonstrated an ability to move up-market, exporting higher quality, higher value-added products, over time).

[479] LARDY, *o.c.*, *supra* note 466, p. 14. Reason for the controversy is that no good statistics are available. On many occasions the asymmetric role of Hong Kong as a transit country, makes adjustments absolutely necessary (see *Idem,* p. 74-75 and 77-79). Therefore nobody can exactly assess the Chinese surplus. See

global economy in the twenty-first century[480]. Notwithstanding the controversy that surrounds these predictions, the pressure on countries' balance-of-payments as a result of China's export-led growth may spark protectionism[481].

When trade between countries remains chronically unbalanced, deficit and/or surplus nations must make adjustments[482]. One of the architects of the 1944 Bretton Woods conference, John Maynard Keynes, believed that an International Clearing Union, which would assess an interest charge on excess reserves above a country's quota, could pressure adjustment on "any country whose balance of payments with the rest of the world is departing from equilibrium in either direction"[483]. However, this proposal was rejected at the conference in favour of the US plan for the IMF, which lacks an explicit mechanism for assessing charges against chronic surplus countries[484]. In theory pressure could be brought to bear on surplus countries to recycle their surpluses through the IMF Articles. Article VII is the so-called "scarce currency clause", which permits the IMF to identify a chronic surplus country, declare its currency as a scarce currency, and allow the rest of the world to discriminate against that country's imports[485]. The scarce currency clause has never been invoked. Consequently, the IMF places the burden of policy change and adjustment on the deficit countries[486]. When a country's balance of payments is chronically in deficit and its reserves are declining, IMF consultations result in a classic austerity programme under which the deficit country deflates its economy by raising interest rates, constraining the growth of the money supply, cutting back on

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also FUNG, K.C. and LAU, L., "The China-United States Bilateral Trade Balance: How Big Is It Really?", 3 *Pacific Economic Review*, 1998, p. 33-47.

[480] See OECD, *o.c.*, *supra* note 473, p. 9-10; 30-34; and 47-49.

[481] See generally JACKSON, J., DAVEY, W. and SYKES, A., *Legal Problems of International Economic Relations*, St. Paul, West Publishing, 1995, p. 1010-1061, at p. 1021.

[482] See, *e.g.*, GILBERT, G., "International Clearing Union", in CATE, T. *et al* (Eds.), *An Encyclopaedia of Keynesian Economics*, Cheltenham, Edward Elgar, 1997, p. 256, 257.

[483] GILBERT, *o.c.*, *supra* note 482, p. 258; see also CROTTY, J., "On Keynes and Capital Flight", 21 *J. Econ. Literature*, 1983, p. 59, at p. 62-63.

[484] GILBERT, *o.c.*, *supra* note 482, p. 258 (noting that this was not surprising, given the fact that the US was a surplus country at that time, and enjoyed a "commanding political and economic position").

[485] See Article VII, sec. 3(a) (providing for the authority to declare a general scarcity of a particular currency); Article VII, sec. 3(b) (authorising any member, after consultation with the Fund, to temporarily impose limitations on the freedom of exchange operations in the scarce currency); See also BLOCK, F., *The Origins of International Economic Disorder*, Berkeley, University of California Press, 1977, p. 52.

[486] See STEWART, F., "Back to Keynesianism: Reforming the IMF", IV *World Pol'y J.*, 1987, p. 465ff, at p. 472.

government spending, and raising taxes. Its citizens will then lose the means to continue to demand imports.

Japan is a good example of a surplus country. Japan has out-traded the rest of the world, but it is sitting on a mountain of foreign reserves, and it is now choking on those surpluses[487]. Instead of recycling its vast surplus, like the US did through the Marshall Plan, the country sunk those funds into speculation in stock and real estate markets and created financial bubbles that burst[488]. Assuming China can avoid trade surpluses of that magnitude and prevent financial bubbles[489], the principal question remains whether the world trading system in general remains as open as it has been over the past five decades, and whether world trade in general continues to grow faster than world GNP[490]. Some in the Chinese government bureaucracy would like to see a system patterned on that of Japan's Ministry of International Trade and Industry (MITI) in the 1960s and 1970s, or Korean industrial policy under President Park in the 1970s[491]. But there are also those who might argue that the government-led industrial policies in Japan and Korea did not work that well[492]. The Chinese economy, however, has run both a trade deficit and current account deficit at several occasions since 1978. And relatively high rates of growth might continue to absorb high domestic savings and large import volumes, the vast bulk of which will continue to be industrial goods. Machinery and transportation equipment, particularly items embodying higher levels of technology than China can produce domestically, are the fastest-growing imports. There is also huge potential for high-value services[493].

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[487] See TURGEON, L., *State and Discrimination: The Other Side of the Cold War*, New York, M.E. Sharpe, 1989, p. 98 (an early explanation of Japan's economic weakness). See also ABRAHAMS, P., "Japanese Trade Surplus Climbs to Record $122bn", *Fin. Times*, 26 Jan. 1999; and ANGELL, W., "How to Save Japan from Oversaving", *Wall St. J.*, 22 June 1998.

[488] Some distrusted the Asian miracle and predicted its bubble to burst. See KRUGMAN, P., "The Myth of Asia's Miracle – A Cautionary Fable", available at http://web.mit.edu/krugman/www/myth.html.

[489] China's trade surplus dropped in 2001. See "Trade Surplus Drops in First 10 Months to US$ 17.33B", available at www.chinaonline.com 14 November 2001. This represented a year-on-year decrease of 25%.

[490] OECD, *o.c.*, *supra* note 473, p. 23.

[491] *Idem*, p. 26.

[492] See WONG, J., "Will China be the Next Financial Domino?", in EAST ASIAN INSTITUTE, *China's Economy and the Asian Financial Crisis*, EAI, Singapore University Press, 1998, p. 25-41. See also KRUGMAN, *o.c.*, *supra* note 488.

[493] OECD, *o.c.*, *supra* note 473, p. 16.

The GATT/WTO implicitly recognises the right of a member to pursue its own domestic policies, even if they give rise to balance-of-payments problems[494]. The GATT allows Members in balance-of-payments difficulty to introduce trade restrictions as one of the major exceptions to the basic principles of tariff bindings. GATT Articles XII and XVIII (b) set out the conditions that have to be met, by developed and developing country Members respectively[495]. If a country running a deficit could not devalue, or not do so easily[496], and if prices on labour markets were relatively inflexible as well, there could be a case for allowing the imposition of temporary import restrictions[497]. The move towards flexible, more easily adjustable exchange rates reduces the rationale for resorting to trade restrictions to safeguard a country's external financial position. Furthermore, experience indicates that quantitative restrictions are not the right instrument to deal with balance-of-payments problems. The IMF and World Bank routinely obtain agreements with borrowing governments, not to introduce import restrictions for balance-of-payments purposes in their adjustment lending to developing countries[498].

The solutions dealing with a big trade imbalance are fairly limited. If devaluation is not feasible, a different reciprocity-based trade policy should enable the enforcement of a reasonable balance, boosting technology, manufacturing, and export expansion[499]. And, although the impact of traditional labour-intensive exports on OECD markets may be relatively limited, as some economists state, because the affected sectors only account for a small proportion of output in most OECD members, there could be import resistance from some countries perceiving a greater amount of "catch-up" adjustment[500]. The challenge thus lies in responding to the change by allowing or inducing resources to shift

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[494] See VAGTS, D., *Transnational Business Problems,* New York, New York Foundation Press, 1998, p. 45.

[495] JACKSON, J., *The World Trading System – Law and Policy of International Economic Relations*, Cambridge MA, The MIT Press, 2nd ed., 1997, p. 241. See also MAH, J., "Reflections on the Balance of Payment Provisions in the WTO", 21 *World Comp.*, September 1998, p. 139.

[496] This might be because surplus countries do not want to appreciate their currency sufficiently. See LOVETT, W, ECKES, A, and BRINKMAN, R., *US Trade Policy – History, Theory and the WTO*, New York, M.E. Sharpe, 1999, p. 138 (referring to the 1985-87 Plaza Agreement to bring down the overvalued dollar).

[497] See HOEKMAN, B. and KOSTECKI, M., *The Political Economy of the World Trading System*, Oxford, Oxford University Press, 1995, p. 187.

[498] *Idem,* p. 188.

[499] LOVETT, ECKES and BRINKMAN, *o.c., supra,* note 496, p. 138ff.

[500] OECD, *o.c., supra* note 473, p. 17.

where new opportunities for more efficient use are emerging. As is stated in the Leutwiler Report:

> *"(...) [T]he choice is between being frozen in existing inefficiencies in each line or industry or continuing the search and struggle for maintaining competitive strength all along the line knowing full well that success can only be limited in each sector with no defined frontiers or turf that can preserved for ever for any country or group of countries. (...) [N]o country that continues to respond to change need fear being converted into an industrial desert even in particular sectors"*[501].

The US and the EC traditionally pursue different strategies with respect to this adjustment. Whereas in the former, displaced workers are often expected to disappear without receiving much, if any, compensation for their loss, the European workers are not viewed as immediately substitutable or disposable. European governments, traditionally, play a more active role in managing the social costs of adjustment imposed on certain groups of society. There may be less emphasis on economic efficiency, but more on socio-political cohesion[502]. However, it may also produce a false sense of tranquillity for those workers who have attained a high standard of living and somehow feel that they can afford the luxury of continuing to enjoy this high standard through adjustment assistance.

The discussion will now focus on whether the employment of WTO-based adjustment mechanisms or safeguards is of any use in the challenge that the developed world faces regarding the integration of a large export development country such as China. Whilst China faces the burden of stepping up its reform policies to meet the WTO standards, and to shed its state-trading label, developed economies too, will have to accept their share of the burden and adjust. However, where there is a clear need to cabin the risks and costs of Chinese WTO integration, it would be unfair to amount the use of safeguard mechanisms to blunt protectionism. At the same time a sufficient amount of flexibility is needed for

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[501] See PATEL, I., "The Adjustment Problem", in *Trade Policies for a Better Future – The 'Leutwiler Report', the GATT and the Uruguay Round*, Boston-Dordrecht-Lancaster, Martinus Nijhoff Publishers, 1987, p. 90.

[502] See OSTRY, S., *The Post-Cold War Trading System*, Chicago, University of Chicago Press, 1997, p. 83, 235.

markets to make swift adjustments to changing circumstances and to find compromises when necessary. Flexible safeguards usually form a very thin line in this regard, and some scholars are concerned about the future direction of Western trade policy and possible trade friction that the use of these safeguards may cause[503].

Below this Chapter will discuss WTO trade policy instruments and particularly how some of them are applied to trade with transition economies and China. Subsequently the question will be raised here, how these instruments will continue to exist after China's WTO accession. The emphasis is limited to EC trade policy, but some reference to US policy will be made when thought relevant.

II. WTO Adjustment Mechanisms

From the previous section it has become clear that the export-led growth of China may create unease in mature Western economies. These economies are alarmed by their balance-of-payments deficit with Asian countries and China in particular. To restrain the losses in certain industrial sectors the EC and the US have resorted to certain trade policy instruments. These instruments are believed to help these trading partners in their efforts to adjust to the rising Chinese competition. In the largest sense these trade policy instruments are referred to as *safeguards*. The GATT/WTO safeguard provisions can be separated into several categories[504]. There are safeguard provisions that allow for the temporary suspension of obligations[505] and those that allow for permanent exceptions[506]. There are safeguards allowing for the protection of a specific industry, and there are safeguards with an economy-wide rationale. In sum, there are at least eight GATT safeguard provisions, which could be used with the following objectives: (1) facilitating adjustment of an industry (Art. XIX); (2) establishment of an industry (Art. XVIII (a) and

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[503] See, *e.g.*, KRUEGER, A., *American Trade Policy – A Tragedy in the Making*, Washington D.C., The AEI Press, 1995, p. 102ff (on the issue whether there is reason to believe that trade friction is on the increase).

[504] See HOEKMAN and KOSTECKI, *o.c., supra, note* 497, p. 161. Further, it should be noted with Hoekman and Kostecki that GATS does contain safeguard provisions, similar to those of GATT, except the one on modification of schedules. GATS does not have provisions allowing for Antidumping, Countervailing Duties, or Infant Industry protection (*Idem,* p. 162). See also below note 508.

[505] These include Antidumping and Countervailing Duties (Art. VI), Balance-of-Payments restrictions (Art. XII and XVIII (b), Infant Industries assistance (Art. XVIII (a) and XVIII (c)); Emergency Protection (Art. XIX); and General Waivers (Art. XXV).

[506] These include the General Exceptions (Art. XX and XXI) and the Tariff Renegotiation (Art. XXVIII).

(c); (3) combating "unfair" trade (Art. VI); (4) allowing for a permanent change of mind, through renegotiating of tariff concessions (Art. XXVIII); (5) seeking a derogation or waiver from specific GATT rules with the agreement of a majority of members (Art. XXV); (6) dealing with macroeconomic (balance-of-payments) problems (Art. XII and XVIII (b)); (7) achieving health, safety, and related objectives (Art. XX); and (8) maintaining national security (Art. XXI)[507]. Apart from GATT safeguard provisions there also exist safeguards in a number of other WTO Agreements, such as the Agreement on Agriculture (Art. 5), the Agreement on Textiles and Clothing (ATC) (Art. 6) and the General Agreement on Trade in Services (GATS) (Art. X)[508]. Moreover, there are many regional and bilateral agreements providing similar instruments.

It will not be possible to discuss in great detail all of the above safeguard mechanisms, and to discuss the possible role they might fulfil in the Western adjustment process. Instead, the discussion here is limited to the few trade policy instruments that are most relevant for the US and especially the EC in relation to the People's Republic of China. These instruments are the emergency safeguard clause (Art. XIX GATT), the product-specific transitional safeguard mechanism (Section 16 Chinese Protocol), and the transitional safeguard mechanism for textiles (Art. 6 ATC). The unfair trade clause (Art. VI GATT) is the subject of Chapter Four.

III. Emergency Safeguard Clause

The systemic approach to WTO trade remedies should recognise the renegotiation of commitments in Article XXVIII GATT as the ultimate trade remedy – the only one based on the WTO principle of reciprocity. It should be taken into account, however, that if trade remedies were necessary only for a limited period, renegotiations would be a disproportionate instrument. Hence a cost-efficient use of renegotiations requires a less permanent safeguard provision – an emergency safeguard clause[509].

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[507] HOEKMAN and KOSTECKI, *o.c., supra, note* 497, p. 162.
[508] On the analogue provision to GATT Article XIX in GATS, see LEE, Y., "Emergency Safeguard Measures under Article X in GATS – Applicability of the Concepts in the WTO Agreement on Safeguards", 33 *J. World Trade*, August 1999, p. 47-59. See also note 504.
[509] See MESSERLIN, P., "Antidumping and Safeguards", in SCHOTT, J., *The WTO After Seattle*, Institute for International Economics, Washington D.C., 2000, p. 159-183, at p. 162.

Therefore, notwithstanding the strict prohibition of quantitative measures by Article XI GATT, or to increase a tariff rate bound according to Article II GATT, a WTO member is allowed to restrict imports of a product temporarily to protect a specific domestic industry from an increase in imports of any product which is causing, or which is threatening to cause serious injury to that domestic industry. This emergency safeguard action is regulated in Article XIX GATT, and since the completion of the Uruguay Trade Negotiations Round also in the WTO Safeguards Agreement.

A. WTO Safeguards Agreement

Under GATT 1947, emergency safeguards were only regulated by Article XIX[510]. Because governments preferred to protect their industries through "grey area measures", such as voluntary export restraints (VER)[511], to escape costly compensation and possibly retaliation, Article XIX was infrequently used[512]. So-called grey area measures did not come under the multilateral disciplines of GATT, and the legality of such measures under the agreement was doubtful. The WTO Safeguards Agreement broke new ground in prohibiting these measures[513] and to rejuvenate the use of the Article XIX safeguard. The Agreement clarifies and reinforces GATT disciplines, re-establishes multilateral control

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[510] This is, apart from the Tokyo Round's Safeguards Code, the predecessor of the current WTO Agreement on Safeguards. For a full account on how Article XIX operated and its implementation in selected Contracting Parties of GATT 1947, see PEREZ-LOPEZ, J., "GATT Safeguards: A Critical Review of Article XIX and Its Implementation in Selected Countries", 23 *Case W. Res. J. Int'l L.*, Summer 1991, p. 517-582. On the use of GATT Article XIX, see also *Guide to GATT Law and Practice: Analytical Index,* WTO Secretariat, Geneva, 6th ed., 1995, (hereinafter GATT Analytical Index), p. 515-539. On safeguards in the EC, see VAN BAEL, I. and BELLIS, J., *Anti-Dumping and Other Trade Protection Laws of the EC,* Brussels, CCH Europe, 3rd ed., 1996, p. 423ff. For a US perspective, read BHALA, R. and KENNEDY, K., *World Trade Law – The GATT-WTO System, Regional Arrangements and US Law*, Charlottesville, Lexis, 1998, p. 897.

[511] See *generally* BRONCKERS, M., *Selective Safeguard Measures in Multilateral Trade Relations*, The Hague, Kluwer Law, 1985. And more specifically LOWENFELD, A., *Public Controls on International Trade*, New York, Matthew Bender, 1983, p. 195ff; and JONES, K., "Voluntary Export Restraint: Political Economy, History and the Role of GATT", 23 *J. World Trade*, n° 2, 1989, p. 125-140.

[512] Other reasons for making little use of safeguards under Article XIX were analysed by the GATT Secretariat at the start of the Uruguay Round, see document MTN.GNG/NG9/W/1 of 7 April 1987 (they are identified as lack of a widely-accepted definition of serious injury; lack of domestic procedures' transparency in determinations; inadequacy of GATT notification and consultation procedures; and failure to respect the short-duration objective for safeguard measures). Apart from these reasons also non-selectivity could be added to the list.

[513] Art. 11 Safeguards Agreement.

over safeguards[514], and encourages structural adjustment on the part of the industries adversely affected by increased imports, thereby enhancing competition in international markets[515].

The conditions under which safeguard measures may be applied are spelled out in Article 2 of the Agreement. These conditions are (i) increased imports and (ii) serious injury or threat thereof caused by such increased imports[516]. It also spells out the general requirement that such measures must be applied on an MFN or non-selective basis[517]. It is long argued that this non-selectivity comes within the logic of Article XIII GATT. Since concessions are granted *erga omnes* their withdrawal should similarly happen in a non-discriminatory way[518]. This non-selectivity was again the focus of debate during the Uruguay negotiations. In particular the EC considered as essential the pursuit of its policy

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[514] A Committee on Safeguards, open to any member's participation, is established to monitor the Agreement's general implementation (Art. 13).

[515] Structural adjustment must be proved in case the initial safeguard is to be extended beyond its initial four-year duration.

[516] These conditions were also part of GATT 1947's Article XIX, but some differences are worth noting. First, it was not enough that imports were increasing and causing serious injury; these events had to be a result of unforeseen developments and of the effect of the obligations incurred by a contracting party, including tariff concessions. This language is absent from the current Safeguards Agreement, nonetheless at two occasions the WTO Apellate Body ruled that Article XIX and the Safeguards Agreement requirements must be applied cumulatively and that as such "unforeseen developments" remains as a condition for the implementation of safeguards (See Korea – Definitive Safeguard Measures on Imports of Certain Dairy Products, WT/DS98/AB/R, and Argentina – Safeguard Measures on Imports of Footwear, WT/DS121/AB/R). A second difference is the identity of the entity charged with making the requisite factual determination. In contrast with GATT 1947, the Safeguards Agreement makes clear that it is the responsibility of the member imposing the safeguard measure, consistent with the procedure, standards and other requirements set forth in the Agreement. On this burden of proof, see Korea – Dairy Products, quoted above. A third difference is that the increase in the quantities of imports may be measured either in absolute terms or relative to domestic production. Finally, by substituting the term "industry" for the term "producers", the new Agreement clarifies that the injury should be to domestic producers as a whole, not merely one, or some domestic producers. See also, NUZUM, J., "The Agreement on Safeguards: US Law Leads Revitalisation of the Escape Clause", in STEWART, T. (Ed.), *The World Trade Organisation – The Multilateral Trade Framework For the 21st Century and US Implementing Legislation*, American Bar Association, Washington D.C., 1996, p. 413-14. The criteria, set forth to be used in making the injury determination, are found in Article 4. On the case law, see also BHALA, R. and GANTZ, D., "WTO Case Review 2000", 18 *Ariz. J. Int'l & Comp. L.*, Spring 2001, p. 1-101; and LEE, Y., "Review of the First WTO Panel Case on the Agreement of Safeguards: Korea – Definitive Measures on Imports on Certain Daily Products and its Implications for the Application of the Agreement", 33 *J. World Trade*, December 1999, p. 27-45.

[517] Under GATT 1947, Article XIX did not expressly address the principle of non-discrimination. See, *e.g.*, BRONCKERS, *o.c., supra* note 511. A traditional reading of GATT Art. XIX suggests that a safeguard measure should apply against imports of any like or directly-competitive products of any origin.

[518] See, *e.g.*, GATT Analytical Index, *o.c., supra* note 510, p. 519; PESCATORE, P., DAVEY, W. and LOWENFELD, A., *Handbook of GATT Dispute Settlement*, Boston, Kluwer, 1991, p. 48; KOULEN, M.,

of imposing selective measures, especially against certain Asian countries. If they were non-selective, EC measures would inevitably hit a number of US products[519]. The EC argued it was more dependent on selective safeguards, because it had reduced tariffs to a lower average level than certain other countries, which had consolidated their customs duties at a high level, thus keeping a significant level of protection[520]. As a result quota shares can be allocated among supplier countries in a selective manner, if (i) the percentage increase in imports from certain Members has been disproportionate to the overall increase in imports; (ii) the reasons for the departure from the general rule of non-selectivity are justified; and (iii) the conditions of such a departure are equitable to all suppliers of the product concerned[521].

The obligation to grant compensation was another issue unacceptable to the EC[522]. According to the text of Article XIX the member invoking the safeguard measure must compensate in the form of concessions. The EC, however, was concerned that this might lead to intra-community trouble. Indeed, compensation in the form of concessions or another product necessarily involves lower protection of another Community industry or Member State[523]. The EC therefore favoured a compromise. Trading partners would renounce their right to compensation, at least for a certain period[524].

The developing country members wanted the adjustment criterion of Article XIX to stand as a very important principle. The EC granted some support to this view by admitting that, if an injury had not been removed within a given deadline, continuation of the measures should only be permitted where accompanied by a restructuring-of-industry adjustment process[525]. In particular, a measure may be extended only if it is found,

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"The Non-Discriminatory Interpretation of Article XIX GATT – A Reply", 9 *LIEI*, 1983, p. 87; For an opposite view, see BRONCKERS, *o.c., supra* note 511, p. 13.

[519] DIDIER, P., WTO Trade Instruments in EU Law: Commercial Policy Instruments, London, Cameron May, 1999, p. 297.

[520] *Ibidem.* The EC also felt that the set of "grandfather clauses" invoked by the US allowed them legally to take unilateral measures without being bound by Art. XIX GATT disciplines.

[521] See Art. 5(2)(b) Safeguards Agreement. In such cases of *quota modulation* the safeguard measure is not subject to extension. See NUZUM, *o.c., supra* note 516, p. 417.

[522] DIDIER, *supra* note 519, p. 298.

[523] *Ibidem.*

[524] This period is limited to three years. Article 7 Agreement on Safeguards deals with the duration of safeguard measures.

[525] See DIDIER, *o.c., supra* note 519, p. 298.

through a new investigation, that the industry is adjusting, and if evidence shows that its continuation is necessary to prevent or remedy serious injury[526].

Another principal achievement of the Agreement on Safeguards is the decrease by stages of the measures, and it provides for a "sunset clause"[527]. Safeguard measures in place for longer than one year must be progressively liberalised at regular intervals. This was supported by the EC, because it realised that a concession on this point was unavoidable to win on the non-selectivity issue, and on the absence of compensation[528]. It was further agreed that if the measures take the form of a quantitative restriction, the level should not be below the actual import level of the most recent three representative years based on past market shares, unless there is clear justification for setting a different, lower, level[529]. The Agreement, however, provides no guidance as to how the level of a safeguard measure in the form of an increase in the tariff above the bound rate should be set, except that measures can only be applied to the extent necessary to remedy, or prevent serious injury, and to facilitate adjustment[530].

The history of Article XIX suggests that the emergency safeguard clause has gone unused, precisely because it was not a back door to protection, at least not as efficient a method as VERs used during the 1970s and 1980s or as antidumping procedures. The following sections will attempt to discuss the use of the emergency safeguard clause in the EC as a trade policy instrument to address the adjustment problem with regard to China, but only after a short introduction of the European trade policy *vis-à-vis* third countries.

B. EC in the Field of Trade

Articles 131 and 134 of the Treaty establishing the European Community (EC) confer the general power in the field of trade directly to the EC. Other specific powers, such as to take autonomous measures to regulate import tariffs and agricultural trade are derived

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[526] Art. 7 Safeguards Agreement.
[527] *Ibidem*.
[528] DIDIER, *supra* note 519, p. 299.
[529] Departure from uniform application is allowed only in circumstances of serious injury (not threat thereof) and only pursuant to satisfactory consultations with the Committee on Safeguards, which must include clear demonstration that the conditions of Art. 5(2)(b) apply. See *supra* note 521, and accompanying text.
[530] Art. 5 Safeguards Agreement.

from other articles. Since the early days of the European Economic Community (EEC) the European Court of Justice (ECJ) has developed this concept of powers[531]. The EC has exclusive powers with regard to its commercial policy as far as goods are concerned[532]. The ECJ, however, did not retain the Commission's arguments in support of its contention of the exclusive competence of the EC for the GATS and TRIPS agreements[533]. Upon ratification by all Member States of the Treaty of Nice the exclusive Community competence will be extended and also apply to negotiations of WTO Agreements that concern services (with certain exceptions), and the commercial aspects of intellectual property rights[534].

As far as trade is concerned, the customs union is the cornerstone of EC trade policy[535]. The most comprehensive trade policy instrument is the Common Customs Tariff (CCT) for it applies to all trade in goods[536]. However, both *ad hoc* and structural exceptions apply. *Ad hoc* exceptions may occur if during a particular calendar year autonomous alterations or suspensions of duties of the CCT are granted. Decisions on tariff increases for the application of GATT Article XIX also fall hereunder. Structural exceptions are built on "special and differential treatment". It should be noted that structural discrimination is not a marginal feature of the European commercial policy. The EC has created a complex pyramid of carefully controlled and delimited preferences[537]. Basically

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[531] Case 26/62, Van Gend en Loos v. Nederlandse Administratie der Belastingen [1963] ECR 1.

[532] On the development of the Common Commercial Policy, see Opinion 1/75 [1975] ECR 1355; Joined Cases 21 – 24/73, *International Fruit Company* [1972] ECR 1219; Joined Cases 37 and 38/73, *Diamantarbeiders v. Indiamex* [1973] ECR 1600; Case 41/76, *Donckerwolcke* [1976] ECR 1921; and EECKHOUT, P., *The European Internal Market and International Trade – A Legal Analysis*, Oxford, Oxford Clarendon Press, 1994.

[533] On the limits and boundaries of these powers to conclude the WTO agreements, see Opinion 1/94 [1995] ECR 5267. See further BOURGEOIS, J., "The WTO in the EC and Opinion 1/94: an Echternach Procession", 32 *CML Rev.*, 1995, p. 3; BOURGEOIS, J. (Ed.), *The Uruguay Round Results: A European Lawyers' Perspective*, Brussels, European Interuniversity Press, 1995; and also VERMULST, E. and INAMA, S., *Customs and Trade Laws of the European Community*, The Hague, Kluwer, 1999, p. 3. The Court admitted that certain specific provisions of these agreements fell within the exclusive competence of the EC (namely cross-frontier suppliers of services in the case of GATS and the section of TRIPS relating to means of enforcement of intellectual property rights). However, all other competences were jointly shared by the Community and its members.

[534] Ten members had ratified the Nice Treaty by May 2002.

[535] See VERMULST and INAMA, *o.c., supra* note 533, p. 5.

[536] See, *e.g.*, VÖLKER, E., *Barriers to External and Internal Community Trade*, The Hague, Kluwer, 1993, p. 50ff.

[537] WOLF, M., *The Resistible Appeal of Fortress Europe*, Washington D.C., AEI Press, 1994, p. 24-25.

there are only a handful of suppliers whose exports face the MFN tariff[538], most countries face lower tariffs, although many of these face other barriers, often themselves discriminatory and steeper than tariff barriers. Nonetheless, the MFN tariff is often the least-favoured tariff. Whereas in terms of economic weight about 60% of the total EC imports were accorded MFN treatment and about 40% were awarded preferential treatment in the early 1990s[539], this relation has somewhat reversed[540].

Traditionally there have been two major structural exceptions to the MFN principle embodied in Article I GATT, consisting of Part IV on Trade and Development[541] and Article XXIV on the formation of free trade areas and customs unions[542]. The former provides for the legal existence of the Generalised System of Preferences (GSP) allowing more favourable tariff treatment for developing nations as well as preferential trading arrangements among developing countries[543]. It can be argued that the EC trade policy, through the conclusion of bilateral or plurilateral contractual and non-reciprocal trade agreements, has added a third exception, as far as these agreements are not acknowledged under Article XXIV GATT[544].

Of all the EC's trading partners the transition economies of Central and Eastern Europe have seen the most dramatic changes in trade relations. Originally the import regime for products originating from state-trading countries was laid down in Regulation 1765/82 on the common rules for imports from state-trading countries[545], which established quotas at the community level; and, in Regulation 3420/83 on import arrangements for products

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[538] In 2002, nine WTO members were subject to exclusively MFN treatment in all product categories: Australia, Canada, Chinese Taipei (Taiwan), Hong Kong, Japan, Republic of Korea, New Zealand and the United States.

[539] WOLF, *o.c., supra* note 537, p. 24-25.

[540] The countries listed in footnote 538 account for 45.2% of the EU's total merchandise imports in 2001.

[541] Decision of the Contracting Parties of 28 November 1979 (GATT document 265/203). Before the adoption of Part IV, the GSP was allowed through waivers based on Art. XXV GATT (see Decision on the Generalised System of Preferences of 25 June 1971, GATT document 2/3545, 185/24).

[542] Understanding on the interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994.

[543] See generally HUDEC, R., Developing Countries in the GATT Legal System, Aldershot, Brookfield, 1987.

[544] See VERMULST and INAMA, *o.c., supra* note 533, p. 46ff. See also CREMONA, M., "Rhetoric and Reticence: EU External Commercial Policy in a Multilateral Context", 38 *CML Rev.*, 2001, p. 359-396.

[545] Regulation 1765/82/EEC of 30 June 1982 on the common rules for imports from state-trading countries, OJ L195, 9 February 1982, p. 21.

originating in state-trading countries, not liberalised at community level[546], which provided for a series of Member States' quotas[547]. However, with the entry into force of the Europe Agreements[548] and Partnership and Cooperation Agreements[549] the trade regime with these countries has undergone substantial changes. Also the Baltic States and Slovenia benefit from agreements on free trade and trade-related matters[550].

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[546] Regulation 3420/83/EEC of 14 November 1983 on import arrangements for products originating in state-trading countries, not liberalised at community level, OJ L346, 8 December 1983, p. 6.
[547] For a detailed account on how the national quantitative restrictions evolved into community-wide quantitative restrictions, see EECKHOUT, *o.c., supra* note 532, p. 149ff.
[548] These are the so-called Association Agreements concluded with the countries of Central and Eastern Europe wishing to accede to the EC and constitute a kind of waiting room for full membership. See, *e.g.*, Europe Agreement establishing an association between the European Communities and their Member States of the one part, and the Republic of Poland, of the other part, OJ L348 (1993); Europe Agreement establishing an association between the European Communities and their Member States on the one part, and the Republic of Hungary, of the other part, OJ L347 (1993); Europe Agreement establishing an association between the European Communities and their Member States on the one part, and the Czech Republic, of the other part, OJ L360 (1994); Europe Agreement establishing an association between the European Communities and their Member States on the one part, and the Slovak Republic, of the other part, OJ L359 (1994); Europe Agreement establishing an association between the European Communities and their Member States on the one part, and Romania, of the other part, OJ L357 (1994); and Europe Agreement establishing an association between the European Communities and their Member States on the one part, and the Republic of Bulgaria, of the other part, OJ L358 (1994).
[549] See, *e.g.*, Council Decision 95/414/EC on the conclusion by the European Community of the Interim Agreement on trade and trade-related matters between the EC, the ECSC and Euratom, of the one part, and the Russian Federation, of the other part, OJ L247 (1995); Council and Commission Decision 97/800/ECSC, EC, Euratom on the conclusion of the Partnership and Cooperation Agreement between the EC and their Member States, of the one part, and the Russian federation, of the other part, OJ L327 (1997); see Council Decision 95/541/EC on the conclusion by the European Community of the Interim Agreement on trade and trade-related matters between the EC, the ECSC and Euratom, of the one part, and Ukraine, of the other part, OJ L311 (1995); Council and Commission Decision 98/149/ECSC, EC, Euratom on the conclusion of the Partnership and Cooperation Agreement between the EC and their Member States, of the one part, and Ukraine, of the other part, OJ L9 (1998); see Council Decision 96/161/EC on the conclusion by the European Community of the Interim Agreement on trade and trade-related matters between the EC, the ECSC and Euratom, of the one part, and the Republic of Moldova, of the other part, OJ L40 (1996); see Council Decision 96/365/EC on the conclusion by the European Community of the Interim Agreement on trade and trade-related matters between the EC, the ECSC and Euratom, of the one part, and the Republic of Kazakhstan, of the other part, OJ L147 (1996); see Council Decision 97/301/EC on the conclusion by the European Community of the Interim Agreement on trade and trade-related matters between the EC, the ECSC and Euratom, of the one part, and Georgia, of the other part, OJ L247 (1995); see Council Decision 97/300/EC on the conclusion by the European Community of the Interim Agreement on trade and trade-related matters between the EC, the ECSC and Euratom, of the one part, and the Republic of Armenia, of the other part, OJ L129 (1997); and see Council Decision 97/567/EC on the conclusion by the European Community of the Interim Agreement on trade and trade-related matters between the EC, the ECSC and Euratom, of the one part, and the Kyrgyz Republic, of the other part, OJ L235 (1997).
[550] Agreement on free trade and trade-related matters between the EC, Euratom and ECSC, of the one part, and the Republic of Estonia, of the other part, OJ L373 (1994); Agreement on free trade and trade-related matters between the EC, Euratom and ECSC, of the one part, and the Republic of Latvia, of the other part, OJ L374 (1994); Agreement on free trade and trade-related matters between the EC, Euratom and ECSC, of the one part, and the Republic of Lithuania, of the other part, OJ L375 (1994); Agreement on free trade and

The Europe Agreements provide for the establishment of a free trade area in ten years time comprising the EC and each of the Central and Eastern European countries. They allow for a gradual phasing out of tariffs and quotas but with an asymmetrical timetable, in which the EC timetable for liberalisation is shorter than that of the Eastern European trading partners. The most important difference with other trade agreements concluded by the EC, beside the creation of a free trade area, is that their scope extends well beyond trade in goods. The Europe Agreements include detailed provisions on the movement of workers, freedom of establishment, supply of services, payments, competition law and approximation of laws. It is clear that the final objective is the preparation for future membership of the EC[551].

As far as the Partnership and Cooperation Agreements with the CIS countries are concerned, they provide for a transitional legal framework for trade relations among the contracting parties by inserting in these agreements references to GATT articles. For those CIS countries in the process of acceding to the WTO, as happened *e.g.* to Ukraine, certain provisions will cease to apply from the date of their accession[552].

The relationship between the EC and China is, at the moment of writing, still governed by the 1985 Agreement on Trade and Economic Cooperation[553], which replaces the previous Trade Agreement of 3 April 1978[554]. The first part of the Agreement concerns matters of bilateral trade, following the rules of the 1978 Agreement. The provisions relating to trade include an MFN clause[555], a safeguard clause[556], a price clause,[557] and a balance of trade clause[558]; both parties making similar commitments as in the 1978 Trade Agreement as almost the same wording is used. However, Article 13 of the 1985

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trade-related matters between the EC, Euratom and ECSC, of the one part, and the Republic of Slovenia, of the other part, OJ L344 (1996). These countries also wish to accede the EU.

[551] For a more detailed description, see VERMULST and INAMA, *o.c., supra* note 533, p. 55ff.

[552] VERMULST and INAMA, *o.c., supra* note 533, p. 62ff.

[553] See Agreement on Trade and Economic Cooperation between the EEC and the PRC, OJ L250, 19 September 1985, p. 2; and Council Decision 2616/85/EEC of 16 September 1985 concerning the conclusion of a Trade and Economic Cooperation Agreement between the European Economic Community and the People's Republic of China, OJ L250, 19 September 1985, p. 1.

[554] Agreement between the EEC and the PRC on Trade, OJ L123, 11 May 1978, p. 1. For a thorough discussion of the 1978 Agreement, see YUE, X., *The EC and China*, London, Butterworths, 1993, p. 21.

[555] Art. 3 Trade Agreement (1985).

[556] Art. 6 Trade Agreement (1985).

[557] Art. 8 Trade Agreement (1985).

[558] Art. 4 Trade Agreement (1985).

Agreement adds that in view of the difference in the two parties' levels of development, the EC is prepared to undertake development activities in China. This provision does not mean that the EC will classify China as a developing country, nor does it change the Agreement from a non-preferential into a preferential one. It merely addresses the problem of financial cooperation and EC aid activities, rather than a problem of trade relations. The EC also continues to treat China as a non-market economy despite the changing economic structure in China, and still allows quantitative restrictions on a number of products originating in China[559].

The MFN clause is more restrictive than the MFN clause of the GATT[560], which is the result of China's non-membership of the WTO/GATT at the time of the conclusion. It also reflects the Community's worries about the possibility that China could produce massive amounts of low-priced products, which would then flood the European market. Reciprocity is also stressed, because China's economic system might create problems for European producers in penetrating the Chinese market notwithstanding the MFN treatment offered by China[561]. Even though China is awarded MFN treatment according to WTO standards after 11 November 2001, it is in fact still in a relatively disadvantageous position compared to most of the Community's other trading partners.

To attain a balance of trade, it was agreed that, were an obvious imbalance to arise[562], the Joint Committee, established by the Agreement[563], should examine the matter so that measures could be taken to improve the situation based on its recommendation. The effect of this clause has been fairly limited. Whereas from 1984 until 1986 China incurred a large deficit with the EC, it is more recently the Community that has incurred an enormous trade deficit with China. Notwithstanding the doubtful useful effects of this clause, it allows either party to demand that the other take steps to remedy the situation, *e.g.* to demand that the other increase its imports in order to attain a trade balance. More

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[559] YUE, *o.c., supra* note 554, p. 56. On quantitative restrictions, see further below, p. 144.
[560] The MFN clause does not confer upon China the same degree of benefits as GATT/WTO members afford to each other. For possible reasons, see YUE, *o.c., supra* note 554, p. 23ff.
[561] *Idem*, p. 23.
[562] Art. 4 Trade Agreement (1985).
[563] Art. 15 Trade Agreement (1985). The EC has established a number of different kinds of joint institutions in various types of agreements concluded with third countries. The emphases and the functions of the institutions established depend largely on the category of the treaty, *i.e.* whether it is an association, free trade or ordinary trade and cooperation agreement. See YUE, *o.c., supra* note 554, p. 33ff.

importantly, it also allows reducing imports from the other party, as China did in 1987 to reduce its trade deficit with the EC[564]. The legal effect of this clause is even more doubtful after the Chinese WTO accession, because the first paragraph of Article 4 is drafted in language that suggests unilateral and discretionary action may be taken[565]. This discussion, however, is largely academic and less practical. It is unlikely the EC will make use of the clause in future; and, in any case, its use should not interfere with established WTO principles now China has become a member. But the academic question remains, as to how such safeguard clauses in bilateral trade agreements relate to multilaterally agreed ones.

Interesting is also the price clause in Article 8, specifying that "trade in goods and the provision of services between the two Contracting Parties shall be effected at market-related prices and rates". "Market-related price" is a very flexible term, the clause lacks any practical procedure as to how to decide it, and a detailed provision to control prices,[566] which occurred in the 1979 Sino-European Textiles Agreement,[567] was abandoned in the 1984 Textile Protocol[568], because the Chinese considered it discriminatory[569]. The clause can also be viewed as a protective measure designed to prevent the Chinese from selling in the Community at prices below market value[570]. Finally, in Article 9 the 1985 Agreement, it also provides that payments for transactions

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[564] YUE, *o.c., supra* note 554, p. 28.

[565] It reads: "The two Contracting Parties will make every effort to foster the harmonious expansion of their reciprocal trade and to help, *each by its own means*, to attain a balance in such trade". Emphasis added.

[566] The price of Chinese made textile products sold to the Community should take particular account of the prices usually governing similar products that were sold under normal trade conditions by other exporting countries in the EC market. See also below note 568.

[567] Agreement between the EEC and the PRC on Trade in Textiles initialled in 1979 as extended and modified, OJ L389, 31 December 1986, p. 3. The textiles trade between the EC and China is governed by a separate legal regime, although certain principles of the 1985 Trade and Cooperation Agreement may apply. Textiles are dealt with separately in later sections.

[568] In the textile agreement there was, until the changes in 1984, a price clause under which imports of a textile product would be suspended, should the price of the product fall below a fixed level. If textile products from China were sold at prices lower than prices sold under normal trade conditions by other exporting countries, then the interested party could request consultations, and in certain circumstances, the EC could suspend delivery of import documents or licences. But there were still difficulties in determining what prices are usually governing normal trade conditions.

[569] In effect the Community had complete freedom to suspend imports, if it regarded suspension to be necessary. YUE, *o.c., supra* note 554, p. 72.

[570] This was definitely the effect of the price clause in the 1979 Textiles Agreement. It excluded the possible application of anti-dumping rules to imports of Chinese textiles. The problem of low-priced imports could easily be eliminated through consultations and/or unilateral action. *Ibidem*.

will be made in convertible currencies accepted by the two parties concerned in the transactions. This reflects the intention to tackle the problem of foreign exchange controls in China.

So far the pyramidal trade policy maintained by the EC was introduced and the framework of Sino-European trade set. It is beyond doubt that against the background of China's WTO accession some of the provisions in the 1985 Trade Agreement are dated, and that these should be brought up to date with WTO/GATT evolutions. What is of interest in the Sino-European trade relation is the employment of safeguards against products, and especially against products originating from China. This is elaborated further below. The following sections first focus on the common regime on safeguards, then the attention will move to safeguards, and how they are applied to state-trading countries, and finally, the regime as it is applied to China in particular will be discussed.

C. EC Regime on Imports and Safeguards

An EC Council Decision[571] approved the WTO Safeguards Agreement, and it was transposed by EC Regulation 3285/94 of 22 December 1994[572]. This Regulation is the last in a long row of safeguard Regulations[573]. The Regulation applies to all products covered by the common commercial policy, except for textile products covered by Regulation 517/94[574], and products originating in certain third countries listed in Regulation 519/94[575]. Apart from these exceptions[576], products originating in third

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[571] OJ L336 of 23 December 1994, p. 184.

[572] Regulation 3285/94/EC of 22 December 1994 on the common rules for imports and repealing Regulation 518/94, OJ L349 of 31 December 1994, p. 53.

[573] See Regulation 1025/70 OJ L124 of 8 June 1970; Regulation 1439/74 OJ L159 of 15 June 1974, p. 1; Regulation 926/79 OJ L131 of 29 May 1979, p. 15; Regulation 288/82 OJ L35 of 9 February 1982, p. 1, as amended by Regulation 1243/86 OJ L113 of 30 April 1986; and Regulation 518/94/EC of 7 March 1994 on common rules for imports and repealing Regulation 288/82, OJ L67, 10 March 1994, p. 77. These Regulations concern trade with market-economy countries and corresponding regulations governing relations with non-market economies were adopted. See further BRONCKERS, M., *Protectionism and the European Community*, The Hague, Kluwer, 1983, p. 56. Apart from setting up common procedures for GATT Art. XIX's application, these Regulations ensured progressive transfer of Member States' trade restriction competencies to the EC. The completion of the internal market and the political changes in Central and Eastern Europe, including the USSR, and the creation of the WTO resulted in an updating of the EC common import regime.

[574] Regulation 517/94/EC of 7 March 1994 on common rules for imports of textile products from certain third countries not covered by bilateral agreements, protocols or other arrangements, or by other specific Community import rules, OJ L67, 10 March 1994, p. 1, as amended.

[575] Regulation 519/94/EC of 7 March 1994 on common rules for imports from certain third countries, OJ L067, 10 March 1994, p. 89, as amended.

countries will take place freely, and will not be subject to any quantitative restrictions[577], with the exception of measures taken under Title V of the Regulation[578]. As far as the scope of these Regulations is concerned, they concern only the liberalisation of imports of goods, coming from third countries into Community territory, and that they do not affect the subsequent marketing of the goods within that territory, which is therefore covered by national legislation or other applicable Community rules[579].

Titles IV and V of the Regulation refer to surveillance and safeguard measures respectively. The WTO Safeguards Agreement does not refer to surveillance measures, but because of their restrictive effects, the EC Regulation regards them as safeguard measures in their own right[580]. Safeguards may, thus, be preceded by surveillance measures. The latter may be taken any time, when the trends in imports on the market in respect of a product covered by the Regulation threatens to cause injury to Community producers[581], and become invalid at the end of the second six-month period following the six months in which the measures were introduced[582]. With respect to safeguard measures, the same conditions apply as in the WTO Safeguards Agreement[583]. However, unlike negotiations on the Antidumping Agreement, those on the Safeguards Agreement did not call for a public interest test[584]. Nonetheless, Regulation 3285/94 provides that, both for surveillance and safeguard measures, the Community's interest must be taken into account[585]. The Community authority should, thus, balance the affected industry's interests with those of the consumers and users of the product concerned, and those of

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[576] Art. 1(1) Reg. 3285/94.
[577] It should be noted that although the safeguard provisions are worded so as to enable also tariff measures to be taken, the EC always preferred quantitative quotas to be applied to these goods.
[578] Art. 1(2) Reg. 3285/94.
[579] The sole objective of Regulations 519/94 and 3285/94 is to achieve greater uniformity in the rules for imports by eliminating the exceptions and derogations, which result from national measures of commercial policy in force prior to their adoption. Placing products on the market is a stage subsequent to importation. The lawful importation of a product does not imply that it will automatically be allowed onto the market. See Case C-296/00, *Prefetto Provincia di Cuneo v. Carbone* [2002] ECR 0 (not yet reported).
[580] Art. 11 Reg. 3285/94; see further DIDIER, *o.c., supra* note 519, p. 336.
[581] Art. 11(1) Reg. 3285/94.
[582] Art. 11(3) Reg. 3285/94.
[583] For a detailed discussion, see DIDIER, *o.c., supra* note 519, p. 312ff. Art. 5(3)(a) Reg. 3285/94 provides us with definitions of the conditions.
[584] DIDIER, *o.c., supra* note 519, p. 318.
[585] See Arts. 11 and 17 Reg. 3285/94.

other industries susceptible to be concerned by compensations[586]. The procedures for obtaining a hearing by the Commission are contained in Article 4. Those interested parties, which make themselves known, may have access to part of the information made available to the Commission by the complainants[587].

The determination of the need to enact a safeguard or surveillance measure is based on the criteria found in Article 10[588]. Before the introduction of a surveillance or safeguard action, consultations may be taken at the initiative either of the Commission or of a Member State[589]. These consultations take place in the Advisory Committee mentioned in Article 4. If, after the consultations, the Commission has obtained sufficient evidence it may initiate an investigation, which will be announced accordingly in the Official Journal containing details of the information on the basis of which was decided to open the investigation, and will state the period within which interested parties may make themselves known[590]. The Regulation sets clear time limits for the duration of the safeguard measures as well[591].

The Safeguards Agreement provides that, when a quantitative measure is applied, the quota is allocated among all the supplying countries. In principle such quotas will be agreed with other WTO members having a substantial interest in supplying the product. A second option is to allocate the quota between members, dividing it by shares based on a previous representative period. Article 5 (2)(b) of the Safeguards Agreement introduces the "selectivity clause", or "quota modulation", whereby a member may depart from these rules[592]. These restrictions have been reproduced in Article 16 of the Regulation,

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[586] This can only be done when hearing all interested parties, including users and consumers. Yet the Commission's investigation is foreseen to concern the increase in imports and the injury, rather than the Community interest (Art. 5(2)). See also Art. 18 Reg. 3285/94.

[587] Art. 6 Reg. 3285/94.

[588] They comprise: (a) the volume of imports, where there has an absolute or relative increase; (b) the price of the imports, where there has been a significant price undercutting; (c) the consequent impact by trends in certain economic factors, such as production, capacity, stocks, sales, market share, prices, profits, return on capital, cash flow, and employment; (d) other factors. In case of threat of serious injury: (a) rate of increase of exports to the Community; and (b) the export capacity in the country of origin.

[589] Art. 3 Reg. 3285/94.

[590] Art. 6(1)(a) Reg. 3285/94.

[591] Art. 20 Reg. 3285/94.

[592] See *supra,* p. 129ff.

which allows departure from non-selectivity in case of serious injury. Departure is not permitted in the case of threat of serious injury[593].

The slightly different wording in Article 16 appears to allow EC institutions more flexibility in adopting quota modulation, but this cannot escape multilateral supervision by the WTO Safeguards Committee. It remains to be seen how large or how narrow the quota modulation will be interpreted. It should be mentioned that this selectivity only applies to quotas and not to tariffs. The administration of quotas among importers is further governed by EC Regulation 520/94[594].

Although Regulation 3285/94 treats products originating from WTO members and non-WTO members similarly, with the exception for products originating from those countries subject to Regulation 519/94, as amended. Basically the difference is that for non-WTO members the safeguard can be triggered either on the basis of such greatly increased quantities, or on the basis of imports made on such terms or conditions as to cause, or threaten to cause, serious injury, whereas for WTO members both these conditions have to be met[595]. It may suggest that the EC would not rigidly apply such criteria to a non-WTO member when adopting a safeguard measure, or would use only one of the indicators[596]. In the following section, I will focus on state-trading countries, many of which are not members of the WTO yet.

D. Imports from State-Trading Countries and China

It was Regulations 1765/82[597] and 1766/82[598], which provided for common rules on imports from state-trading countries and China respectively. These Regulations contained the rules applicable to goods, not subject to quantitative restrictions, and liberalised at Community level[599]. The quantitative restrictions maintained at the national level[600] for

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[593] Art. 5(2)(b) Safeguards Agreement; and Art. 20(2) Reg. 3285/94.
[594] Regulation 520/94/EC of 7 March 1994 establishing a community procedure for administering quantitative quotas, OJ L66 of 10 March 1994, p. 1, as amended.
[595] Art. 16(2) Reg. 3285/94.
[596] VERMULST and INAMA, *o.c.*, *supra* note 533, p. 25.
[597] Regulation 1765/82/EEC of 30 June 1982 on the common rules for imports from state-trading countries, OJ L195, 9 February 1982, p. 1.
[598] Regulation 1766/82/EEC of 30 June 1982 OJ L195, 9 February 1982, p.21.
[599] An annex to the Regulations listed the products, which could be imported into any part of the Community from these countries free of quantitative restrictions. See VERMULST and INAMA, *o.c.*,

these countries, including China, were contained in Regulations 3420/83[601], and 3421/83[602]. Since the entry into force of trade agreements with many of the Central and Eastern European countries, these transition economies came under the scope of the general import regime as described in the previous section[603]. And a new set of rules dealing with imports from the remaining state-trading economies was created in Regulation 519/94[604], which repealed Regulations 1765/82, 1766/82 and 3420/83. This Regulation eliminated the exceptions and derogations resulting from the remaining national commercial policy measures[605], and thus completed the common commercial policy. Like the regime for market economies, the starting point is the absence of any trade restrictions with the exception for safeguard measures pursuant to Title V. However, for a limited number of products originating in the PRC, owing to the sensitivity of certain sectors of Community industry, quantitative quotas and surveillance

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supra note 533, p. 26. For a detailed discussion, see generally VÖLKER, E., *Protectionism and the European Community*, Deventer, Kluwer, 1987, Chapter Two.

[600] Each year before 1 December the Council laid down the Member States' import quotas for the following year in respect of the various state-trading countries. *Ibidem*.

[601] Regulation 3420/83/EEC of 14 November 1983 on import arrangements for products originating in state-trading countries, not liberalised at community level, OJ L346, 8 December 1983, p.6.

[602] Regulation 3421/83/EEC of 14 November 1983 laying down certain detailed rules for the implementation of the Trade Agreement between the Community and China, OJ L346, 8 December 1983, p. 91.

[603] See, *e.g.*, Regulation 517/92/EEC of 27 February 1992 amending the autonomous arrangements for products originating in Hungary, Poland and the Czech and Slovak Federal Republic, OJ L56 (1992) p. 1; Regulation 3859/91/EEC of 23 December 1991 to liberalise or suspend quantitative restrictions in respect of Albania, extending the suspension of certain quantitative restrictions in respect of countries of Eastern and Central Europe and laying down the import arrangements applicable to products originating from the Baltic States, OJ L362 (1991) p. 83.

[604] OJ L67, 10 March 1994, p. 89. For the list of State-trading countries, see Annex I, it contains Albania, Armenia, Azarbaijan, Belarus, China, Estonia, Georgia, Kazakhstan, North Korea, Kyrgyzstan, Latvia, Lithuania, Moldova, Mongolia, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan and Vietnam.

[605] This package involved the unilateral elimination of 6.417 national quantitative restrictions (of which 4700 concerned Chinese products), see EC Commission, 6th Report from the Commission on the quantitative quotas and surveillance measures applicable to certain non-textile products originating in the PRC, COM (2001) 84 final. It should be noted that many national quantitative restrictions had already been abolished, see Commission Decision 84/12/EEC of 21 December 1983 changing the import arrangements established by Council Regulation 3420/83 and applied in the Benelux countries, in the Federal Republic of Germany, in the United Kingdom and in Greece in respect of the PRC, OJ L16, 19 January 1984, p. 32; Commission Decision 82/912/EEC of 15 December 1982 changing the import arrangements established by Commission Decision 81/248/EEC and applied in the Benelux countries, the Federal Republic of Germany and Greece in respect of China regarding various industrial products, OJ L381, 31 December 1982, p. 26; and Commission Decision 82/45/EEC of 14 January 1982 changing the import arrangements established by Commission Decision 81/248/EEC and applied in the Benelux countries, the Federal Republic of Germany, Greece, Italy and the United Kingdom in respect of China regarding various industrial products, OJ L20, 28 January 1982, p. 40, as amended OJ L58 2 March 1982, p. 30.

measures applicable at the Community level are incorporated in this Regulation. The Regulation lays down a procedure for reviewing and checking these measures in order to adapt them to changes in the situation. Although the recitals claim that there no longer exists a justification for maintaining two separate sets of Community rules for state-trading countries and the PRC, by abolishing the duality that existed in the two separate Regulations 1765 and 1766, the Community *de facto* continued to treat China separately from other state-trading nations, because the quotas in Annex II, and the surveillance measures in Annex III of the Regulation, only concern Chinese products. I will first spend some time on these quantitative restrictions and then discuss the safeguard measures *vis-à-vis* China.

a. EC Quotas on Products from China

Regulation 519/94 introduced quantitative restrictions on seven categories of products originating in the PRC, namely, gloves, footwear, porcelain tableware, ceramic tableware, glassware, car radios and toys, and certain surveillance measures[606]. The introduction of such measures had been agreed by the Council in December 1993 as part of a global package including acceptance of the Uruguay Round results, as a reinforcement of the trade policy instruments, and completion of the common commercial policy. The introduction depended on the sensitivity of the Community industry concerned, and on the increasing threat posed by imports from China, made more acute by the particular characteristics of the Chinese economy. As a result of the bilateral Agreement reached with China on 19 May 1999 in Beijing and the finalisation of China's Accession Protocol to the WTO, the remaining quantitative restrictions will be phased out progressively by the year 2005[607].

As indicated earlier Council Regulation 520/94 of 7 March 1994 established a Community procedure for administering quotas[608]. The Commission accordingly adopted

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[606] Since their entry into force in March 1994, the quotas have been modified on a number of occasions in order to balance the objective of ensuring an appropriate protection of the Community industry concerned, with that of maintaining trade flows with China. The last change happened as a result of Regulation 1138/98 of 28 May 1998, OJ L159, 3 June 1998, p. 1. See also, Case C-150/94, *UK v. Council* [1998] ECR I-7235; and Case C-284/94, *Spain v. council* [1998] ECR I-7309.

[607] See Annex VII of the Chinese Protocol of Accession, WT/L/432. The surveillance measures already ended upon China's accession.

[608] See *supra* note 594.

Regulation 738/94[609], laying down general rules for the implementation of Regulation 520/94. Both these Regulations apply to the administration of the quotas for certain products originating in the PRC as listed in Annex II to Regulation 519/94. Any problems regarding the administration of the quotas, until the end of 2004, will be dealt with in the context of the Committee established by Regulation 520/94 and the Community procedure for administering these quotas. In the management of the quotas, the Commission has been guided by two principles, *viz.* that administrative quotas should not add to the intended effect of the quotas on trade, and that the available quantities should be fully used; and, that non-discrimination among all Community importers, no matter where they are established, and no matter where they submit a licence application, would be ensured.

In conformity with these two principles, the Commission resorted to the first method of allocation provided for in Regulation 520/94, *i.e.* the method based on traditional trade flows, which guarantees that traditional importers receive at least a part of their previous trade performance realised during a reference period, while ensuring a fair access to the quotas to non-traditional importers. The method used for the allocation of the part of the quotas set aside for this category of importers, is the third method provided for by Regulation 520/94, *i.e.* the method of proportional allocation to the quantities requested. In order to exclude speculative applications, a maximum quantity, which may be applied for by non-traditional importers is set. Over the years the portion of the quotas reserved for non-traditional importers was gradually increased, while at the same time the maximum individual quota quantity entitlement was increased for some products as well in 1999[610].

For the quota year 2000, 27.247 applications were submitted, while for 2001 the applications reached 58.524. This extremely high number may result in each individual non-traditional importer being allotted very limited quantities, which in turn may lead to

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[609] Regulation 738/94/EC of 30 March 1994 laying down general rules for the implementation of Regulation 520/94, OJ L87, 31 March 1994, p. 47, as last amended by Regulation 983/96, OJ L131, 1 June 1996, p. 47.

[610] See COM (2001) 84 final, *supra* note 605.

under-utilisation of the quota. Any unused portions of the quotas must be redistributed[611]. Traditional importers are asked to prove that they imported products originating in China subject to the relevant quotas in the course of a reference period. This reference period was either 1998 or 1999 for applications made in 2001[612]. For non-traditional importers, only those who participated and made use of at least 80% of their import licences under the annual quota year allocation can have access to these unused quotas.

The EC quantitative restrictions regime towards China was partially liberalised for the last time in 1998. No EC quotas were removed in 1999 and 2000 in view of the situation of Community industries in the sectors concerned, and the lack of progress in the liberalisation of the Chinese quota regime. The progressive removal of quantitative restrictions on both sides is now part of China's WTO accession package, with quotas from both sides to be removed by 2005. However, the phase-out timetable for quotas as originally envisaged was not entirely met because China did only enter the WTO late in 2001. This late Chinese entry meant that the implementation periods had to be mutually agreed prior to completion by the working party on Chinese accession of its Report and the attached protocols and annexes. Subsequently these changes had to be set out in a legislative proposal from the Commission to the Council as an amendment of Annex II of Regulation 519/94. Eventually, these quantitative restrictions will gradually phase out[613]. It should be made crystal clear that under normal circumstances after WTO accession no discriminatory quantitative restrictions can be taken against China, unless they are WTO compatible. Of course the abolition of existing discriminatory quantitative restrictions as bilaterally agreed with China, approved by all WTO members and then included in Annex VII of the Chinese Protocol of Accession, is allowed. Nonetheless, even as far as the imposition of new discriminatory measures are concerned, the EC and the US have secured the right for WTO parties to impose quantitative restrictions as selective safeguard measures against China. As for the right to impose selective safeguards on future Chinese imports, this is further discussed below.

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[611] See Regulation 650/2001 of 30 March 2001 redistributing unused portions of the 2000 quantitative quotas for certain products originating in the People's Republic of China, OJ L91, 31 March 2001, p. 51.
[612] Art. 4 Reg. 650/2001.
[613] See COM (2001) 84 final, *supra* note 605.

b. EC Emergency Safeguards and Products from China

Although the provisions of Regulation 519/94 are similar to the provisions of Regulation 3285/94, there are certain marked differences[614]. For instance there is no language similar to that of Article 5 of Regulation 3285/94 determining and defining the injury criteria in Regulation 519/94. Further, Article 8 of Regulation 519/94, which mirrors Article 10 of Regulation 3285, includes a reference to the particular economic system of the countries whose products are subject to the regulation. Article 8 also seems to suggest that the Commission in its investigation is not specifically obliged to pinpoint "factors other than trend in imports which are causing or may have caused injury to the Community producers concerned", as this language is absent from Regulation 519/94. Also standards for the introduction of surveillance measures are less rigorous than under Regulation 3285/94. Further, Regulation 519/94 requires only Community interest, whereas Regulation 3285/94, additionally, requires a threat to cause injury in Article 11.

An important difference concerns the standards for applying the emergency safeguards. As discussed above, to undertake a safeguard action against WTO members, the two conditions in Article 16 of Regulation 3285/94 have to be met, whereas for safeguards to be applied against non-members only one of the two conditions would suffice. According to Article 15(1) of Regulation 519/94 these two conditions are not imposed, and only one of the two conditions is required to trigger a safeguard action without any difference as to whether the products originate from a WTO member. Moreover, Regulation 519/94 does not contain the detailed discipline on the duration of the measures as in Regulation 3285/94. Once again, Regulation 519/94 is more lenient than Regulation 3285/94 in the sense that, for the application of provisional measures, Regulation 519/94 does not require a preliminary determination of cause and effect, *i.e.* increased imports and injury. There are further no corresponding disciplines on duration and the type of provisional safeguards. Finally, Regulation 519/94 does not contain any provisions regarding quota modulation either, and does not prohibit the selective application of safeguards to the countries listed in Annex I.

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[614] For an overview of these differences, see also VERMULST, INAMA, *o.c.*, *supra* note 533, p. 30.

As far as the countries listed in Annex I of Regulation 519/94 are members of the WTO, one can suspect that this Regulation runs contrary to the WTO Safeguards Agreement and Article XIX. However, the EC has embedded trade relations exceptions in bilateral or plurilateral trade agreements, such as the Partnership and Cooperation Agreements with the CIS countries. Article 10 of those Agreements usually provides for a safeguard clause. This is no different for China, because the 1985 Sino-European Trade Agreement also provides a safeguard clause. This raises the academic question as to what will happen when these bilaterally or plurilaterally agreed safeguards are applied in conformity with their respective treaty provisions, but in conflict with the multilateral WTO safeguards Agreement. First, both Regulation 519/94 and Regulation 3285/94 state that they will not preclude the fulfilment of obligations arising from special rules contained in agreements concluded between the Community and third countries. This means that the bilaterally or plurilaterally agreed safeguards will take precedent over the one described in the Regulations, even when the safeguard clause of Regulation 3285/94 is the only one which really implements the WTO Safeguards Agreement. Second, as far as China is concerned, Regulation 3421/83 of 14 November 1983 laying down certain detailed rules for the implementation of the Trade Agreement between the Community and China seems to have survived. According to this Regulation the procedures of adopting safeguard actions as laid down in Regulation 519/94, formerly Regulation 1766/82, in respect of products subject to the Regulation, can only be adopted once the consultations with China provided for in the 1985 Trade and Cooperation Agreement have been completed. This means that the Joint Committee still has to meet beforehand to discuss the matter. Further, even where the Chinese Protocol of Accession allows for the application of selective measures against the country, the Joint Committee will still have to be consulted. Although the application of a safeguard against products from Chinese origin according to the 1985 treaty or according to Regulation 519/94 theoretically is possible, it is in practice very unlikely that the Joint Committee will allow the application of a safeguard measure that is not conform the WTO.

Notwithstanding the limited and unlikely practical use of an emergency safeguard action, it should be noted that Regulation 519/94 is a liability for the EC. The scope of application of the Regulation should be reconsidered and its safeguard provision should

be brought up to date with WTO standards as far as WTO members are concerned. It would further be appropriate for the EC to allow China to graduate from the scope of application of Regulation 519/94, because the application of its safeguard provision may well contravene the multilateral safeguard rules. Instead, it will be possible for the EC to implement Section 16 of the Chinese Protocol of Accession, and apply another product-specific transitional safeguard mechanism, which is dealt with in the paragraphs below. In this regard the EC should clarify the role of Regulation 3421/83 and the Joint Committee for the application of this new safeguard, based on market disruption. In my opinion the EC should renegotiate the 1985 Trade Agreement to bring it up to date with WTO obligations.

c. Transitional Product-Specific Safeguard Mechanism

The Chinese Protocol of Accession in Section 16 spells out the conditions for measures taken by WTO trading partners in case of "market disruption". Market disruption exists "whenever imports of an article, like or directly competitive with an article produced by the domestic industry, are increasingly rapidly, either absolutely or relatively, so as to be a significant cause of material injury, or threat of material injury to the domestic industry"[615]. The term "market disruption" reminds of a special provision for relief from increasing imports from state-controlled economies, which became law in the US as Section 406 of the Trade Act of 1974[616]. Specifically, Section 406 authorises relief against imports of an article from a state-controlled country when such imports are causing market disruption. According to the statute, "[m]arket disruption exists within a domestic industry whenever imports of an article, like or directly competitive with an article produced by such domestic industry, are increasing rapidly, either absolutely or relatively, so as to be a significant cause of material injury, or threat thereof, to such domestic industry"[617]. This language is identical to that used in Section 16. However, this does not necessarily mean that the US interpretation of this language also will prevail at the WTO level.

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[615] Protocol of Accession, Section 16(4).
[616] Trade Act of 1974, Pub. L. No 93-618, § 406, 88 Stat. 2062 (1978) (Codified at 19 U.S.C. § 2436 (1976))
[617] See 19 U.S.C. § 2436 (e)(2).

The criteria for relief under Section 406 and Section 16 are more relaxed than those under the WTO Safeguards Agreement and Article XIX, which are implemented by Section 201 in the US Trade Act of 1974[618], and EC Regulation 3285/94 as discussed above. Under Section 406 and Section 16, injury to the domestic industry must be "material", as compared to "serious" under Article XIX GATT, and the increasing imports must be a "significant" cause of such injury, compared to its US counterpart in Section 201, which demands for a "substantial" increase, and whereas Article XIX GATT chooses not to qualify the increase of imports with an adjective[619]. The US may want to read its own lesser standards of Section 406 in Section 16, but it should be warned that the Committee on Safeguards, and eventually the Appellate Body of the WTO, might not agree with this interpretation[620]. "Material" injury is interpreted by the International Trade Commission (ITC) in the US as the level of injury required in an antidumping or countervailing duty case investigation[621]. With regard to the "significant" cause of injury requirement, the ITC interprets this as imposing a lesser standard than the "substantial" cause requirement of Section 201, but a greater causation requirement than under the antidumping and countervailing statute[622]. Because there is no close relative to a 'market disruption' clause in EC trade policy laws, such as Section 406 in US trade law, it is hard to know how the EC Commission will gauge this transitional safeguard mechanism. For the time being we will have to wait and see how the EC will implement this provision, if at all. To determine market disruption objective factors such as the volume of imports, the effect of

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[618] 19 U.S.C. §§ 2251, 2436. For a detailed account on the operation of GATT-WTO Safeguards in US law, see BHALA. and KENNEDY, *o.c.*, *supra* note 510, Chapter 9.

[619] The qualification of the increased imports should be read in the "unforeseen developments" and the effect of GATT obligations.

[620] The US has not been particularly successful in employing safeguard measures. In its Steel Line Pipe report of 15 February 2002, the Appellate Body once again found that the US had acted in violation of WTO safeguard rules (see United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea, WT/DS202/AB/R) after the Lamb case of 1 May 2001 (see United States – Safeguard Measures on Imports of Fresh, Chilled and Frozen Lamb Meat from New Zealand and Australia, WT/DS177/AB/R and WT/DS178/AB/R) and the Wheat Gluten dispute of 22 December 2000 (see United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities, WT/DS166/AB/R).

[621] See, *e.g.*, Certain Ceramic Kitchenware and Tableware from China, USITC Pub. 1279, TA-406-8 (1982); Ferrosilicon from the USSR, USITC Pub. 1484, TA-406-10 (1984); and S. REP. NO. 93-1298, 93d Cong., 2d Sess. 212 (1974).

[622] See, *e.g.*, Clothespins from China, Poland, and Romania, USITC Pub. 902, TA-406-2-3-4 (1978). Under the dumping and countervailing duty laws, injury must be "by reason of" unfairly traded imports, which is

imports on prices for like or directly competitive articles, and the effect of such imports on the domestic industry producing like or directly competitive products[623].

Apart from the injury and causation differences between the safeguard regimes of Article XIX GATT and Section 16 of the Protocol, the latter is a selective safeguard clause. It therefore allows to investigate imports from China only, and to apply measures with regard to Chinese products only. This selectivity simply follows from the fact that the Protocol of Accession, which contains the safeguard clause, is by nature country specific. However, this selectivity undermines the WTO Safeguards Agreement, of which non-selectivity is a central feature. Moreover, by allowing selectivity in trade relations with China, it can be asked whether it would be possible for trading partners to agree on Voluntary Export Restraints (VER) with China. In so far affected WTO members may request consultations with China with a view to seeking a mutually satisfactory solution, and of course with China's agreement that imports of Chinese origin are a significant cause of material injury, the preferred outcome for the trading partners could be a negotiated deal in the form of a VER. At least one author mentions the possible use of VERs in this respect[624]. This would undermine the general prohibition on VERs in the WTO Safeguards Agreement, and brings into memory the many VERs with Japan. Of course any such action will have to be notified immediately to the Committee on Safeguards, but many trade economists would not like the idea of VERs to slip in through the backdoor again.

It should be noted, however, that measures taken pursuant to Section 16 are not entirely without retaliatory effect. If a measure is taken as a result of a relative increase in the level of imports, China has the right to suspend the application of substantially equivalent concessions or obligations, if such measure remains in effect more than two years. However, if a measure is taken as a result of an absolute increase in imports, China has a

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interpreted by the ITC to mean that imports must have only some causal relationship to injury. See, *e.g.*, Menthol from China, USITC Pub. 1151, 731-TA-28 (1981).

[623] Section 16(4) Protocol and paragraph 246(c) Working Party Report.

[624] His interpretation is based, however, on the Sino-US Bilateral Agreement of 15 November 1999, and not on the text of the Protocol of Accession. See BHALA, R., "Enter the Dragon: An Essay on China's WTO Accession Saga", 15 *Am. Univ. Int'l L. Rev.*, 2000, p. 1469-1538, at p. 1515.

right to suspend the application of substantially equivalent concessions or obligations, if such measure is in effect for more than three years[625].

Measures can be applied only for such period of time as may be necessary and the application of Section 16 will be terminated twelve years after the date of accession[626]. Probably the transitional nature of Section 16 did not urge negotiators to deal with the maximum duration of the measures. Further, no investigation under Section 16 of the Protocol on the same subject matter could be initiated less than one year after the completion of a previous investigation[627]. The period of application could be extended, provided that the competent authorities of the importing WTO member determines that the action continues to be necessary to prevent or remedy market disruption[628]. A unique feature to the transitional safeguard provision is that WTO members are allowed to limit imports from China as a result of significant trade diversions caused by other members' measures taken pursuant to Section 16[629]. This could possibly lead to a cascade of trade restricting measures against China. The Chinese representative's worries in this respect were noted in paragraph 245 of the Working Party Report[630].

The question is whether it was really necessary to adopt an eclectic relief provision modelled on Section 406 of the US Trade Law dealing with market disruption. In the past such selective safeguard clauses, as *e.g.* in the Polish Protocol of Accession, proved to be of very limited use, just as Section 406 itself. Moreover, as was demonstrated in the previous Chapter, Chinese state trading has become far too decentralised and this decentralisation makes it virtually impossible for the Chinese central government to take concerted action, and to target a Western industry so as to cause market disruption. The type of market disruption Western countries feared during the Cold War era, with state-controlled enterprises deliberately mass-producing goods, and to flood them onto the international markets so as to wipe out Western market share, really belongs to the past.

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[625] Section 16(6) Protocol.
[626] Section 16(9) Protocol.
[627] Paragraph 246(g) Working Party Report.
[628] Paragraph 246(f) Working Party Report.
[629] Section 16(8) of the Protocol of Accession.
[630] "(...) [T]he representative of China expressed particular concern that WTO members provide due process and use objective criteria in determining the existence of market disruption or trade diversion, because WTO members did not have wide experience in implementing the provisions of Section 16 of the

Instead, it would have been a much better exercise if Section 16 of the Protocol had specifically allowed for quota modulation to be applied to China with relaxed criteria for a number of years. This alternative would have resulted in greater conformity with the WTO Safeguards Agreement, and China would not have to be treated as a state-trading economy.

So far only the import regime dealing with products other than textiles was discussed, textile products is the subject of further study in the paragraphs below.

IV. Textiles Regime

Textiles are undoubtedly one of the main products traded between the EC and China. As I briefly mentioned above, the textile regime is subject to a separate trade regime, which is currently based on the WTO Agreement on Textiles and Clothing (ATC). From the onset of Sino-European trade relations in the 1970s textiles were treated differently. Next to the 1978 general Sino-European Trade Agreement the two parties concluded a separate Textile Agreement in 1979[631]. In 1984 at the time of China's accession to the Multilateral Fibre Agreement (MFA), the 1979 Textile Agreement was expanded with a Supplementary Protocol[632]. A couple of years later, when China had become one of the top textile suppliers to the Community, the 1988 Textile Agreement was negotiated and concluded[633]. In 1995 the two trading partners concluded an Agreement on Trade in

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Draft Protocol." As a result the WTO members reiterated and specified in paragraph 246 the requirements on implementing the provisions on market disruption.

[631] See *supra* note 567. Before the conclusion of the first textile agreement, the Community had a great deal of discretion in regulating textile trade between the EC and China. Council Decision 74/652/EEC, OJ L358, 31 December 1974, p. 1, laid down the import quotas applicable in the Member States to imports of textiles from China. The following year the Council issued Council Decision 75/210/EEC on unilateral import arrangements for various products (including textiles) from state-trading countries, OJ L99, 21 April 1975, p. 7. This Decision stated in article 8 that before 30 November each year the Council would decide the following year's quota. See YUE, *o.c.*, *supra* note 554, p. 67 and 68 (noting that the negotiations proved to be very difficult and protracted, and although China was not yet a member of the MFA at the time, the terms of the 1979 Agreement were more favourable than normal MFA bilateral agreements concluded between the Community and other developing countries).

[632] OJ L198, 27 July 1984, p. 1. See YUE, *o.c.*, *supra* note 554, p. 75ff (noting that in practice the parties simply continued to follow the 1979 Agreement, it tightened up restrictions on imports of textiles from China and in return for these additional restrictions the Community agreed to increase the amounts of some quotas).

[633] Agreement between the EEC and the PRC on trade in textile products, OJ L380, 31 December 1988, p. 2-73 (hereinafter 1988 Agreement). See YUE, *o.c.*, *supra* note 554, p. 82ff (noting that while the Community offered to increase the amount of quotas for Chinese textiles, including those of very sensitive

Textile Products not covered by the 1988 Textile Agreement[634]. Finally, both textile agreements were amended[635] and last extended[636] in 2000 to prepare for China's WTO Accession. I will come back to these amendments in later sections, but will first discuss briefly the WTO textiles regime and the European implementation thereof. Then I will turn to the specifics of trade in textiles with state-trading countries and China.

A. WTO Textiles Regime[637]

Since 1 January 1995 textiles and clothing has been governed by the ATC. This was one of the hardest-fought issues in the WTO. For more than thirty years, this sector was governed by special regimes. First, there was the Short Term Cotton Arrangement in 1961, followed by the Long Term Cotton Arrangement between 1962 and 1973, and finally, the MFA from 1974 to 1994. This arrangement provided, up to the end of the Uruguay Round, for the application of selective quantitative restrictions when surges in imports of particular products caused, or threatened to cause, serious damage to the industry of the importing country[638]. The ATC replaced this selective mechanism with a transitional process for the ultimate removal of these quotas[639]. Under this Agreement WTO members have committed themselves to remove the quotas by 1 January 2005,

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products, it also introduced quantitative restrictions on a number of textile products which were not subject to quantitative restrictions under the previous textile agreement).

[634] Agreement between the EC and the PRC on trade in textiles products not covered by the MFA bilateral Agreement on trade in textile products initialled on 9 December 1988 as extended and modified, OJ L104, 6 May 1995, p. 1 (hereinafter 1995 Agreement).

[635] Agreement in the form of an Exchange of Letters between the EC and the PRC initialled in Beijing on 19 May 2000 amending the Agreement between them on trade in textile products and amending the Agreement between them initialled on 19 January 1995 on trade in textile products not covered by the MFA bilateral Agreement, OJ L314, 14 December 2000, p. 14 (hereinafter 2000 Agreement).

[636] See OJ L314, 14 December 2000, p. 14, *supra* note 635. Their application was extended to 31 December 2001.

[637] For an introduction, see HOEKMAN and KOSTECKI, *o.c., supra, note* 497; JACKSON, *o.c., supra* note 495; and TREBILCOCK, M. and HOWSE, R., *The Regulation of International Trade*, London, Routledge, 1995.

[638] The MFA was thus a major departure from the basic GATT rules and particularly the principle of non-discrimination. The quotas were the most visible feature and conflicted with GATT's general preference for customs tariffs over measures that restrict quantities.

[639] The ATC is a transitional instrument with the following key elements: (1) the product coverage encompasses yarns, fabrics, made-up textile products and clothing; (2) a programme for progressive integration of these products into GATT 1994 rules; (3) a programme to progressively enlarge existing quotas until their ultimate removal; (4) a transitional safeguard mechanism; (5) the establishment of a Textiles Monitoring Body to supervise implementation; (6) tighter provisions for the circumvention of quotas, their administration etc.

after having implemented a 10-year transitional programme[640]. These programmes are monitored by the Textiles Monitoring Body (TMB) created under the Agreement[641].

The Agreement provides for the phased liberalisation and elimination over the transition period of quotas on the importation of textiles and apparel from countries that are WTO members through two mechanisms. Article 2 ATC provides first that each country should declare the products covered by the Agreement, which it chooses to subject to GATT 1994. This is the "integration" mechanism. In three successive tranches, on the date the Agreement takes effect[642], three years later[643], and at the beginning of year eight[644], products listed will henceforth observe full GATT disciplines. This means that, once a product is "integrated" into the GATT, a WTO member may not impose or maintain import quotas on that product other than those under normal GATT procedures, such as Article XIX and the WTO Safeguards Agreement[645]. Each country is free to select the precise products to integrate in each tranche, however, goods from each of the following categories must be included: tops and yarns, fabrics, made-up textile products, and clothing[646].

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[640] Art. 3 ATC. Any quotas that were in place on 31 December 1994 were carried over into the new agreement. For this purpose all quantitative restrictions were to be notified in detail. Restrictions not notified within 60 days of the date of entry were terminated (Art. 2(1) and 2(4)). For products, which had quotas, the result of integration into GATT will be the removal of these quotas over time.

[641] Art. 8 ATC. The TMB is a quasi-judicial body consisting of a chairman and ten members on an *ad personam* basis, and taking all decisions by consensus. The ten members are appointed by WTO member governments according to an agreed grouping of WTO members into constituencies. The TMB also deals with disputes under the ATC. If they remain unresolved, the disputes can be brought to the WTO's regular Dispute Settlement Body (DSB).

[642] 1 January 1995.

[643] 1 January 1998.

[644] 1 January 2002.

[645] Before it integrates a product, a country may continue to maintain a quota on imports of that product if the quota was negotiated or notified under the MFA before the entry into force of the ATC, or may establish new quotas pursuant to the transitional safeguard mechanism. Each quota must be notified to the TMB, including the growth rate and flexibility provisions for that quota contained in relevant bilateral agreements (Art. 2 and Art. 3 ATC).

[646] The integration will operate as follows: when the ATC enters into force, each WTO member must integrate products by either textile category or tariff line number accounting for at least 16 percent by volume of that country's 1990 imports of textile and apparel products covered by the Agreement. Three years later that country must integrate an additional 17 percent by volume of 1990 covered imports of textile and apparel products. After seven years, that country must add a further 18 percent. All remaining products will be integrated at the close of the transition period, ten years after the WTO goes into effect. Nine members (Australia, Brunei, Darussalam, Chile, Cuba, Hong Kong, Iceland, Macau, New Zealand and Singapore) decided not to maintain the right to use the ATC transitional programme. They are deemed to have integrated 100 percent at the outset.

The second mechanism through which textile quotas will be liberalised is the "acceleration" of the rate at which individual quotas for each country grow. All existing quotas have percentage rates, specified in bilateral agreements, at which the quotas grow annually. Those growth rates allowed under each bilateral agreement will increase in three successive stages over the course of the transition period[647]. For major supplying countries, the growth rates will be increased by 16 percent when the ATC takes effect. They will be increased for those countries by an additional 25 percent after the third year and by a further 27 percent at the beginning of the eighth year[648]. For countries that qualify as "small suppliers", the Agreement provides for an accelerated growth rate, or a mutually agreed alternative equivalent with respect to a different mix of base levels, growth and flexibility provisions[649]. Article 3 ATC provides that quantitative restrictions, which cannot be justified under a GATT provision, must be either brought within conformity of GATT, or phased out according the ten-year transitional period[650].

During the ten years that the Agreement is in force, Article 6 ATC allows WTO countries to limit imports of textile or apparel products by applying a "transitional safeguard". This safeguard may be applied only to products that are neither subject to quotas in the importing country nor integrated into the GATT 1994 pursuant to Article 2 of the ATC. This safeguard recognises that some importing countries may need a special mechanism for avoiding serious damage to their domestic textile or apparel industries during the transition period. The transitional safeguard may be invoked in the same way as Article XIX, namely when a particular product is being imported into its territory in such increased quantities as to cause serious damage, or actual threat thereof, to the domestic industry producing like and/or directly competing products. In making this determination the importing country is also required to examine the effect of the imports on the state of

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[647] Art. 2, paragraphs 12-16 ATC. Quotas will be eliminated either when the products concerned are integrated into GATT at one of the stages or at the end of the transition on 1 January 2005. There are additional provisions in Article 2 for early removal of quotas and integration of products.

[648] The actual formula for import growth under quotas is: by 0.16 x pre-1995 growth rate in the first step; 0.25 x step 1 growth rate in the second step; and 0.27 x step 2 growth rate in the third step. The increased quota levels they entail are automatic and will in absolute terms be smaller or larger depending on the starting point, which are the quota levels and the growth rates under the MFA bilateral agreements as they existed on 31 December 1994.

[649] Special treatment is also awarded to new market entrants and least developed countries.

[650] A plan is to be submitted to the TMB not later than six months after the date of entry into force. Otherwise they must be brought into conformity within one year after entry into force.

the industry as reflected in changes in relevant economic variables, such as output, productivity, utilization of capacity, inventories, market share, exports, wages, employment, domestic prices, profits, and investment. However, contrary to the established principle of non-selectivity in Article XIX GATT and the WTO Safeguards Agreement, the transitional safeguard of Article 6 is selective and thus applicable on a country-by-country basis[651].

Before applying a transitional safeguard, an importing country must first attempt to reach agreement with the relevant exporting country or countries on a mutually satisfactory quota level[652]. If sixty days after requesting consultations, no agreement has been reached, the importing country may impose a quota[653]. This quota may not be lower than the actual level of imports for the exporting country during a recent twelve-month period[654] and it may remain in effect for up to three years[655]. It must be removed before that time, however, if the product is integrated into the GATT.

B. EC Textiles Regime

The EC imports of textile products are also subject to the ATC, and previously the MFA, and are governed by Regulation 3030/93 on common rules for imports of certain textile products from third countries[656], which in view of the single European market abolished the subdivision of the Community quantitative limits into Member States' shares[657]. Regulation 3030/93 is complemented by Regulation 517/94 on common rules for imports of textile products from certain third countries, not covered by bilateral agreement,

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[651] Provided that a sharp and substantial increase from the specific export country can be identified and the damage can be attributed individually (Art. 6(4) ATC). This is actually the second step in a two-tier approach. First the importing member must determine that a particular product is being imported in such increased quantities from all sources in examining the effects of the imports on the state of its industry (Art. 6(2) and 6(3) ATC).

[652] Art. 6(7) to 6(9) ATC.

[653] Art. 6(10) ATC; but at the same time the matter must be referred to the TMB for prompt review. In very specific cases, described in the Agreement as "highly unusual and critical circumstances where delay would cause damage which would be difficult to repair" (Art. 6(11)), it is possible to impose a restraint provisionally, on certain conditions. Agreed restraints will be subject to TMB review. Some exporting countries can be given more favourable treatment when applying this transitional safeguard (Art. 6(6)).

[654] Art. 6(8) ATC.

[655] Art. 6(17) ATC.

[656] Regulation 3030/93 of 12 October 1993 on common rules for imports of certain textile products from third countries OJ L275, 8 November 1993, p. 1, and as last amended by Regulation 27/2002, OJ L9, 11 January 2002, p. 1.

[657] On this earlier reform, see EECKHOUT, *o.c.*, *supra* note 532, p. 186ff.

protocols or other arrangements, or by other specific import rules[658]. It is these two regulations as modified together with the bilateral agreement(s) concluded by the EC with the supplier country in question that regulate the import regimes of textile products in Europe[659]. Following the conclusion of the ATC, Regulation 3030/93 was amended by Regulation 3289/94[660], which implemented the commitments made under WTO agreements and transposes the integration and acceleration mechanisms in EC law.

Regulation 3030/93[661] now applies to imports of textile products listed in Annex I as last amended in 2002[662], which originate in the countries with which the Community has concluded bilateral agreements, protocols or other arrangements. These are listed in Annex II of the Regulation, as amended in 2001[663]. Also falling within its ambit are the textile products, which have not yet been integrated according to Article 2(6) or 2(8) ATC as far as they originate in third countries members of the WTO. These products are listed in Annex X. The Council, acting by qualified majority on a proposal from the Commission, will amend Annex X in order to integrate these products according to the three stages identified in the previous section. As a result on 1 January 1998, products, which in 1990 accounted for not less than 17 percent of the total volume of 1990 imports into the Community of all textiles and clothing products covered by the ATC were integrated. On 1 January 2002 products accounting for not less than 18 percent of that volume were integrated and on 1 January 2005 all remaining products will be. All the products coming within the Regulation's scope are in principle not subject to quantitative restrictions or measures having equivalent effect[664].

Textile products covered by bilateral agreements with the EC, including products originating from WTO members, which are listed in Annex X, are in principle allowed to enter and to circulate freely in the EC. However, as far as these products have not yet been integrated in GATT 1994 and appear in Annex X of the Regulation, the transitional

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[658] OJ L67, 10 March 1994, p. 1.
[659] With regard to China, see the Agreements quoted above.
[660] Regulation 3289/94/EC of 12 December 1994, OJ L349, 31 December 1994, p. 85.
[661] See especially amendments made by Regulation 3289/94/EC, OJ L349, 31 December 1994, p. 85 and Regulation 824/97/EC, OJ L 119, 8 May 1997, p. 1.
[662] Regulation 27/2002/EC, OJ L9, 11 January 2002, p. 1.
[663] Regulation 1809/2001/EC, OJ L252, 20 September 2001, p. 1.
[664] Art. 1(4) Regulation 3030/93.

safeguard in Article 6 ATC as transposed in Article 10 of the Regulation[665] is applicable. More restrictive is the legal regime concerning products listed in Annex V of the Regulation as amended and which originate in one of the supplier countries listed there. These products, *a fortiori* not integrated in GATT 1994, are subject to annual quantitative restrictions as listed in Annex V[666]. The products listed there are subject to the acceleration mechanism as stipulated in Article 2 ATC. The acceleration growth rates will be applied automatically to remaining Community quantitative limits on imports from WTO members for a period of maximum 10 years following the entry into force of the WTO. Because these products are already subject to quotas, it should be reminded that they cannot be subjected to further quantitative measures under the transitional safeguard mechanism of Article 6 ATC[667].

The quantitative restrictions referred to in Annex V do not apply to the cottage industry and folklore products specified in Annex VI[668] as far as on import they are accompanied by a certificate issued by the competent authorities of the country of origin in accordance with the provisions in that Annex and which fulfil the other conditions laid down therein[669]. However, this exception does not exist for Brazil, Hong Kong and Macao[670]. Where exports from China of these products reach 15 percent of any Community quantitative limit laid down in Annex V, China will refrain from issuing the necessary certificates[671]. Other exceptions to quantitative limitations in Annex V include temporary imports, such as under arrangements governing customs warehouses, or inward processing[672]. If these products, however, are subsequently released for free circulation their release will become subject to the presentation of an import authorisation and will

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[665] Art. 10 Regulation 3030/93 as amended by Regulation 3289/94.
[666] See Art. 2 Regulation 3030/93 as amended by Regulation 3289/94.
[667] As confirmed in Art. 10 Regulation 3030/93 as amended.
[668] As last amended by Regulation 339/98/EC, OJ L45, 16 February 1998, p. 1.
[669] Art. 3 Regulation 3030/93 as amended. If similar machine-made products are subject to quantitative limits, the release for free circulation of the handloom and folklore substitutes is granted only when accompanied also by an import document issued by the competent authorities of the Member State. With regard to China, this used to come under Art. 4(3) of the 1988 Agreement and Protocol B and its Annex.
[670] Vietnam also used to be short listed in this respect.
[671] Art. 3(4) Regulation 3030/93.
[672] Note however that Regulation 3030/93 Appendix A of Annex V listed 33 products of Chinese origin, for which an import authorisation is nevertheless required in these circumstances. Art. 4 of both the 1988 and the 1995 Agreements provided that products declared to be for re-export outside the Community in the same state or after processing, were not subject to quantitative limits.

be charged against the quantitative limits established for the year for which the export licence was issued[673]. Also excused from Annex V quotas are re-imports into the Community of textile products after processing in the countries listed in Annex VII[674] and subject to the conditions laid down in that Annex. To benefit from this exception it is also necessary that the re-imports be effected in accordance with the Community legislation on economic outward processing[675].

Traditionally, imports of a textile product from China could be suspended should the price of the product fall below a fixed level. This was briefly discussed above[676]. Article 6 of Regulation 3030/93 still contains a price clause to be used in accordance with the relevant provisions of the bilateral arrangements concerned[677]. Where imports into the Community of textile products listed in Annex I[678] are effected at abnormally low prices, the Commission or a Member State may request consultations with the supplier country in question[679]. Any measure to remedy this situation must be taken in accordance with the terms and conditions in the relevant bilateral agreement and Article 17 of the Regulation[680].

Article 7 of the Regulation deals with flexibility provisions[681]. There are usually three possible areas of flexibility available to an exporting country within the restraint levels. These are known as swing, carry forward and carry over. Swing is an adjustment between the restraint levels for different products during a particular year[682]. When the level of export of a product is likely to exceed the restraint level in a particular year there is a

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[673] Art. 4 Regulation 3030/93. Note that imports of textile products charged against a quantitative limit as laid down in Annex V and which have subsequently been exported outside the Community must be notified. This is reflected also in Art. 4 of both the 1988 and 1995 Agreements with China.

[674] As last amended by Regulation 1809/2001/EC, OJ L252, 20 September 2001, p. 1. With regard to China this was especially considered in Art. 11 of the 1995 Agreement in which China and the Community recognised the special and differential character of re-imports of textile imports into the Community after processing in China. They were exonerated from the quantitative restrictions when they were made according to the specific arrangements laid down in Protocol B to the 1995 Agreement.

[675] Art. 5 Regulation 3030/93. With regard to China, see *supra* note 674.

[676] See *supra* note 568 and accompanying text.

[677] With regard to China these price clauses have been omitted. Instead the Community uses antidumping proceedings.

[678] As last amended in Regulation 1809/2001.

[679] See Art. 16 of Regulation 3030/93, as amended by Regulation 824/97.

[680] As amended by Regulation 391/2001/EC, OJ L58, 28 February 2001, p. 3 (adding Art. 17(a)).

[681] With regard to China, see Art. 5 of the 1988 Agreement and Art. 8 of the 1995 Agreement.

provision for borrowing from the quota of the same product in the next year. This provision is known as carry forward[683]. Similarly, when the restraint level of a product in a particular year is not fully utilised by the actual export level of that product, there is a provision for utilisation of the unused level in the next year, *i.e.* carry over[684]. The extent to which supplier countries may affect transfers between the quantitative limits listed in Annex V is stipulated in Annex VIII.

Under particular circumstances, the Commission may open up additional opportunities for imports during a given quota year, in spite of the existence of Annex V restrictions. This provision in Article 8 of the Regulation must prevent possible shortages of particular textile products[685]. These additional opportunities are not taken into account for the purpose of applying Article 7. This emergency shortage clause is not the same as a guaranteed supply clause, the latter being an unusual feature of the 1988 Sino-European Textiles Agreement[686].

Article 9 of Regulation 3030/93 embodies an anti-surge clause, which was introduced in the MFA[687]. This clause is to ensure that exports of textile products subject to quotas are

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[682] Art. 5 of the 1988 Agreement allowed for swings between certain categories of products, which were allowed up to 7%. For the products that come under the 1995 Agreement, Art. 8 allowed also for swings between certain products up to 6%.

[683] Art. 5 of the 1988 Agreement allowed for an advance use of up to 5% of the quantitative limit of the current year. Art. 8 of the 1995 Agreement allowed for only 1%, with a possibility to reach 5% after consultations. See, *e.g.*, Regulation 501/2001/EC, on the authorisation of transfers between the quantitative limits of textiles and clothing products originating in the People's Republic of China, OJ L73, 15 March 2001, p.13.

[684] Carry over to the corresponding quantitative limit for the following year of unused amounts is authorised for each category up to 7% as far as Art. 5 of the 1988 Agreement is concerned. This was only 3% according to the 1995 Agreement, with the possibility to reach 7% after consultations between the parties (Art. 8). See, *e.g.*, Regulation 1479/2001/EC, OJ L195, 19 July 2001, p. 36; and Regulation 2195/2001/EC, OJ 295, 13 November 2001, p. 8, authorising transfers between the quantitative limits of textiles and clothing products originating in the People's Republic of China.

[685] For certain tariff lines spelled out in Art. 3, the 1988 and 1995 Agreements explicitly provided that respectively 50 and 23% of the quantitative limits will be reserved for industry users during respectively 150 and 90 days from 1 January each year.

[686] Art. 11 of the 1988 Agreement provided for a guaranteed supply of minimum annual quantities as laid down in Annex IV of the Agreement. It concerned raw silk, waste silk, angora, and cashmere. Each year the parties will examine the needs of the Community industry and China's export possibilities. The Community may submit a list of interested manufacturers and processors, which China will undertake to give favourable consideration. Art. 12 of the 1995 Agreement provided that the Chinese supply to the Community industry of raw materials will be made at conditions not les favourable than to Chinese domestic users. This is not so much a guaranteed supply clause, but an interesting MFN clause, which was explained in a separate Protocol attached to the 1995 Agreement.

[687] Art. 10 of the Protocol of Extension of the Arrangement regarding International Trade in Textiles, GATT, BISD, 28 Supp p. 6.

distributed as regularly as possible over the year, taking particular account of seasonal factors. Article 9 allows the Commission to seek for a solution in the case of a sudden and prejudicial change in the traditional trade flows of products subject to quantitative or surveillance measures from a supplier country resulting in a regional concentration of direct imports into the Community. It appears that the EC is more concerned about the equal geographical distribution of the quota by supplier nations than about a possible seasonal surge. These seasonal surges appear nonetheless in bilateral agreements, such as the Sino-European one[688].

The allocation of quotas to specific countries for selected categories of products, as set out in Annex V as amended, is accompanied by a complex system of administration. When quantitative limits on imports of certain categories of textile products are applied, the competent authorities of the Member States may issue permits only after receiving a confirmation from the Commission that there are still quantities available for that specific category of products originating in a specific country[689]. As far as quotas under Annex V of the Regulation are concerned, the administration thereof is carried out through the establishment of a double-checking system[690]. Under the double-checking system, the competent authorities of the supplier countries will issue an export licence in respect of the textile products subject to the measure[691]. At the time of importation the authorities of the Member States will issue an import authorisation following the afore-mentioned prior confirmation by the Commission[692], and the presentation by the importer of the corresponding export licence[693].

When according to Article 13 of the Regulation a system of *a priori* surveillance is introduced on certain categories of products, which are not subject to quantitative limits, double-checking will only be applied if the products originate from the supplier countries

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[688] Art. 8 of the 1988 Agreement provided that exports should be spaced out as evenly possible over the year, and that, should there be an excessive concentration of imports, the Community may request consultations according to Art. 16 of the Agreement. There was a similar provision in Art. 5 of the 1995 Agreement, which also served as a Trade Balance clause.

[689] Art. 12 Regulation 3030/93, as amended by Regulation 391/2001.

[690] See Annex III Regulation 3030/93, as amended by Regulation 339/98, OJ L45, 16 February 1998, p. 1; and Regulation 391/2001. With regard to China, see Art. 3(1) of the 1988 and 1995 Agreements. For administrative provisions, see Art. 15 of the 1988 Agreement and Art. 6 of the 1995 Agreement.

[691] Art. 11(1) Annex III of Regulation 3030/93 as amended.

[692] Art. 12(1) Regulation 3030/93.

[693] Art. 14(1) Annex III of Regulation 3030/93 as amended.

listed in Table A of Annex III[694]. Textile products coming from supplier countries listed in Table B will be subject to a system of single prior surveillance, which means that they will only need a surveillance document from the competent authorities of the Member State[695]. The textile products from countries listed in Tables C and D will be subject to a system of posterior statistical surveillance[696]. In case of surveillance, the issuing of an import document does not require the prior authorisation of the Commission, as in the case of quantitative restrictions.

So far three different regimes with respect to textiles have been discussed. First, there are those textile products, which have already been fully integrated in GATT 1994 according to the successive stages provided for in the ATC. These products are to be treated according to GATT, and can be made subject to quantitative restrictions under Article XIX GATT and the corresponding WTO Safeguards Agreement. Therefore they should be subject to Regulation 3285/94. Second, there are those products, which are covered by Regulation 3030/93, as amended, in its Annex I - originating from countries listed in Annex II, which have concluded a textile agreement with the EC - and Annex X - as far as they originate from WTO members. This complicated wording entails that Regulation 3030/93 will also apply to imports from countries, with no mention of their being WTO members or not, as long as they have concluded some bilateral textile arrangement with the EC and the products mentioned herein. This includes certain textiles from transition economies such as CIS countries, non-WTO members, and included China before it became a WTO member. These textile products are not yet integrated according to the ATC. As far as they do not appear in Annex V of the Regulation, these products can be imported freely, but they can be made subject to the transitional selective safeguard of Article 6 ATC as transposed in Article 10 of the Regulation. Finally, the textile products listed in Annex V are for the time being still subject to selective quantitative restrictions, which are to be phased out by 2005.

However, Regulation 3030/93, as amended, is complemented by Regulation 517/94[697], with amendments[698], which established common rules for imports of textile products

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[694] Art. 18 Annex III of Regulation 3030/93 as amended.
[695] Art. 25 Annex III of Regulation 3030/93 as amended.
[696] Art. 27 Annex III of Regulation 3030/93 as amended.
[697] See *supra* note 658 and accompanying text.

from certain third countries *not* covered by bilateral agreements, protocols or other agreements, or by other specific common import rules. The aim of this Regulation is to suspend the national commercial policy measures and to complete the common commercial policy in accordance with the results of the GATT Uruguay Round negotiations. Obviously specific import regimes such as those contained in Regulation 3030/93 as amended remain entirely valid, because they are regarded as *lex specialis* derogating from the common import regime in Regulation 517/94. Textile products listed in Annex I of Regulation 517/94[699], and which do not originate in one of the countries listed in Annex II of that Regulation[700] are in principle free to enter the Community. This is with the exception of safeguards taken under Title III of the Regulation, the measures taken under specific common import rules such as Regulation 3030/93, the annual quantitative measures listed in Annex III A (the remaining national quantitative restrictions as suspended[701]), and the annual quantitative restrictions listed in Annex III B applicable to textile products originating in the Republics of Bosnia-Herzegovina and Croatia and the Federal Republic of Yugoslavia. According to Article 3 (1) and (2) imports of certain textile products from the Democratic People's Republic of Korea (North Korea) and China are subject to the annual quantitative limits provided for in Annex IV and must on import be presented with an import authorisation[702]. In the case of textile products referred to in Annex V and originating in China and North Korea as provided for in Article 3 (3), their importation into the Community is also subject to specific annual quantitative limits. The latter restrictions in Annex V of Regulation 517/94 may be imported provided an annual quantitative limit is established according to the procedure laid down in Article 25. All other textile products originating from the countries listed in Annex II are free to enter the Community subject to Title III measures except those as specified in Article 3 (1) and (3) and listed in Annexes IV and V.

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[698] Last amended by Regulation 2878/2000/EC, OJ L333, 29 December 2000, p. 60.
[699] This Annex lists all categories of textile products.
[700] This Annex lists following countries: Armenia, Azerbaijan, Belarus, People's Republic of China, Estonia, Georgia, Kazakhstan, North Korea, Kyrgyzstan, Latvia, Lithuania, Moldova, Mongolia, The Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, and Vietnam.
[701] Art. 2(2) Regulation 517/94.
[702] Art. 3(2) Regulation 517/94.

C. Quantitative Restrictions on Textiles from China

The quantitative restrictions of Annex V in Regulation 3030/93, as well as the amount of quotas and their administration laid down in Regulation 517/94, have been subject to major modifications. In particular quotas for Chinese textiles were opened or increased following the request by Member States under the procedure provided for by Article 25[703]. But it is especially the 2000 Agreement that set the stage for bringing the Sino-European textiles trade into the realm of the WTO[704]. The restrictions in force under the 1988 and 1995 Textile Agreements are phased out in the framework of the WTO ATC, and China's Protocol of Accession to the WTO[705].

For the purposes of Article 2 ATC, and thus as far as products are concerned that are covered by the MFA, the European Union will notify to the TMB the quantitative restrictions maintained under the MFA Agreement as far as they have not yet been integrated under stages 1 and 2, at the levels agreed for the year during which China accedes to the WTO as being the restraint levels[706]. The European Union will notify to the TMB the growth rates applicable to the restraint levels, and the relevant parts thereof, being those growth rates applied for the renewal of the MFA agreement for the year 2000[707]. These growth rates will be increased by the growth on growth provisions of the ATC for the second stage of integration beginning from 1 January of the year following accession, and, after 1 January by the growth on growth provisions for the third stage of integration[708]. Needless to say that China became a member later than the EC expected and thus the third stage of ATC integration should be applied to China. Regarding the flexibility provisions contained in Article 5 of the 1988 Agreement, the EC will notify these flexibility rates, save for the cap in paragraph 5 of that Article[709].

Concerning the notifications in respect of the restrictions under the 1995 non-MFA Textiles Agreement, the EC will notify to the TMB the quantitative restrictions maintained under the 1995 Agreement at the levels specified for the year during which

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[703] See VERMULST, INAMA, *o.c.*, *supra* note 533, p. 43.
[704] See *supra* note 635.
[705] Paragraph 3 of the 2000 Agreement.
[706] Paragraph 4(a) of the 2000 Agreement.
[707] Paragraph 4(b) of the 2000 Agreement.
[708] Paragraph 4(c) of the 2000 Agreement.
[709] Paragraph 4(d) of the 2000 Agreement.

China accedes to the WTO as being the restraint levels for the purposes of Article 3 ATC. These notifications will detail the remaining quantitative limits contained in Annex II of that Agreement, as well as the separate quantitative limits reserved for outward processing traffic. Pending the liberalisation of these quantitative restrictions in line with Article 3 ATC the growth rates applicable to them will be included in the notification, as well as the flexibility provisions in Article 8 of the Agreement. A programme to phase out these quantitative restrictions progressively in accordance with Article 3 (2) ATC was attached in Annex I of the 2000 Agreement. Upon the Chinese accession the administration of the quotas will also be harmonised[710].

Because China did not become a WTO member until after 31 December 2000, the parties agreed that both the 1988 and 1995 Agreements would be automatically extended for a further period of one year to 31 December 2001, on the basis of the quantitative limits for the year 2000, together with all the relevant parts thereof including the quantities reserved for European industry, the quantities set for outward processing traffic and for European fairs, increased by the growth rates, if any, applied to the quantitative limits, and the relevant parts thereof, on the renewal of 1988 and 1995 Agreements for the year 2000. Should China become a WTO member before the date of expiry, 31 December 2001, which it did on 11 December 2001, the restrictions in force under those Agreements are phased out in the framework of the ATC and China's Protocol of Accession. In this sense Regulation 3030/93 was amended on 28 December 2001 to provide that quantitative limits for the year 2001 for China in respect of the categories covered would not be maintained as of 11 December 2001, its date of accession to the WTO[711]. Earlier, immediately following China's accession to the WTO on 11 December 2001, the EC and China agreed to implement the removal of the quantitative restrictions on textile categories related to the first and second stage of integration on the same day[712]. As of that date, these categories will no longer require the issue of export licences and will fall under the general provisions concerning the certificates of origin. As a result these

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[710] Paragraph 6 of the 2000 Agreement.
[711] Regulation 27/2002/EC, OJ L9, 11 January 2002, p. 1.
[712] See China's accession to the WTO – First and Second Stage of Integration under the Agreement on Textiles and Clothing, OJ C356, 14 December 2001, p. 4.

products will no longer require import authorisations for customs clearance, regardless of the date of shipment.

However, it seems that the provisional 2000 Agreement did not address the phase out of the quantitative restrictions on Chinese textiles that fall under the provisions of Regulation 517/94. This may be challengeable under the WTO texts, if the EC persists in keeping these quantitative restrictions unchanged, and as far as these quotas have not been notified in accordance with Article 3 ATC, which demands that these quotas should be phased out as well.

To bring Chinese textile products within the ATC, and thereby to phase out the quantitative restrictions, is good news for a country that has been a member of the MFA since the mid-eighties. However, it does not necessarily mean that these products will be subject to the same safeguard clause as products from all other WTO members. This needs to be examined further below.

D. Transitional Textiles Safeguard

The safeguard clause of Regulation 3030/93 was amended by Regulation 3289/94[713] to bring the safeguard clause provisions in line with Article 6 ATC with regard to imports from WTO members. The amended Article 10 provides that if imports into the Community of products within any given category, not already subject to quantitative limits set out in Annex V (MFA quotas) and originating in a country listed in Annex IX[714] exceed, in relation to the preceding calendar year's total imports into the Community of products in the same category, the percentages appearing in Annex IX, such imports may be made subject to quantitative limits as set forth in that article[715]. This is a departure from the normal WTO safeguards rule that imports should have increased in such great quantities so as to cause serious damage or actual threat thereof to the Community's production. Instead this article triggers a safeguard investigation whenever a supplier country listed in the Annex concerned exceeds - for any group of products,

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[713] Regulation 3289/94/EC of 22 December 1994 amending Regulation 3030/93, OJ L349, 31 December 1994, p. 85.

[714] These include Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Cambodia, Former Yugoslav Republic of Macedonia, Kazakhstan, Laos, Nepal, Tajikistan, Turkmenistan, Ukraine, Uzbekistan and Vietnam.

[715] Annex IX was last amended by Regulation 1809/2001.

which is not yet subject to quotas - a certain percentage calculated on the basis of the preceding year. As soon as that threshold is triggered consultations have to be held by the Commission with the supplier country in accordance with the procedure of Article 16 to reach a mutually satisfactory solution[716]. Pending such mutually satisfactory solution, the Commission may request the supplier country to limit exports of the product in the category concerned for a provisional period of three months from the date on which the request for consultations is made. Such provisional limit shall be established at 25% of the level of imports during the previous calendar year, or 25% of the level resulting from the application of the formula based on Annex IX, whichever is the higher[717]. It may, pending the outcome of the consultations, also apply quantitative limits identical to the export limits in the previous sentence, and this without prejudice to the definitive arrangements after successful consultations[718]. If successful, these consultations may lead to an arrangement between the Community and that country on the level of quantitative limits, which will be administered in accordance to the double-checking system[719]. Should the parties be unable to reach a satisfactory solution within sixty days following notification of the request for consultations, the Community may, pursuant to Article 10 (9), have the right to introduce a definite quantitative limit at an annual level. This annual quantitative limit cannot be lower than the formula set out in Article 10 (9)(a) as far as countries in Annex IX are concerned.

As far as WTO members, such as China, are concerned, Article 10 (5), (6) and (9)(c) provide for the imposition of transitional safeguard measures. Products not yet integrated into the GATT 1994 coming from WTO members and not subject to any of the quantitative restrictions in Annex V of Regulation 3030/93 may be subjected to a safeguard action where it is demonstrated that a particular product is being imported into the Community in such increased quantities as to cause serious damage, or actual threat thereof, to the domestic industry producing like and/or directly competitive products. This is language almost identical to Article 6 ATC and Article XIX GATT. Paragraph 5(a) requires further that serious damage or actual threat thereof must demonstrably be

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[716] Art. 10(3)(a) Regulation 3030/93 as amended by Regulation 3289/94.
[717] Art. 10(3)(b) Regulation 3030/93, as amended by Regulation 3289/94.
[718] Art. 10(3)(c) Regulation 3030/93, as amended by Regulation 3289/94.
[719] Art. 10(8) Regulation 3030/93, as amended by Regulation 3289/94.

caused by such increased quantities in total imports of that product and not by such other factors as technological changes in consumer preference. In making this determination Paragraph 5(b) lists the same factors to be examined as Article 6 ATC. Paragraph 5 also follows the two-tiered test of Article 6 ATC, which allows first to determine the increase of imports from all sources and then allows a selective safeguard action if a sharp and substantial increase, actual or imminent, can be attributed to particular individual members[720]. If the conditions of paragraph 5(b) seem to apply, the Commission opens consultations as specified in Article 16 of the Regulation with the WTO member concerned. Provisional quantitative limits are also possible, but only if the stringent conditions of paragraph 6(b) in Article 10 apply. The actual level of the imports from the WTO member subjected to a transitional safeguard may not be lower than the level during the twelve-month period terminating two months preceding the month in which the request was made. This is again in line with Article 6 ATC, which also requires, as transposed in Article 10 (12) of Regulation 3030/93 as amended, that transitional safeguard actions taken with respect to WTO members may only remain in place for up to three years without extension, or until the product becomes integrated into GATT 1994, whichever comes first.

A peculiar position is taken by Bulgaria, the Czech Republic, Hungary, Poland, Romania and the Slovak Republic. Article 10 (4)(a) and (b) of Regulation 3030/93 as amended, sets forth special rules for imposing a safeguard by referring to the conditions laid down in the additional protocols inserted in the Europe Agreements concluded with those countries. In so far as these countries are WTO members, one could argue that this contravenes the WTO MFN clause, but these agreements have been notified to the WTO. With regard to the products that do not fall under Regulation 3030/93, the safeguard provisions of Regulation 517/94 will apply. It concerns the textile products not covered by bilateral agreements, protocols or other arrangements, or other specific import regulations, and originating from third countries. Where it concerns textile products originating in state-trading countries listed in Annex II[721], the Commission may, acting at

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[720] Art. 10(5)(c) Regulation 3030/93, as amended by Regulation 3289/94. Other factors to attribute the damage to individual members include the domestic prices at a comparable stage of the commercial transaction.

[721] See *supra* note 700.

the request of a Member State or on its own initiative, alter the import rules[722] for the product in question by providing that these products may only be put into free circulation on production of an import authorisation[723], the granting of which will be governed by such provisions and subject to such limits as the Commission will lay down[724]. The Commission can do so if imports take place in absolute or relative increased quantities or under such conditions as to cause or threaten to cause serious injury to the Community industry[725]. It can even do so if Community interest requires it[726], thus leaving large room for discretion. The exact procedure is laid down in Article 25 of Regulation 517/94. The same safeguard is applied to products from any other country not listed in Annex II of the Regulation, but it leaves less room for discretion, as it will require the absolute or relative increase of imports in combination with the actual or imminent threat of injury to the Community industry in the case of WTO members[727].

Whereas in Regulation 3030/93 as amended, and with the exception of some Eastern European transition economies, the difference in treatment is marked by whether the country is a WTO member or not, it seems that the different treatment regarding safeguards in Regulation 517/94 is more due to the old legacy of state-trading countries. As far as these state-trading countries have become WTO members this different treatment should end. It is also no longer appropriate for the EC to treat some Chinese products the same way as products from North Korea. As far as this treatment discriminates China and other WTO members, this Regulation is challengeable under WTO texts. The EC should at least overhaul Regulation 517/93 and repeal the discriminatory treatment of China under this Regulation. Differences between Regulation 3030/93 and 517/94 also exists regarding the decision-making procedures, but I choose not to analyse these further[728]. Instead I briefly wish to add that both Regulations also

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[722] This alteration of import rules does not necessarily entail the establishment of quantitative limits, but according to Art. 13 Regulation 517/94 this belongs to the possibilities.
[723] See Art. 14(b) Regulation 517/94.
[724] Art. 12(2) Regulation 517/94.
[725] *Idem.*
[726] *Idem.*
[727] Art. 12(1) Regulation 517/94.
[728] Compare Art. 25 Regulation 517/94 with Art. 17/17a Regulation 3030/93, as amended.

contain detailed provisions concerning surveillance measures[729]. Finally, it should be noted that the Regulations allow for the application of regional safeguards as well[730].

However, as if it were not enough to have a transitional safeguard in Article 6 ATC, the Working Party Report on China's Accession in paragraph 242 reveals details of a transitional safeguard to be applied to imports of Chinese origin of textiles and apparel products covered by the ATC due to market disruption until 31 December 2008. Despite full integration of Chinese textiles into the GATT 1994 by 2005, Chinese textiles will remain subject to a selective transitional safeguard mechanism based on market disruption for a full three-year period beyond 2005. It will be very interesting to see how the WTO Dispute Resolution Body (DSB) will interpret the relationship between the WTO Safeguards Agreement and Article XIX on the one hand; and Section 16 of the Protocol and paragraph 242 of the Working Party Report on the other hand.

Basically paragraph 242 allows for a VER as soon as a member requests consultations with China with a view to easing or avoiding market disruption. The member requesting these consultations would have to provide China with a detailed factual statement of reasons and justifications to show the existence or threat of market disruption and the role of products of Chinese origin in that disruption[731]. Upon request for consultations, China will hold its shipments to the requesting member of textile or textile products in the category or categories subject to these consultations to a level no greater than 7.5 % (6 % for wool product categories) above the amount entered during the first twelve months of the most recent fourteen months preceding the month in which the request for consultation was made. If no mutually satisfactory solution is reached during the ninety-day consultation period these limits could continue[732]. But the term of any restraint limit established would be effective for twelve months maximum[733]. Reapplication of measures can only take place when agreed between parties; and measures could not be applied to the same product at the same time under this provision and Section 16[734].

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[729] See Art. 11, 14(a) and 15 Regulation 517/94 and Art. 13 Regulation 3030/93.
[730] See Art. 16 Regulation 517/94 and Art. 9 and 11 Regulation 3030/93. With regard to China, see also Art. 6(6) of the 1988 Agreement and the inserted Protocol C.
[731] Paragraph 242 (a) and (b).
[732] Paragraph 242 (c) and (d).
[733] Paragraph 242 (d) and (e).
[734] Paragraph 242 (f) and (g).

V. Note on Agricultural Products and ECSC Products

Although developing countries were keen to have all products brought under Article XIX's scope, and thus Regulation 3285/94, the developed countries, including the EC, were keen to keep exceptions to Article XIX[735]. The Safeguards Agreement does not affect other special safeguards, such as for agricultural products. With regard to agricultural products GATT Article XI (2)(c) allows quantitative restrictions necessary to ensure stabilisation of production and of trade in an identical, or substitute, national product[736]. This was further developed by derogations granted on the basis of GATT Article XXV (5)[737]. However, this system of restrictions was thought to be insufficient, and the 1994 Agreement on Agriculture allows additional safeguards. In Article 5 of this Agreement a special agricultural safeguard clause allows additional duties to be imposed for one year in case the volume of imports exceeds, or the price falls below, a triggering level. Regulation 3285/94 will be applied without prejudice to the more specific instruments that concern the agricultural markets[738]. Indeed, each basic agricultural regulation contains its own safeguards clause, which after the Uruguay Round will have to be used in respect of obligations arising from the agreements concluded during that round. The general safeguard in Regulation 3285/94 operates by way of complement to those agricultural trade instruments[739]. For the steel sector it is provided in Article 26 of Regulation 3285/94 that the residual national restrictions relating to products covered by the ECSC Treaty will be gradually dismantled in accordance with the WTO provisions, that is at the end of the Uruguay Round implementation period in 1999. As a

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[735] See DIDIER, *o.c., supra* note 519, p. 303. The French text of the Safeguards Agreement makes it clear that it establishes some ("des") rules, not the ("les") rules. This suggests that other rules may coexist, though the last paragraph of the Agreement's Preamble emphasises the need for agreement on all aspects of safeguards.
[736] See GATT Analytical Index, *o.c., supra* note 510, p. 315-348.
[737] DIDIER, *o.c., supra* note 519, p. 306. See also USHER, J., "The Common Agricultural Policy and Commercial Policy", in MARESCEAU, S. (Ed.), *The European Community's Commercial Policy after 1992 – The Legal Dimension*, The Hague, Kluwer, 1993, p. 135-156.
[738] Art. 25 Regulation 3285/94.
[739] *Idem.*

consequence these products now fall under the general application of the Agreement of Safeguards[740] and Regulation 3285/94 has become applicable to these products[741].

VI. Final Observations

This chapter started with addressing the concerns WTO members, and especially Western trading partners, have about increased competition from China. This increased competition undermines the balance of trade, and as a result, Western governments, to ward off protectionist industries, have embraced specially designed safeguard measures in China's Protocol of Accession and the Working Party Report to alleviate these concerns. Because quantitative restrictions and other NTBs are in principle prohibited, emergency safeguard measures are the only realistic option which countries can lawfully take to combat fair import competition from China. As a result, the EC phases out its remaining quota restrictions on Chinese products and integrates Chinese textiles into the GATT regime through the transitional ATC.

However, as far as certain Regulations are concerned, the EC still maintains restrictions on trade with China along the historical lines of traditional state-trading countries. Moreover, the transitional product-specific safeguard mechanism provided for in Section 16 of the Protocol of Accession also makes clear reference to the historical divide between market economies and state-controlled economies in that it borrows the exact language from Section 406 of the US Trade Law of 1974. It was argued that the allusions on market disruption actually belong to the past, because China's decentralised state economy, as can be inferred from Chapter Two, is no longer in a position to inundate Western or international markets by way of concerted action under a planned economy. It will therefore be interesting to see how the DSB will interpret market disruption and the relationship between, on the one hand, Article XIX and the Safeguards Agreement, and the Protocol of Accession, on the other hand, because its interpretation of market

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[740] Efforts to adopt a specific multilateral agreement failed in 1993. At the end of 1996, the EC started discussions with the US on an agreement, possibly extendable to other WTO members. The intention is to deal with structural excess capacity and over-supply problems. DIDIER, *o.c.*, *supra* note 519, p. 307.

[741] For the imposition of safeguard measures, see Art. 74 (3) ECSC Treaty. See also Regulation 2914/95/EC of 18 December 1995 introducing prior Community surveillance on imports of certain iron and steel products covered by the ECSC and EC treaties, OJ L305, 19 December 1995, p. 23. This regulation

disruption, and the lesser injury standard that is derived from it, might be quite different from the American interpretation in Section 406. It should be acknowledged that the type of market disruption Western countries feared during the Cold War era, with state-controlled enterprises deliberately mass-producing goods to inundate the international markets and to wipe out Western market share, belongs to the past. Therefore, it would have been more appropriate, had the Protocol of Accession used an express reference to allow quota modulation as specified in Article 5 (2)(b) of the WTO Safeguards Agreement to be used *vis-à-vis* China, and relaxed the criteria for the use of such selective safeguards, instead of introducing market disruption modelled on Section 406 of the US Trade Law.

Secondly, the conclusion can be reached that the safeguard provisions in Regulations 519/94 and 517/94, as far as they are still applicable to products originating from China, are discriminatory, and prevent China from being treated as a full member of the WTO. The same goes for the products originating in China, which are restricted according to Article 3 and listed in Annexes IV and V of Regulation 517/94. It is believed that these Regulations go beyond what is allowed by the Protocol of Accession, and that the EC should at least make proper adjustments so as to phase out these quotas in accordance with Article 3 ATC, and should exclude China from its scope as far as the treatment under this Regulation is discriminatory and challengeable under WTO provisions.

Thirdly, the critical question remains though, whether the trade imbalances resulting from China's export-oriented development strategy, and the transitional character of its economic and legal system can adequately be addressed by the WTO 's safeguard mechanisms. The next Chapter will address this question with regard to anti-dumping law. Although Article XIX and the WTO Safeguards Agreement may be too narrow in scope to deal with the unique economic position China is in, it seems that unless Europe and America are willing to make adjustments in line with their comparative advantage, and give up market share in certain industries, these specially designed safeguards are not going to curb China's economic growth. What the EC needs is a liberal economic policy that will allow Europeans to stay ahead of Chinese competition instead of the rhetorical

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deals with the supervision of imports, from all countries except EFTA or members of the European Economic Area, of certain tubes and steel fittings.

language of market disruption. It would be wise as well for the EC to take this a step further and to harmonise its many safeguard provisions. Treating China differently and applying safeguards is not going to make the Chinese economy less competitive. Tough policy decisions will have to be made over the next couple of years.

Chapter Four: EC Trade Policy Response – Antidumping

As the previous Chapter has demonstrated, trade imbalances challenge Europe's and America's role in the global economy; and, reprocity-based trade policy is considered to be an answer to this. In a normal adjustment process, to correct trade imbalances, there should be devaluation, but generally key export countries do not allow appreciating their currency sufficiently. Nonetheless, open trade should also be balanced trade, if not de-industrialisation might be the result, and this can undermine the national security of a country in the long-term. An extreme solution to trade imbalances would be to

discontinue MFN treatment until disproportionate trade surpluses are eliminated[742]. Fortunately, there are less extreme and more temporary solutions, such as emergency safeguards and antidumping (AD). Historically, emergency safeguard measures have been dwarfed by AD measures, and it seems AD has become the weapon of choice[743]. The WTO Appellate Body (AB) does not seem to like emergency safeguards very much, as Reports, such as *Korean Dairy Products*[744] and *Argentinean Footwear*[745], have shown. The important difference between emergency safeguards and AD is that the latter deals with imports considered being "unfair", and are therefore believed easier to justify, whereas emergency safeguards protecting markets from "fair" imports, should come at a higher injury standard.

Notwithstanding the strong case for temporary safeguards, and the plea for "fair and equitable commerce"[746], it is argued here that the only long-term strategy to keep a sound trade balance, and to remedy chronic trade deficits, is the case for continuing industrial rejuvenation efforts and competitive adjustment. It is in this regard that emergency safeguards and AD should be treated with extreme caution, because the continuous use of AD and administered protectionism remains a threat to the huge potential for economic growth that the liberalisation of trade has on offer[747].

The widespread use of AD in the European Community (EC) raises doubt about the future, especially in relation to Asian trading partners[748], such as China. In the last decade, European trade policy has become more pro-active. Whereas in the late eighties, to early nineties, the EC was primarily focused on the creation of the internal market, its focus has become more international, especially because it thinks to link market opening in third countries with access to the European market and to reduce possible trade

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[742] Words of Benjamin Franklin, in LOVETT, W., ECKES, A., and BRINKMAN, R., *US Trade Policy – History, Theory and the WTO*, New York, M.E. Sharpe, 1999, p. 143.

[743] On the use of AD measures and other trade policy instruments, see *infra*, note 771, and accompanying text.

[744] Korea – Definitive Safeguard Measures on Imports of Certain Dairy Products, WT/DS98/AB/R.

[745] Argentina – Safeguard Measures on Imports of Footwear, WT/DS121/AB/R.

[746] ECKES, A., *Opening America's Market – US Foreign Trade Policy Since 1776*, Chapel Hill, University of North Carolina, 1995, p. 219.

[747] KRUEGER, A, *American Trade Policy – A Tragedy in the Making*, Washington DC, AEI, 1995, p. 103.

[748] See HIZON, E., "Virtual Reality and Reality: The East Asian NICs and The Global Trading System", 5 *Ann. Surv. Int'l & Comp. L.*, Spring 1999, p. 81-161; and ACHARYA, R., *Making Trade Policy in the EU – Between 'Managed Liberalisation' and 'Cautious Activism'?*, The Royal Institute of International Affairs, Discussion Paper 61, 1996, p. 1-2.

deficits[749]. This issue of market access remains problematic, because the EC does not always reconcile bilateral preferential trade with multilateral trade very well[750]. Although the EC models its trade policy on preferential trade, it has also been formed often in reaction to US trade policy in which 'fairness' is much more emphasised[751]. Nonetheless, the EC remains at the same time uneasy with the US unilateral approach[752].

The real question remains, however, whether AD can really address the actual problem of declining competitiveness in European industries. At least the future enlargement of the EC may introduce further pressures to liberalise certain sectors of Community industry and they may look for increased protection against products from elsewhere. This concern about Europe's competitiveness influences attitudes. Views differ on how far intervention, by governments or by the Community will help to make European industry better able to compete, either in less sophisticated products or in high technology. Still more discussion exists as to whether European industry really requires increased external protection, and to what extent it should be applied[753]. This level of protection is also relevant in the context of transition economies and the recent WTO accession of China.

Nearly all countries in transition have gone through a cycle that started with the attempt to create an open liberal market economy. They streamlined their laws and procedures, both for domestic economic activity and for international trade. Barriers to trade were reduced sharply or removed as quickly as the authorities could act. However, it was quickly discovered, that despite the spirit of GATT/WTO, the trade practices of many of the large industrialised countries are protectionist and restrictive, yet legal, because WTO rules are loosely worded. These practices are not centred so much on customs duties, but rather on non-tariff barriers involving quotas, minimum import prices, licensing and

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[749] ACHARYA, *o.c., supra* note 748, p. 28. See in this regard the so-called "Trade Barrier Regulation", Regulation EC/3286/94 of 22 December 1994, laying down community procedures in the field of the common commercial policy in order to ensure the exercise of the community's rights under international trade rules, in particular those established under the auspices of the WTO, OJ L349, 31 December 1994, p. 71.

[750] ACHARYA, *o.c., supra* note 748, p. 31. See in this regard the long-standing "Banana dispute" between the EC and the US. For further reference, see SALAS, M. and JACKSON, J., "Procedural Overview of the WTO EC – Banana Dispute", 3 *JIEL*, March 2000, p. 145-166.

[751] ACHARYA, *o.c., supra* note 748, p. 8.

[752] ACHARYA, *o.c., supra* note 748, p. 10.

[753] PEARCE, J. and SUTTON, J., *Protection and Industrial Policy in Europe*, Royal Institute of International Affairs, London, Routledge, 1986, p. 54.

monitoring of imports, technical requirements and standards, and not in the least, AD procedures. Such a pattern prompts the authorities in economies in transition to imitate the sorts of protective measures applied in the industrialised countries. The pressure for protection in home markets intensifies as domestic producers begin to learn how to lobby, and their influence in the political process grows stronger[754]. The fact that the international economy is less liberal than the ideals of GATT/WTO is thus a factor leading to more protectionist policies in economies in transition than otherwise would be the case[755].

The fact that China is a transition economy and, at the same time, has adopted the export-oriented growth policy of a traditional Newly Industrialised Country (NIC) makes it very vulnerable to AD proceedings. The country has therefore been a very frequent victim of administered protectionism. This administered protectionism in the case of China is justified by at least one scholar, because free trade in the context of China is very difficult to achieve with a country that has a cultural resistance of imports and foreign influence[756]. However, it should be noted that by examining the AD treatment China receives as a Non-market Economy (NME), this chapter will show that despite the efforts of AD authorities, there does not exist a satisfactory solution to the problems of pricing production factors in NMEs. The view is taken that the AD practice involving China does not allow the country the full benefits of a WTO member. Moreover, the use of AD proceedings against transition economies, and China in particular, may harm the process of market reform by reducing market access and hence aggravate Chinese cultural resistance to further trade liberalisation. Market access is vital for the implementation of market reforms, which require transition economies such as China to export. It is argued further that the theory and practice of AD is inconsistent in its application to China. It is based on unexamined assumptions of categories of markets, for which the criteria are loosely worded and which, if AD is to be used as a possible interface between different economic systems, should not complicate matters. Before this Chapter suggests some

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[754] PIETRAS, J., "The Role of the WTO for Economies in Transition", in KRUEGER, A. (Ed.), *The WTO as an International Organisation*, Chicago, The University of Chicago Press, 1998, p. 353-61, at p. 358.
[755] PIETRAS, *o.c., surpa* note 754, p. 359.
[756] MASTEL, G., The Rise of the Chinese Economy – The Middle Kingdom Emerges, New York, M.E. Sharpe, 1997, p. 67.

adjustments to the AD Regulation as far as NMEs are concerned, it first, however, introduces briefly the economic and legal context of AD.

I. The Economic Context of Dumping

The concept of dumping in international trade has a long history. Jacob Viner makes note of discussions by Alexander Hamilton in 1791 US debates about foreign country dumping so as to undersell competitors in other countries, and mentions practices that Adam Smith called "dumping"[757]. When a firm sells an identical product in two different markets for different prices that, by definition, is called price discrimination. If it so happens that the firm sells in the export market at a price lower than the price it charges its customers for the like product in its home market, this form of price discrimination is called dumping[758]. Price discrimination implies some departure from the ideal of perfect competition, because a perfectly competitive firm would sell all its output in the market with the higher price. However, many will agree that dumping is quite a natural economic phenomenon, as is price discrimination[759], and although one can argue correctly that price discrimination would be impossible if some sort of barrier to imports did not protect the exporting firm from competition in its domestic market, this is hardly what those who seek protection under the AD laws have in mind. They are usually looking for a higher price with which to compete, and would be dismayed if the only effect of their actions were to open up foreign markets to greater competition[760].

Apart from price discrimination, another standard defence of AD laws is that they are necessary to prevent international predatory pricing. But such practices only make sense if the practitioner of predatory pricing can later raise prices to recoup any profits lost during the period of the low pricing. This can occur only when there are significant barriers that prevent the firms driven out of the market or possible new entrants from coming into the market to compete as soon as prices have indeed been increased. In any

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[757] VINER, J., *Dumping: A Problem in International Trade*, New York, Kelley, reprinted 1966, p. 38-50.

[758] Reverse dumping, when the export price is higher than the price in the home market, is not objected to. This is usually attributed to transport costs. Note also that dumping is often circumscribed as "selling below cost", which may be the case, however, is legally inaccurate.

[759] See DEARDORFF, A., "Economic Perspectives on Antidumping Law", in JACKSON, J. and VERMULST, E. (Eds.), *Antidumping Law and Practice – A Comparative Study*, New York, Harvester Wheatsheaf, 1989, p. 23-39, at p. 24 and 26 (noting that price discrimination is a fact of economic life).

event, the European AD laws do not direct government investigators to determine whether imports reflect a predatory pattern. The inquiry mandated by the AD laws is a purely mathematical exercise[761].

Over the years many eminent scholars have carefully argued that AD laws are illogical[762]. They note that dumping itself is not harmful to the economy of the importing nation. A view that relies predominantly on consumer gains outweighing producer losses. They will argue that the imposition of AD duties actually injures the importing nation by placing a tax on imports, which inevitably becomes a tax on exports[763]. The transfer of wealth from consumers in the importing country to the possibly inefficient domestic industry of the importing country is considered to be simple protectionism by these critics. However, some accept that AD rules are a necessary evil, on balance being better than any practical alternative[764]. The imperfect success with which domestic interests have pursued unfair trade remedies suggests perhaps the only principled reason for the AD laws, *viz.* as a legal safety valve for channelling the strongest claimants for protection away from less transparent forms of protection[765]. Because completely liberal markets are non-existent, some form of protection should be there, and in the sense that AD laws may successfully prevent more unjustified protection than it hands out, it can indeed be regarded as the

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[760] See DEARDORFF, *o.c., supra* note 759, p. 28.

[761] BOLTUCK, R. and LITAN, R., "America's 'Unfair' Trade Laws", in BOLTUCK, R. and LITAN, R. (Eds.), *Down in the Dumps – Administration of the Unfair Trade Laws*, The Brookings Institution, Washington DC, 1991, p. 1-21, at p. 9-10.

[762] See, *e.g.*, EHRENHAFT, P., "Protection Against International Price Discrimination: United States Countervailing and Antidumping Duties", 58 *Colum. L. Rev.*, 1958, p. 44; BARCELO, J., "Antidumping Laws as Barriers to Trade: The United States and the International Antidumping Code", 57 *Cornell L. Rev.*, 1972, p. 491; LOWENFELD, A., "Fair or Unfair Trade: Does It Matter?", 13 *Cornell Int'l L. J.*, 1980, p. 205; DAVEY, W., "Antidumping Laws: A Time for Restriction", in HAWK, B. (Ed.), *North American Common Market Antitrust and Trade Laws: Annual Proceedings of the Fordham Corporate Law Institute*, New York, Matthew Bender, 1988, chapter 8; and SYKES, A., "The Economics of 'Injury' in Antidumping and Countervailing Duty Cases", in BHANDARI, J. and SYKES, A. (Eds.), *Economic Dimensions in International Law – Comparative and Empirical Perspectives*, Cambridge, Cambridge University Press, 1997, p. 83.

[763] See in this regard STEGEMANN, K., "Anti-Dumping Policy and the Consumer", 19 *J. World Trade L.*, 1985, p. 446. Similarly, see SCHUHKNECHT, L., *Trade Protection in the European Community*, Reading, Harwood, 1992, p. 137 (who refers to the cascading effect of AD, whereby the input producer's protection causes downstream producer losses, making it eligible for its own AD protection).

[764] See, *e.g.*, VERMULST, E., "Injury Determinations in Antidumping Investigations in the United States and the European Community", 7 *N.Y.L.Sch. J. Int'l & Comp. L.*, 1986, p. 301ff, at p. 304; and CASS, R., and NARKIN, S., "Antidumping and Countervailing Duty Law: The United States and the GATT", in BOLTUCK and LITAN, *l.c., supra* note 761, p. 200-38, at p. 201.

[765] BOLTUCK and LITAN, *o.c., supra* note 761, p. 13.

lesser evil[766]. Besides alternatives to AD are limited, and these days much is expected from competition law policy to render AD superfluous[767]. These criticisms of AD measures collide, however, with the widespread and growing political support for AD actions[768]. Apparently the EC and the US even tried to water down sections of an OECD report[769] that were critical of AD measures before allowing it to be published[770].

In a world where tariff and non-tariff barriers decrease rapidly, AD measures are becoming increasingly important in protecting domestic manufacturers[771]. Historically, the US, EC, Canada[772] and Australia[773] have been the primary users of AD law. This small number of countries has successfully used AD to protect national industries for years. Developing countries have learned well from this experience and, to the consternation of the traditional users group, have begun to make great use of the AD weapon[774] themselves. Developed countries will have a hard time complaining about the acquisition and use of this weapon by others[775]. Also Japan, South Korea, Taiwan[776] and China[777], which have been most frequent victims of AD actions, are emerging users of AD legislation[778]. And although it is often noted that trade restrictions are

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[766] See, *e.g.*, CASS and NARKIN, *o.c., supra* note 764, p. 201.
[767] See, *e.g.*, ROSENTHAL, D., "Equipping the Multilateral Trading System with a Style and Principles to Increase Market Access", 6 *George Mason L. Rev.*, Spring 1998, p. 543-572.
[768] CORR, C., "Trade Protection in the New Millennium: The Ascendancy of Antidumping Measures", 18 *Northwestern J. Int'l Trade L.*, Fall, 1997, p. 49-110, at p. 102.
[769] INTERNATIONAL TRADE AND INVESTMENT DIVISION, *Trade and Competition: Friction After the Uruguay Round*, OECD, Paris, 1996.
[770] CORR, *o.c., supra* note 768, p. 102.
[771] See BHALA, R., "Rethinking Antidumping Law", 29 *Geo. Wash. J. Int'l & Econ.*, 1995, p. 1-144, at p. 3. A view that is apparently also shared by China, see WALKER, T., "Beijing in Tough Line on Dumping", *FT*, 4 February 1997, quoting the Deputy Director General, Zhang Yugling, of the Chinese Ministry of Trade.
[772] MAGNUS, P., "The Canadian Antidumping System", in JACKSON, J. and VERMULST, E. (Eds.), *Antidumping Law and Practice*, Ann Arbor, University of Michigan, 1989, p. 167.
[773] STEELE, K., "The Australian Antidumping System", in JACKSON, J. and VERMULST, E. (Eds.), *Antidumping Law and Practice*, Ann Arbor, University of Michigan, 1989, p. 223.
[774] The Economist described it as "(...) the chemical weapons of the world's trade wars", see BHALA, *o.c, supra* note 771, p. 4.
[775] CORR, *o.c., supra* note 768, p. 55-6.
[776] See, *e.g.*, OHNESORGE, J., "States, Industrial Policies & Antidumping Enforcement in Japan, South Korea, and Taiwan", 3 *Buff. J. Int'l L.*, Winter 1996-97, p. 289-411.
[777] DONG, Y., XU, H. and LIU, F., "Antidumping and the WTO – Implications for China", 32 *J. World Trade*, no. 1, 1998, p. 19-27. SHEN, J., "A Critical Analysis of China's First Regulation on Foreign Dumping and Subsidies and Its Consistency with WTO Agreements", 15 *Berk. J. Int'l Law*, 1997, p. 295-328.
[778] ZHANG, S., ZHANG, Y., and WAN, Z., *Measuring the Costs of Protection in China*, Institute for International Economics, Washington DC, and Unirule Institute of Economics, Beijing, 1999.

disproportionately imposed against the exports of developing countries, some argue that many of the "biases" in developed countries' trade restrictions against exports from developing countries are also found in many developing countries' trade restrictions[779]. AD is no longer an exception to that.

II. The Legal Context of Dumping

The legal definition of dumping follows the economics of international price discrimination, not necessarily below cost. Dumping is not illegal unless it is injurious, and in contrast with emergency safeguards, deals with unfair imports, but the question remains what is or should be considered unfair. This seems to be a matter of perception and culture rather than economics or law[780]. According to one authoritative Japanese source trade friction between countries is confused with so-called unfair trade, an expression for which there is no established definition[781]. From this perspective the Japanese prefer the term trade friction, which they consider to be a more dispassionate and constructive term. AD measures themselves do not represent unfair practices if applied in accordance with international agreements, but create serious problems when they are abused or arbitrarily applied[782].

According to John Jackson the term "unfair", when describing AD or countervailing duty (CVD) cases as responses to "unfair trade", is inappropriate as far as imports from state-trading countries are concerned. He believes it would be better to designate the problems generated by trade between a "market-oriented" society and a "state-trading" economy or a government-owned enterprise, as a problem of "interface"[783]. He further argues that

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[779] See FINGER, M. and LAIRD, S., "Protection in Developed and Developing Countries – An Overview", 21 *J. World Trade L.*, no. 6, 1987, p. 9-23.

[780] See generally BHAGWATI, J. and HUDEC, R. (Eds.), *Fair Trade and Harmonization: Prerequisites for Free Trade?*, Cambridge, MIT Press, Vol. 2, 1996. In this context especially CASS, R. and BOLTUCK, R., "Antidumping and Countervailing-Duty Law: The Mirage of Equitable International Competition", in BHAGWATI and HUDEC, *l.c.*, p. 351ff.

[781] Industrial Structure Council Japan, "1992 Report on Unfair Trade Policies by Major Trading Partners – Trade Policies and GATT Obligations", JETRO, 1993, p. 6.

[782] *Idem*, p. 10.

[783] JACKSON, J., "United States Policy Regarding Disruptive Imports from State Trading Countries or Government Owned Enterprises", in WALLACE, D., SPINA, G. *et al* (Eds.), *Interface One – Conference Proceedings on the Application of US Antidumping and Countervailing Duty Laws on Imports from State-Controlled Economies and State-owned Enterprises*, The Institute for International and Foreign Trade Law, Washington DC, 1980, p. 1-20, at p. 1.

countervailing laws, and to a lesser extent AD laws, are shouldering most of the interfacing responsibility[784].

Interestingly, the question should also be raised whether the investigations themselves are fair. Do the AD procedures punish truly unfair trade, or do they punish only trade that the country initiating the investigation deems to be unfair? Unfair practice investigations are designed to ensure their obscurity and to insulate them from the highly charged political atmosphere that surrounds trade disputes. The investigation is more like a judicial contest than a political event, so that politicians can say trade matters are "out of their hands" and thus out of the political arena. If foreigners complain about the outcome, it should be because they are guilty of offending the internationally accepted rules of the game[785]. There probably is at least some coloration in AD practice of an effort to protect domestic producers, and to tilt the field slightly in favour of the home market. But this should not go out of control.

Some authors, such as Anne Krueger, would like to alter administered protection procedures in ways that could make them less conducive to seizure for protectionist purposes, and nonetheless permit them to perform their intended functions against practices deemed to be unfair[786]. Raj Bhala considered how to deal with the problem of protectionist abuse, and proposed a traffic-light system, similar to the one used in CVD cases, based on the micro-economic theory of the cost structure of a firm[787]. Alan Deardorff[788] suggested redefining dumping as price discrimination below cost and to clarify the cost element, and also Edwin Vermulst suggested his changes in AD law to make the 21st century[789]. All these suggestions each have their own merit, but are limited in use in the context of NME or transition economies, because the main problem there is

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[784] *Idem*, p. 2.
[785] BOLTUCK and LITAN, *o.c., supra* note 761, p. 2.
[786] KRUEGER, *o.c., supra* note 747, p. 118. Suggested solutions are *e.g.* to raise *de minimis* standards, and to substitute 'below average cost' with 'below marginal cost'.
[787] BHALA, *o.c, supra* note 771, p. 1-144, Part V. The system focuses on predatory behaviour. Unlawful red-light dumping occurs when an exporter sells merchandise at a price below its average total and variable cost of production. Yellow-light dumping occurs when an exporter sells at a price below its average total cost but above its average variable costs of production, and it leads to the issuance of a caution. Green-light dumping is defined as pricing above average total cost of production and is lawful.
[788] See DEARDORFF, *o.c., supra* note 759, p. 23-40.
[789] See VERMULST, E., "Anti-dumping in the Second Millennium: The Need to Revise Basic Concepts", in BRONCKERS, M. and QUICK, R. (Eds.), *New Directions in International Economic Law – Essays in Honour of John H. Jackson*, Boston, Kluwer, 2000, p. 259-277.

that still no satisfactory solution exists for the determination of costs and prices in these economies. I agree with Raj Bhala that it should be our aim to circumscribe the law so as to minimise the risk of protectionist abuse. The profile of a protectionist abuser is a petitioner who has lost his comparative advantage in manufacturing merchandise to a respondent who makes the same or similar merchandise, and who is unwilling to reduce his cost structure to meet global competitive pressures, fails to incorporate technological innovations in his manufacturing process and product design, or is insensitive to changes in consumer tastes[790]. Unfortunately, AD methodology as applied to NMEs is rife with opportunities for protectionist abuse.

AD measures are unilateral, and the WTO Antidumping Agreement (ADA) does not pass judgment on whether dumping is unfair competition, it focuses on how governments can or cannot react to dumping, but many governments do take action against dumping in order to defend their domestic industries. Broadly speaking, where there is genuine injury to the competing domestic industry as a result of dumped imports, the Agreement allows countries to act. The WTO principles on AD serve two distinct purposes. The first purpose is to provide procedural and substantive safeguards against the abuse of national AD rules. The second purpose is to liberalise trade movements, to attempt to rid the world of harmful distortions, such as the private act of price discrimination[791]. In particular some argue that AD measures may serve as a necessary trade-off to achieve further liberalisation in reducing global tariffs and duties. Many countries may have been willing and able to agree to the dramatic liberalisation that have rolled back import tariffs over the past twenty years, only if they were allowed discretionary use of AD measures as a fall back[792]. The WTO AD Agreement is discussed in greater detail below.

A. WTO Antidumping Code

Article VI of GATT 1994 explicitly authorises the imposition of a specific AD duty on imports from a particular source, in excess of bound rates, in cases where dumping causes or threatens to cause injury to a domestic industry, or materially retards the establishment

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[790] BHALA, *o.c, supra* note 771, p. 21.
[791] DENTON, R., "(Why) Should Nations Utilize Antidumping Measures?", 11 *Mich. J. Int'l L*, Fall, 1989, p. 224-272, at p. 225.
[792] BHAGWATI, J., *Protectionism*, Cambridge, MIT Press, 1988, p. 485-530.

of an industry[793]. The article does not contain much guidance as to criteria for determining dumping, whether injury exists, nor as to the methodology or procedure, so GATT Contracting Parties negotiated several detailed Codes relating to AD. The first such code, the 1967 Kennedy Round Code, was never signed by the US and the subsequent 1979 Tokyo Round Code, gave more guidance, and contained substantial detail covering procedure and due process requirements, but was only binding for the 27 parties who subscribed to it. Finally, the Uruguay Round Antidumping Agreement (ADA), or in full the "Agreement on Implementation of Article VI of the GATT 1994", is the most complete international AD text. It calls in addition to its predecessors for notifications of legislation and AD actions as required by WTO guidelines, and clarifies the relationship between Article VI GATT and the ADA[794]. Although the latest Agreement significantly modifies certain aspects of prior law, it leaves other major areas, such as procedural aspects of preliminary and final determinations, relatively untouched[795].

The ADA establishes the basic principle that a member may not impose AD measures, unless it determines, according to an investigation[796] in conformity with the provisions of the ADA, that there are dumped imports[797], material injury[798] to a domestic industry[799], and a causal link[800] between the dumped imports and the injury. A failure to respect these substantive requirements or any of the procedural requirements explained further in the following paragraph can lead to dispute settlement before the Dispute Settlement Body (DSB)[801].

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[793] On the evolution of Article VI GATT, see the study by BIERWAGEN, R., *GATT Article VI and the Protectionist Bias in Anti-Dumping Laws*, Boston, Kluwer Law, 1990.

[794] Art. 1 makes it clear that the AD Agreement is to be considered *lex specialis* with respect to Art. IV GATT. This relationship is therefore much clearer than that between Art. XIX and the Safeguards Agreement.

[795] For a discussion, see, *e.g.*, HORLICK, G. and SHEA, E., "The World Trade Organization Antidumping Agreement", 29 *J. World Trade*, February 1995, p. 5-31; and PALMETER, D., "Commentary on the WTO Anti-Dumping Code", 30 *J. World Trade*, February 1996, p. 43-69.

[796] Art. 5 ADA.

[797] On the determination of dumping, see Art. 2 ADA.

[798] Art. 3 ADA.

[799] Art. 4 ADA.

[800] Art. 3 (5) ADA.

[801] It should be noted, however, that the standard of review in the 1994 ADA is limited. See, *e.g.*, in this regard, AKAKWAM, P., "The Standard of Review in the 1994 Antidumping Code: Circumscribing the Role of GATT Panels in Reviewing National Antidumping Determinations", 5 *Minn. J. of Global Trade*,

It is a principal objective of the procedural requirements of the Agreement to ensure transparency of proceedings, a full opportunity for parties to defend their interests, and to give adequate explanations by investigating authorities of their determinations[802]. Detailed procedural requirements exist relating to investigations to ensure that meritless investigations are not investigated through minimum information and 'standing' requirements[803]. And additional procedural requirements relate to the offering, acceptance, and administration of price undertakings[804] by exporters in lieu of the imposition of AD duties. Further, the ADA demands public notice and explanation of determinations[805], it also establishes rules for the timing of the imposition of duties, the duration thereof, and obliges members to periodically review the continuing need for duties and price undertakings[806]. Other detailed provisions guide the imposition and collection of duties under various duty assessment systems, intended to ensure that duties in excess of the margin of dumping are not collected[807]. The Agreement also requires members to provide for judicial review of final determinations in investigations and reviews[808]. Members may, at their own discretion, take AD actions on behalf of and at the request of a third country[809], and recognise that "special regard" should be given by developed country members to the situation of developing country members when considering the application of AD duties[810]. The European AD legislation closely follows the principles spelled out in the ADA.

Summer 1996, p. 277-310; and GOMULA, J., "The Standard of Review of Article 17.7 of the Anti-Dumping Agreement and the Problem of its Extension to Other WTO Agreements", 23 *PolYB*, 1997-98, p. 229ff. Important in this regard is also Regulation 1515/2001/EC of 23 July 2001, on the measures that may be taken by the Community following a report adopted by the WTO DSB concerning AD and anti-subsidy matters, OJ L201, 26 July 2001, p. 10. Recital 6 provides, however, that the recommendations in DSB reports only have prospective effect.

[802] Art. 6 ADA.

[803] Art. 5 (4) ADA.

[804] Art. 8 ADA.

[805] Art. 12 ADA.

[806] Art. 11 ADA.

[807] Art. 9 ADA.

[808] Art. 13 ADA.

[809] Art. 14 ADA.

[810] Art. 15 ADA.

B. EC Antidumping Legislation[811]

The first European AD rules were enacted in 1968, along with the transfer of responsibility for commercial policy and tariff setting from the Member States to the Community authorities. Following the acceptance of the GATT AD and CVD Codes, legal instruments were adopted in 1979 with amendments in 1982. Reforms made in 1984 were accompanied by the adoption of a more professional approach, including much fuller statements of reasons for decisions. In 1987 a controversial procedure was introduced to prevent circumvention of dumping duties by the establishment of assembly plants (screwdriver plants) within the Community. Further amendments were made in 1988 in the course of a general consolidation. The last major modifications of the legal instruments occurred after the latest AD Code was adopted. The current legal framework for AD is laid down in Regulation 384/96/EC of 22 December 1995 on protection against dumped imports from countries not members of the European Community[812], as amended, and Commission Decision 2277/96/ECSC of 28 November 1996 on protection against dumped imports from countries not members of the European Coal and Steel Community (ECSC), as amended[813], which will be disregarded for further purposes. In the following sections the three substantive requirements of AD are discussed. These are the determination of (1) dumping, (2) injury, and (3) the causation between dumped imports and the injury.

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[811] On European AD law see, FARR, S., *EU Anti-Dumping Law – Pursuing and Defending Investigations*, London, Palladian Law, 1998; MÜLLER, W., KHAN, N. and NEUMANN, H., *EC Anti-Dumping Law – A Commentary on Regulation 384/96*, New York, John Wiley & Sons, 1998; STANBROOK, C. and BENTLEY, P., *Dumping and Subsidies – The Law and Procedures Governing the Imposition of Anti-Dumping and Countervailing Duties in the European Community*, The Hague, Kluwer, 1996, 3rd ed.; VERMULST, E. and WAER, P., *EC Anti-Dumping Law and Practice*, London, Sweet & Maxwell, 1996; VAN BAEL, I. and BELLIS, J., *Anti-Dumping and other Trade Protection Laws of the EC*, Bicester, CCH, 1996; BESELER, J. and WILLIAMS, A., *Anti-Dumping and Anti-Subsidy Law – The European Communities*, London, Sweet & Maxwell, 1986; and MONTAG, F. and FIEBIG, A., "The European Union", in STEELE, K. (Ed.), *Anti-Dumping under the WTO: A Comparative Review*, The Hague, Kluwer, 1996, p. 97-120.

[812] Regulation 384/96/EC of 22 December 1995 on protection against dumped imports from countries not members of the EC, OJ L056, 6 March 1996, p. 1 (hereinafter Basic Regulation).

[813] Commission Decision 2277/96/ECSC of 28 November 1996 on protection against dumped imports from countries not members of the ECSC, OJ L308, 29 November 1996, p. 11.

a. Determination of Dumping

Establishing normal value is usually the first step in any AD investigation. The Basic Regulation gives the Commission a number of different methods for arriving at normal value[814]. There is a general rule and various exceptions, which normally apply when domestic sales are not in the ordinary course of trade, or do not allow a proper comparison[815]. The general rule is that normal value will normally be based on the prices paid or payable, in the ordinary course of trade, by independent customers in the exporting country[816]. Thus the prices used in sales to related customers will be deemed unreliable. This general rule will not apply in the following circumstances. First, it will not apply where the exporter does not sell the goods on his home market. This will be the case also where an exporter only sells small quantities, as less than 5% of the sales volume to the EC[817]. Second, exception will be made where sales on the domestic market are made between companies which are related or which have a compensatory arrangement with each other[818]. Third, the general rule does not apply in circumstances where sales at prices below unit production costs (fixed and variable) occur. The conditions laid down in such a case are that the sales must be made within an extended period not less than six months and in substantial quantities (20%)[819]. Finally, where the imports in question come from NME the general rule will not apply either[820]. This situation will be dealt with in greater detail later.

Of the alternative methods of ascertaining normal value when the general rule does not apply, by far the most frequent method is the constructed normal value. Where the Commission chooses this method, the normal value of the like product will be calculated on the bases of the costs of production in the country of origin, plus a reasonable amount for selling, general and administrative costs (SGA), and for profits[821]. The Regulation contains detailed provisions on costs, SGA expenses, as well as profits[822].

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[814] Art. 2 Reg. 384/96.
[815] Art. 2(3) Reg. 384/96.
[816] Art. 2(1) Reg. 384/96.
[817] Art. 2(2) Reg. 384/96.
[818] Art. 2(1) Reg. 384/96.
[819] Art. 2(4) Reg. 384/96.
[820] Art. 2(7) Reg. 384/96.
[821] Art. 2(3) Reg. 384/96.
[822] Art. 2(5) and (6) Reg. 384/96.

The second step in the investigation is to determine the export price based on the transaction price at which the foreign producer sells the product to an importer in the importing country[823]. However, as is the case with normal value, this transaction price is sometimes not appropriate for purposes of comparison, as there may not be an export price if the export transaction is an internal transfer, or if the product is exchanged in a barter transaction, or the transaction price may be unreliable because of an association or a compensatory arrangement between the exporter and the importer or a third party; in such a case, the transaction price may be manipulated for tax purposes[824]. In either of these cases a constructed export price may be calculated on the basis of the price at which the imported products are first resold to an independent buyer, or on any other reasonable basis[825].

Once the Commission has established normal value and export price, it must then make a fair comparison[826] of these two values, establishing the dumping margin. This is the third step in the determination process. Prices being compared are those of sales made at the same level of trade, normally the ex-factory level, and of sales made at as nearly possible the same time; and due account must be taken of other differences which affect price comparability. Investigating authorities are required to inform parties, regarding adjustments, allowances, and currency conversion, and may not impose an unreasonable burden of proof. If the export price is lower than the normal value, the dumping margin is positive and dumping is taking place.

In calculating the dumping margin, either the comparison of the weighted average normal value to the weighted average of all comparable export prices, or a transaction-to-transaction comparison of normal value and export price will be made[827]. A different basis of comparison can be used in case of targeted dumping, *i.e.* if a pattern exists of export prices differing significantly among different purchasers, regions or time periods[828].

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[823] Art. 2(8) Reg. 384/96.
[824] Art. 2(9) Reg. 384/96.
[825] *Idem*.
[826] Art. 2(10) Reg. 384/96.
[827] Art. 2(11) Reg. 384/96.
[828] *Idem*.

Finally, it should be noted that duties must be collected on a non-discriminatory basis, except when a price undertaking[829] has been accepted. A dumping margin is calculated for each single exporter, except when sampling[830] is used and for NME exporters[831]. Furthermore, the amount of the duty collected may not exceed the dumping margin, but in the EC this amount is even limited to the margin of injury. Injury is the second substantive requirement for the use of AD and is discussed below.

b. Determination of Injury

The objective of Regulation 384/96 is to prevent material injury being caused by dumped imports to the Community industry, which produces the like product. The sequence of events in an injury determination is as follows. First, it is considered whether the imported products and those of the Community producers are like products. Second, it is then examined whether the domestic producers fall within the definition of Community industry. And third, it has to be ascertained whether the Community industry is suffering material injury as defined in Article 3.

Like product is defined as a product that is identical to, or in the absence of such product, one that has characteristics closely resembling those of the imported product under consideration[832]. Community industry is defined as the Community producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion, as defined in the Regulation[833]. Special rules exist for regional Community industry[834], and Community producers may also be excluded from consideration as part of a Community industry if they are related[835], which is defined as a situation of legal or effective control to exporters or importers of the related product[836].

Injury means either material injury, threat of material injury or material retardation of the establishment of a Community industry[837]. Determination of injury requires an objective

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[829] Art. 8 Reg. 384/96.
[830] Art. 17 Reg. 384/96.
[831] See *infra*, p. 219.
[832] Art. 1(4) Reg. 384/96.
[833] Art. 4(1) Reg. 384/96.
[834] Art. 4(1)(b) Reg. 384/96.
[835] Art. 4(1)(a) Reg. 384/96.
[836] Art. 4(2) Reg. 384/96.
[837] Art. 3(1) Reg. 384/96.

examination, based on positive evidence of the volume and price effects of dumped imports and the consequent impact of dumped imports on the domestic industry[838]. Article 3 contains further specific rules regarding factors to be considered in making determinations of material injury, while specifying that no one or several of the factors, which must be considered is determinative.

c. Determination of Causality

It is not enough to establish a dumping margin and injury if it cannot be demonstrated from all the relevant evidence that the dumped imports are causing the injury. This entails a demonstration that the volume and/or the price levels identified are responsible for an impact on the Community industry[839] and that this impact exists to a degree, which enables it to be classified as material[840]. To this end known factors other than the dumped imports, which at the same time are injuring the Community industry will also be examined to ensure that injury caused by these factors is not attributed to the dumped imports[841]. A typical European feature of the AD legislation is that the Commission must show additionally that the action it takes under the Regulation is in the interest of the Community[842]. So far the three substantive elements of AD were introduced. The following paragraphs will elaborate dumping caused by imports from state-trading countries or NMEs.

III. Antidumping and State-Trading Countries

Since many years it has been very difficult to identify true dumping from state-trading countries, because of the irrationality of their internal price structure and the existence of foreign trade monopolies[843]. State-socialist countries may be thought of as particularly inclined to dump for a variety of reasons. Most obviously, state-wide monopolies are in a uniquely favourable position to engage in price discrimination while the resources of the state might theoretically be used to provide limitless finance for the purpose of predatory

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[838] Art. 3(2) Reg. 384/96.
[839] Community industry is defined in Art. 4 Reg. 384/96.
[840] Art. 3(6) Reg. 384/96.
[841] Art. 3(7) Reg. 384/96.
[842] Art. 21 Reg. 384/96.

dumping. In addition it has been argued that state planning may result in periodic surpluses, which must be disposed of outside the domestic economy, as well as in occasional production shortfalls resulting in unplanned imports financed through low-priced exports. However, the task of arriving at a meaningful price comparison, for the purpose of determining whether or not price discrimination or below-cost sales are taking place, presents the importing country with insuperable difficulties[844].

The system of administered exchange rates adopted in centrally-planned economies tends to result in the overvaluation of their currencies *vis-à-vis* market economies. That means that, with international prices below domestic prices, virtually every transaction between a NME and a market economy can be characterised as dumping. This appearance is misleading, however, since the planned economy's export prices, too, will be abnormally low so that from the point of view of combined export and import transactions there need be no price discrimination. After all, if a SOE sells a commodity at two thirds of domestic cost in order to import another commodity purchased at one third of the cost this may be regarded as a legitimate commercial transaction, entirely in keeping with the principles of comparative advantage[845].

As far as the below cost aspect of the dumping problem is concerned, domestic prices in the NME do not reflect domestic production costs as understood in the market economies; and, it would be impossible in practice to unravel the system of subsidies and turnover taxes in order to arrive at a realistic estimate of cost. Even if it were possible to estimate production costs in NMEs it is not at all clear that this would be helpful in reaching a solution to the dumping problem. In terms of Viner's argument[846] it is the temporariness of the dumping price that importing countries have to be on guard against, and in the case of NMEs there is no reason why exports should not be priced below cost for a prospectively permanent period. It may be in the best interests of market economies to accept the fact that these products are under-priced as a permanent fact of life[847].

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[843] See HOLZMAN, F., International Trade under Communism – Politics and Economics, New York, Basic Books, 1976, p. 38-39.
[844] DALE, R., *Antidumping Law in a Liberal Trade Order*, New York, St-Martin's Press, 1980, p. 172.
[845] DALE, *o.c.*, *supra* note 844, p. 172-3.
[846] VINER, *o.c.*, *supra* note 757.
[847] DALE, *o.c.*, *supra* note 844, p. 173.

There are strong objections, both on theoretical and practical grounds, to invoking AD legislation in such a context[848]. It is not clear why low-priced imports from planned economies should be considered objectionable, merely because they do not comply with the market concept of comparative advantage[849]. Nonetheless, AD action remains one of the favoured defences against low-priced imports from NMEs[850]. However, one can question the typical NME methodology in AD laws even more these days, simply because almost all these traditionally planned economies have embarked on serious economic reforms. This means that their market economy features should be taken into account, and the NME methodology actually should belong to the past.

GATT, and nowadays the WTO, itself offers very little guidance as to how the price comparison problem should be dealt with in investigations involving NMEs or transition economy countries. The second interpretative note to Article VI GATT, in the particular situation of economies where the government has a complete or substantially complete monopoly of its trade, and where all domestic prices are fixed by the state, so that a strict comparison with home market prices may not be appropriate, allows importing countries to exercise significant discretion in the calculation of normal value of products exported from NMEs[851]. The question remains, whether transition economies still fall under these particular circumstances, since many have reformed their monopolies and not all prices are fixed by the state. In the case of China, however, the Protocol of Accession explicitly allows to continue the country's NME status for a number of years to come[852].

The Polish protocol of accession to the GATT, included in its Working Party Report the statement that 'a Contracting Party may use as the normal value for a product imported from Poland the prices which prevail normally in its market, or alternatively, 'a price constructed on the basis of a like product originating in another country'[853]. Similar understandings were recorded in the Reports of the Working Parties on the accession of

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[848] DALE, *o.c., supra* note 844, p. 174.
[849] DALE, *o.c., supra* note 844, p. 176.
[850] DALE, *o.c., supra* note 844, p. 174.
[851] The full text reads: "It is recognised that, in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1, and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate."
[852] Sections 15 and 16 of the Protocol of Accession.

Romania and Hungary, although the Protocols themselves do not make any reference to the price comparison issue[854]. At the GATT level, it was originally proposed that the Polish Protocol of Accession should tackle the problem of low-priced imports directly by including a clause on pricing[855]. Specifically, the suggestion was that Poland would endeavour to ensure that its exports would be offered at prices and on conditions in line with those prevailing in the markets concerned, and that contracting governments were free to levy duties on products offered at lower prices. This approach, which had been first adopted by Belgium, of course limits severely the possibility of mutual gains from trade between market economies and NMEs based on comparative advantage. Nonetheless a similar, albeit less explicit clause, was incorporated in the Report of the Working Party on the accession of Hungary[856]. Because GATT and WTO texts do not offer much guidance on these problems, users of AD law, such as the EC, had to come up with their own solutions to the problem. The objective is to arrive at a pattern of trade based on comparative advantage as understood and applied in market economies, and their stated rationale that it is fair. The Chinese Protocol of Accession, despite China's continuing reform efforts to become a market-based economy, allows these NME methodologies still to be used for fifteen years after its accession, unless these countries decide to grant China market economy status before that time[857]. However, it should be repeated that there are no criteria to base China's graduation on, before the lapse of this fixed period. This is left to the discretion of the individual member.

Up to April 1998, the EC AD legislation categorised third countries as either a 'Market Economy' or a 'Non-market Economy', this latter category comprised Albania, Armenia, Azerbaijan, Belarus, China, Georgia, Kazakhstan, North Korea, Kyrgyzstan, Moldavia, Mongolia, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan and Vietnam[858]. However, even if a country is not categorised as such in Regulation 519/94, it must, according to EC Case law, be regarded as a NME if prices are not the result of market

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[853] GATT, *Basic Instruments,* 15th Supplement, Geneva, 1968, p. 111.
[854] For the relevant documents, see Chapter One, note 68.
[855] Such a clause existed, *e.g.*, in the 1978 Sino-European Trade in Textiles Agreement. See Chapter Three, for a discussion of this price clause.
[856] DALE, *o.c., supra* note 844, p. 182.
[857] Section 15 Protocol of Accession.

forces, *i.e.,* if there is a strong influence of the state on this process. This is in particular the case where trade in the product concerned is subject to a total or near monopoly of the state or if all domestic prices are fixed by the state. These conditions are met if, during the investigation period concerning dumping, market forces are eliminated due to the existence of a general system for the fixing of prices or at least one for the product concerned[859]. A country such as Cuba, which is not mentioned as a NME within the meaning of Article 2 (7), presumably would have to be considered as such a case[860]. In general, little guidance has emerged to indicate where the line between non-market and market economy status falls.

In the US the term NME includes any foreign country that the Department of Commerce (DOC) determines "does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise."[861] The DOC's determination of NME status remains in effect until it is revoked[862], and may make such determination at any time[863]. Unlike in the EC the determination is an administrative decision and not determined directly by law. The effect, however, is the same because in neither part of the world the determination is subject to judicial review[864]. This non-reviewability gives the impression that, both in the US and in the EC, the NME determination is a political one rather than a predictable and methodical one. This impression is even reinforced in the European context, because unlike the US statute, the EC legislation provides no criteria to be considered in determining whether a country is a NME[865]. As early as 1990, former USTR Charlene

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[858] Regulation 519/94/EC of 7 March 1994 on common rules for imports from certain third countries are non-market economies, OJ L67, 10 March 1994, p. 89 as amended.

[859] Case C-323/88 *SA Sermes v. Directeur des services des douanes de Strasbourg* [1990] ECR I-3027 (paragraphs 23 and 24), Joined Cases C-305/86 and C-160/87 *Neotype Techmashexport GmbH v. Commission and Council* [1990] ECR I-2945 (paragraph 28). *SA Sermes* and *Neotype* concerned the same regulation imposing an AD duty and in both cases the Court came to the conclusion that the former Yugoslavia could be considered as a market economy country within the meaning of Article 2 (7).

[860] MÜLLER, *et al., o.c., supra* note 811, p. 154.

[861] Section 771 (18)(A) of the Tariff Act of 1930, 19 U.S.C § 1677(18)(A) (1994).

[862] See 19 U.S.C § 1677(18)(C)(i) (1994).

[863] See 19 U.S.C § 1677(18)(C)(ii) (1994).

[864] See 19 U.S.C § 1677(18)(D) (1994 & Supp. III 1997). For the US, see also NEELY, J., "Nonmarket Economy Import Regulation from Bad to Worse", 20 *Law & Pol'y in Int'l Bus.*, 1989, p. 529-554, at p. 549.

[865] These involve: (1) the extent to which the currency of the foreign country is convertible, (2) the extent to which wage rates in the foreign country are determined by free bargaining between labour and

Barchefsky already pleaded to make these decisions judicially reviewable[866]. Making these determinations judicially reviewable in Europe would certainly be an improvement with regard to transparency, and would require an answer as to when exactly NMEs can be considered market economies for the purpose of AD legislation. However, this will not be a solution either if the criteria used to this end are different from those used in other WTO members. For instance Poland is considered a market economy in both the US and the EC, but in Brazil it is still considered a NME. Maybe a concerted effort on the WTO level could change that.

In practical terms the difference between non-market and market economy status means that for the purposes of establishing normal value in dumping investigations concerning a NME, information on domestic prices and costs is considered unreliable, because of the significant distorting effect of state influence and control, and the absence of meaningful market signals due to state interference. Therefore in these cases normal value is based on information from companies in a market economy third country, *i.e.* the "analogue country"[867]. However, this situation did not recognise the ongoing economic and political reforms in countries, such as China and Russia. It was considered that the NME calculation method automatically applied in AD investigations concerning these two countries was no longer appropriate in each and every AD proceeding. As a result it was considered that there was clear economic justification to adapt European AD practice so as to accommodate the impact of the ongoing reforms on individual companies. In April 1998, the Council amended the Basic AD Regulation to allow, on a case-by-case basis, individual Russian and Chinese companies the opportunity to prove that they operate in market economy conditions in accordance with certain criteria contained in the legislation[868]. Where they prove this is the case, dumping allocations for the company are based on their own domestic prices and costs. The amendment did not grant full market

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management, (3) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country, (4) the extent to which government ownership or control of the means of production, (5) the extent of government control over the allocation of resources and over the price and output decisions of enterprises, and (6) such other factors as the administering authority considers appropriate. For a discussion on these criteria, see LAROSKI, J., "NMEs: A Love Story of Nonmarket and Market Economies Under US Antidumping Law", 30 *Law & Pol'y in Int'l Bus.*, Winter 1999, p. 370-398.

[866] BARCHEFSKY, C., "Non-market Economies in Transition and the US Antidumping Law: Remarks on the Need for Reevaluation", 8 *Boston Univ. Int'l L. J.*, Fall 1990, p. 373-380.

[867] Art. 2(7)(a) of Regulation 384/96, as amended by Reg. 905/98.

economy status to Russia and China, and the analogue country approach is maintained for companies in those countries who do not meet the Market Economy Treatment (MET) criteria. The amendment became effective on 1 July 1998.

Since July 1998, only a small percentage of companies who applied for MET were successful in proving their claim. However, according to the Commission this has more to do with the economic situation in Russia and China rather than with the criteria for MET being too strict[869]. The Commission argues its experience has shown the criteria to be a good framework to evaluate whether or not a company operates in a market economy environment[870]. The Commission shares the view that, both Russia and China, have still some way to go before they can be considered market economy countries, and that the regime itself gives a certain impetus to the reform processes. For these reasons, the Commission considers it appropriate to continue applying this regime to AD proceedings involving Russia and China.

In reviewing the situation in other countries classed as NMEs with a view to adapting their treatment in AD cases, the EC decided to automatically extend the ad hoc regime, previously only applicable to Russia and China, to any of the remaining NMEs that are WTO members, or as soon as they join the WTO in the future for current applicants[871]. The main argument for this change was the fact that membership of the WTO presupposes a certain level of economic reform[872]. Although NMEs now are treated alike as soon as they become WTO members, their respective Protocol of Accession should allow explicitly for AD treatment different from other market economy members. Otherwise, especially to the extent that these economies do not meet the definition of a centrally-planned economy[873], it could be challenged whether this discriminatory treatment should still be allowed under the WTO texts.

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[868] Regulation 905/98/EC of 27 April 1998 amending Regulation 384/96, OJ L 128, 30 April 1998, p. 18.
[869] See Proposal for a Council Regulation amending Regulation (EC) No 384/96 on protection against imports from countries not members of the European Community, Brussels, 15 June 2000, COM (2000) 363 final, p. 3.
[870] *Ibidem.*
[871] See COM (2000) 363 final, *o.c., supra* note 869, p. 15. Regulation 2238/2000/EC of 9 October 2000 amending Regulation 384/96, OJ L257, 11 October 2000, p. 2.
[872] See COM (2000) 363 final, *o.c., supra* note 869, p. 15.
[873] As specified in the second interpretative note of Article VI GATT, see note 851.

In applying the *ad hoc* market economy regime to Chinese and Russian enterprises, one problem arose relating to an overlap between the market economy criteria, which essentially apply to the domestic situation of a company, and the criteria for so-called "individual treatment", which concern their export activities. Individual Treatment (IT) means that, for companies in NME who can prove that their exporting activities are determined by market forces, and are not affected by state influence, based on criteria set by the Commission, an individual dumping margin is calculated for them based on a comparison of their own export prices with the normal value from the analogue country. However, the overlap in the criteria created the anomaly that only those exporters that could fulfil the requirements for full MET could qualify for IT[874]. Given that the key issue for IT is that export transactions are not subject to state interference, the EC proposed to amend the criteria accordingly by focusing on those areas having a direct impact on the export activities of the exporting company[875].

The following sections will discuss the EC AD authorities' methodology in dealing with NMEs and in particular China. It should already be noted, however, that calculating the dumping margin for NMEs is a complicated exercise rife with opportunities for protectionist abuse.

A. Determination of Normal Value

As far as market economies are concerned, normal value may be determined on the bases of one of the three following normal value tests: (1) the prices paid or payable in the ordinary course of trade by independent customers in the exporting country; or (2) the constructed value; or (3) the export prices, in the ordinary course of trade, to an appropriate third country, provided that these prices are representative[876]. In AD investigations concerning imports from the Russian Federation, China, Ukraine, Vietnam, Kazakhstan and any NME which is a member of the WTO at the date of the initiation of the investigation, normal value will be determined in accordance with the methods

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[874] See COM (2000) 363 final, *o.c.*, *supra* note 869, p. 14.

[875] It was decided by the Council that in case of individual treatment, *i.e.* determination of the individual dumping margin as opposed to the single national margin, the Commission will comply with the criteria set out in the Annex to its communication to the Council (5070/98 COMER 4).

[876] Art. 2(1) to (6) Regulation 384/96. Note, however, that the Community authorities may determine normal value on any other basis where interested parties refuse to cooperate.

applicable to market economies. However, this will only be the case if it is shown, on the bases of properly substantiated claims, by one or more producers subject to the investigation, and in accordance with certain criteria and procedures that market economy conditions prevail for this producer or producers in respect of the manufacture and sale of the like product concerned[877]. A claim for such MET must be made in writing and contain sufficient evidence along the line of the following criteria set forth in the next couple of paragraphs.

First, it should be proven that decisions of firms regarding prices, costs and inputs, including for instance raw materials, cost of technology and labour, output, sales and investment, are made in response to market signals reflecting supply and demand, and without significant state interference in this regard, and that costs of major inputs substantially reflect market values[878]. In *certain electronic weighing scales from inter alia China*[879] the Commission found that two companies applying for MET were selling at more or less uniform, loss making prices in the PRC for several years. It is the Commission's practice to reject MET claims when domestic sales are restricted and where there is no price variation between customers. It is interpreted that this may result from centrally imposed price controls. Moreover, it was argued that prices at loss-making levels for several years were an indication that the producers did not operate under market economy conditions[880]. In *zinc oxides from China*[881] MET was granted to some Chinese producers, but the Commission subsequently refused to use prices paid by the producer in question for the zinc raw material. The consistency of this decision is questionable, because if the main cost element, zinc raw material, did not reflect market value, MET should not have been granted in the first place. However, MET was granted before the Commission found that certain cost elements were unreliable, and therefore it adjusted the cost by basing them on zinc quotations on the London Metal Exchange[882].

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[877] Art. 2(7)(b) Regulation 384/96, as amended.
[878] Art. 2(7)(c) Regulation 384/96, as amended.
[879] Regulation 2605/2000/EC of 27 November 2000, OJ L301, 30 November 2000, p. 42.
[880] Imposing definitive AD duties on imports of certain electronic weighing scales from the PRC, Korea and Taiwan, OJ L301, 30 November 2000, p. 42 (recital 46).
[881] Regulation 408/2002/EC of 28 February 2002 imposing a definitive AD duty on imports of certain zinc oxides from the PRC, OJ L62, 5 March 2002, p. 7.
[882] *Idem*, p. 7 (recital 16).

As a second criterion, the applicant for MET should show that it has one clear set of basic accounting records, which are independently audited in line with international accounting standards and are applied for all purposes[883]. In *certain iron or steel ropes and cables from Russia et aliud*[884], the cooperating exporting producer *inter alia* failed to prove the existence of a single set of accounts. In addition there was no evidence that any of the accounts had been independently audited in line with international accounting standards[885].

Other factors mentioned in the Regulation to investigate MET include that the production costs and financial situation of firms are not subject to significant distortions carried over from the former NME system, in particular in relation to depreciation of assets, other write-offs, barter trade, and payment via compensation of debts[886]. Barter trade was subject of discussion in *urea from inter alia Belarus and Ukraine*[887]. And triangular debts were discussed in *iron or steel ropes and cables from inter alia Russia*[888]. The Regulation also mentions that the firms concerned should be subject to bankruptcy and property laws, which guarantee legal certainty and stability for the operation of firms[889]. And finally, exchange rate conversions should be carried out at the market rate[890]. It seems, however, that the Commission generally enjoys much discretion in applying these criteria and it is nowhere said that the list is exhaustive, or whether all criteria have to be used cumulatively to deny MET. Also the relative weight and importance of each factor is not clear from the Regulation.

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[883] Art. 2(7)(c) Regulation 384/96, as amended.
[884] Regulation 1601/2001/EC of 2 August 2001, OJ L211, 4 August 2001, p. 1.
[885] Definitive AD duties on certain iron or steel ropes and cables from the Czech Republic, Russia, Thailand and Turkey, OJ L211, 4 August 2001, p. 1 (recital 79). The company submitted financial statements in US dollars prepared in line with international accounting standards but not audited. It presented also financial statements audited in line with Russian accounting standards and could not reconcile the discrepancies found in these different sets of financial statements.
[886] Art. 2(7)(c)iii Regulation 384/96, as amended.
[887] See also Regulation 92/2002/EC of 17 January 2002 definitive AD duties on urea from Belarus, Bulgaria, Croatia, Estonia, Libya, Lithuania, Romania and the Ukraine, OJ L17, 19 January 2002, p. 1 (recitals 32ff). Here the existence of barter chain arrangements and tolling agreements is discussed in light of MET.
[888] The existence of numerous triangular transactions was mentioned as problematic in Regulation 1601/2001/EC definitive AD duties on certain iron or steel ropes and cables from the Czech Republic, Russia, Thailand and Turkey, OJ L211, 4 August 2001, p. 1 (recital 79).
[889] Art. 2(7)(c)iv Regulation 384/96, as amended.
[890] Art. 2(7)(c)v Regulation 384/96, as amended.

In the US, manufacturers will be treated as market economy producers when they meet a three-factor market oriented industry test expanding the DOC's inquiry to the market orientation of the industries that supply factor inputs as well as the industry under investigation[891]. To be deemed a market-oriented industry, the DOC must find that there is virtually no government involvement in setting prices, and setting volume of production for the subject merchandise. Second, the DOC must also be satisfied that the entire industry is characterised by private or collective ownership. And third, it must be clear that all but an insignificant portion of all material and nonmaterial inputs have been purchased at market-determined prices. Only if all three factors are met, and the DOC has enough information available to calculate normal value, then the DOC may use the market oriented industry method to calculate normal value. If any one of these factors are not met, the manufacturers will be treated as NME producers and normal value will be derived by factors of production analysis, which means that the department will determine the normal value of the good by valuing each factor of production that goes into making the good based on the values of those factors in a market economy country[892]. The reason why this test is so stringent is because giving in too easily to MET in the US would open the floodgates for CVD cases against NMEs, which in the US does not require an injury standard[893]. Eventually the administration will have to develop a new policy for administering US unfair trade laws in cases involving transition economies[894].

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[891] Sulfanilic Acid from the PRC, 57 Fed. Reg. 15,052 (Dep't Comm. 1992); and Chrome Plated Lug Nuts from the PRC, 56 Fed. Reg. 46,153 (Dep't Comm. 1991). See also LANTZ, R., "The Search for Consistency: Treatment of Nonmarket Economies in Transition under United States Antidumping and Countervailing Duty Laws", 10 *Am. Univ. J. Int'l L. & Pol'y*, Spring 1995, p. 993-1073, at p. 1042-1043.

[892] See LAROSKI, *o.c., supra* note 865, p. 370-398.

[893] See HORLICK, G. and SHUMAN, S., "Nonmarket Economy Trade and US Antidumping/Countervailing Duty Laws", 18 *Int'l Lawyer*, Fall 1984, p. 807-840; and LANTZ, *o.c., supra* note 891, p. 993-1073

[894] For further criticism and discussion, see RICHARDSON, D. and NIELSEN, R., "Recent Developments in the Treatment of Nonmarket Economies under the AD/CVD Laws", *PLI Order No. B4-7013*, October 1-2, 1992, p. 151-167; BOGARD, L. and MENGHETTI, L., "The Treatment of Non-Market Economies under US Antidumping and Countervailing Duty Law: A Petitioner's Perspective", *PLI Order No. B4-7013*, October 1-2, 1992, p. 217-253; and KEARNEY, J. and WANG, J., "The DOC's Market-Oriented Industry Methodology for Nonmarket Economies in Antidumping Investigations: The Responding Party's Perspective", *PLI Order No. B4-7013*, October 1-2, 1992, p. 257-284.

In Europe, the determination to allow MET will remain in force throughout the investigation, and should be taken within three months of the initiation[895]. However, in *ferro molybdenum from China* MET granted at the provisional stage was decided not to be justified at the definitive stage, because significant information had come to light[896]. It was established that the China Chamber of Commerce and Minmetals hosted a meeting shortly after the publication of the Provisional Regulation. The company that was granted MET was seen to be aligning its operations and business decisions, not only with companies that failed to satisfy the MET criteria, but also with SOEs that did not cooperate in the proceeding. Because it had modified its behaviour since it received its individual dumping margin, it became apparent that it was subject to state interference and a party to export constraints in terms of prices and quantities[897].

According to the letter of the Regulation, producers from countries eligible for MET explicitly have to apply for such treatment. To allow these producers to submit their claim the AD authorities send out an MET claim form. It must be asked, however, why the Commission cannot investigate such claims *ex officio* based on the general progress of the country's or the economic sector's reform efforts towards marketisation. The AD authorities have always claimed to be unable to investigate without having received detailed additional information for such purposes. But in practice, the authorities can always request supplemental information when the investigation gets stuck, *e.g.* by carrying out an onsite investigation. Of course an *ex officio* investigation whether MET can be granted does not guarantee that MET will be applied in a larger number of cases, but it should save the respondents in such countries from the initial hassle to claim the treatment.

Additionally, it should also be questioned why in review cases of imports from countries eligible for MET the Commission does not *ex officio* examine whether the NME methodology used in the original investigation should be changed so as to enable the granting of MET. Under the present regulation NME producers have to launch an interim

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[895] The determination whether the producer meets the criteria will be made after specific consultation of the Advisory Committee and after the Community industry has been given an opportunity to comment. See Art. 2(7)(c) Regulation 384/96, as amended.

[896] Regulation 215/2002/EC of 28 January 2002, OJ L35, 6 February 2002, p. 1 (recital 10).

review, sometimes parallel with a sunset review, simply because otherwise the Commission will not consider to investigate whether MET is applicable. In my opinion Article 11 (2) should be amended for that reason. Take for instance the expiry review of *certain magnetic disks from inter alia China*[898] in which the Chinese producer objected to the fact that an analogue country had to be selected, and argued that normal value should instead be calculated on the basis of its own cost of production. It claimed that it met all the criteria to receive MET. However, the Commission did not accept this claim on the grounds that, under expiry reviews pursuant to Article 11 (2), measures must either be maintained or repealed, but not modified. The company was informed that it could claim MET in the context of an application for an interim review pursuant to Article 11 (3), which the company declined to do[899]. This undermines the function of sunset reviews, which should be able to take changing factors, such as MET, into account in order to investigate the likelihood of recurrence of dumping. Apparently, the Commission sits still, unless there is sufficient evidence for it to open a parallel review under Article 11 (3) by the time the present expiry review is initiated. This was the case in *bicycles from China*[900] in which producers also argued to operate under market economy conditions and that this justified a change in methodology from the one used in the original investigation. The change was not granted, however, and a parallel interim review was not opened for lack of sufficient evidence[901].

When a claim for MET cannot be substantiated, or for all those producers from other NMEs, which the Regulation cannot grant *ad hoc* MET, because they are not so privileged, the normal value will be determined on the basis of the price or constructed value in a market economy third country referred to as the "analogue country"[902], or the price from such a third country to other countries, including the Community, or where those are not possible, on any other reasonable basis, including the price actually paid or

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[897] Definitive antidumping duties on imports of ferro molybdenum from the PRC, OJ L35, 6 February 2002, p. 1 (recitals 15 and 16).
[898] Regulation 312/2002/EC of 18 February 2002, OJ L50, 21 February 2002, p. 24.
[899] Imposing definitive AD duties on certain magnetic disks from Japan and the PRC (Expiry Review), OJ L50, 21 February 2002, p. 24 (recital 19).
[900] Regulation 1524/2000/EC of 10 July 2000 imposing a definitive AD duty on imports of bicycles from the PRC (Expiry Review), OJ L175, 14 July 2000, p. 39.
[901] *Idem*, p. 39 (recital 27).
[902] In the US this third country is referred to as a 'surrogate' country.

payable in the Community for the like product, duly adjusted, if necessary, to include a reasonable profit margin[903]. The aim is to avoid the use of prices and costs, which are not dictated by market forces[904]. An appropriate market economy third country will be selected for this purpose, and the selection is discussed in greater detail in the next section. Because only in few cases MET is granted, an analogue country still has to be elected in a majority of the cases.

a. Selection of the Analogue Country

According to the second subparagraph of Article 2 (7), the analogue country chosen must be "appropriate", and it "shall be selected in a not unreasonable manner". Due account must be taken "of any reliable information made available at the time of the selection". Account must also be taken of time limits[905] and where appropriate a "market economy third country", which is subject to the same investigation, must be used. According to Article 2 (7) "[t]he parties (...) shall be informed shortly after the initiation of the market economy third country envisaged and shall be given 10 days to comment". However, it is standard practice to inform the parties already at the time of the notice of initiation published pursuant to Article 5 (10)[906]. When it occurs that the producers in the analogue country have chosen not to cooperate in the end, although they had chosen to, the authorities will have to inform the parties of a new country envisaged[907]. Although non-cooperation is not in itself enough to vitiate the selection of the analogue country, the authorities should make every effort to obtain information from independent sources, and this includes that the Commission may have to approach again those producers, which did not comply with earlier requests for cooperation[908].

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[903] Art. 2(7)(a) Regulation 384/96, as amended.
[904] Case C-26/96 Rotexchemie International Handels GmbH & Co v. Hauptzollamt Hamburg-Waltershof [1997] ECR I-000 (paragraph 9), Case C-16/90 Detlef Nölle v. Hauptzollamt Bremen-Freihafen [1991] ECR I-5163 (paragraph 10), Case C-323/88 SA Sermes v. Directeur des services des douanes de Strasbourg [1990] ECR I-3027 (paragraph 23), Joined Cases C-305/86 and C-160/87 Neotype Techmashexport GmbH v. Commission and Council [1990] ECR I-2945 (paragraph 29), Joined Cases 296/86 and 77/87 Technointorg v. Commission and Council [1988] ECR 6077 (paragraph 29).
[905] The time limits referred to are those as contained in Articles 6(9) and 7(1).
[906] MÜLLER, *et al., o.c., supra* note 811, p. 170.
[907] *Ibidem.*
[908] Case T-164/94 *Ferchimex SA v. Council* [1995] ECR II-2681 (paragraph 69).

The criteria upon which the authorities base the selection are discussed in the section below. It should be noted that it is not a precondition for the selection of an analogue country that all the criteria are met with regard to such country. The ECJ has ruled that Community institutions enjoy wide discretion in the choice of an analogue country given the complex nature of the issue[909]. The review carried out by the ECJ is limited to the examination as to whether the institutions neglected to take account of essential factors for the purpose of establishing the appropriateness of the country chosen, and whether the information contained in the documents in the case were considered with all the care required, for the view to be taken that the normal value was determined in an appropriate and not unreasonable manner[910]. Moreover, the ECJ has held that Community institutions were not required to consider every analogue country suggested by the parties during an AD proceeding[911]. However, if certain doubts arose as to the appropriateness and reasonableness of the choice of an analogue country, such suggestions put forward by parties had to be examined in depth[912].

Community institutions are not bound by their selection of an analogue country, which was chosen for the purposes of imposing a provisional duty. They are free to choose another analogue country when imposing a definitive duty. *A fortiori*, the analogue country selected in a review investigation might be different to that selected in the original investigation, for instance if exporters in the original analogue country refuse to cooperate in the review investigation[913]. If an AD proceeding covers imports from two or

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[909] Case T-164/94 Ferchimex SA v. Council [1995] ECR II-2681 (paragraphs 66ff.), Case C-26/96 Rotexchemie International Handels GmbH & Co v. Hauptzollamt Hamburg-Waltershof [1997] ECR I-000 (paragraph 10), Case C-16/90 Detlef Nölle v. Hauptzollamt Bremen-Freihafen [1991] ECR I-5163 (paragraph 11).

[910] Case C-16/90 Detlef Nölle v. Hauptzollamt Bremen-Freihafen [1991] ECR I-5163 (paragraph 13), Case C-26/96 Rotexchemie International Handels GmbH & Co v. Hauptzollamt Hamburg-Waltershof [1997] ECR I-000 (paragraph 12).

[911] Alternative suggestions by parties concerning the selection must reach the authorities within the periods specified in the notice of initiation. See Article 5 (10) Reg. 384/96.

[912] Case C-16/90 Detlef Nölle v. Hauptzollamt Bremen-Freihafen [1991] ECR I-5163 (paragraph 32), Case C-26/96 Rotexchemie International Handels GmbH & Co v. Hauptzollamt Hamburg-Waltershof [1997] ECR I-000 (paragraph 21).

[913] Regulation 1824/2001/EC of 12 September 2001 imposing definitive AD duties on imports of certain non-refillable and refillable pocket flint lighters from China and Taiwan, OJ L248, 18 September 2001, p. 2 (recital 17). Thailand had served as an analogue country in the original investigation. In the subsequent review the Philippines had been used as the Thai producers refused to cooperate.

more NMEs the selection of an analogue country has to be justified for each of these NMEs[914].

b. Relevant Criteria

There are about six relevant criteria, which the European AD authorities usually will consider when selecting an analogue country. Before to look into these relevant criteria it is also important to mention briefly which criteria the AD authorities usually do not consider relevant, though have sometimes been argued to influence the choice of the analogue country. Such arguments included, *e.g.* the size of the domestic market[915], the fact that the cooperating producer has ceased production[916], that the analogue country itself is not an importer of the product concerned[917], and that the level of economic development the analogue country has attained does not match that of the NME[918]. This last criterion is, however, explicitly considered in the US[919].

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[914] Regulation 2998/95/EC of 20 December 1995 imposing provisional AD duties on imports of unwrought magnesium from Russia and Ukraine, OJ L312, 23 December 1995, p. 37 (recital 21).

[915] Neither is the ratio between the production in the analogue country and the world production relevant with regard to the choice. See Regulation 95/95/EC of 16 January 1995 imposing definitive AD duties on furfuraldehyde from the PRC, OJ L15, 21 January 1995, p. 11 (recital 6). *A contrario* the size of the Brazilian market was taken into account in Regulation 1100/2000/EC of 22 May 2000 imposing AD duties on silicon carbide from *inter alia* China, OJ L125, 26 May 2000, p. 3 (recital 17).

[916] The cooperating producer ceased production after the investigation period. This was considered not a reason to consider the choice inappropriate. See Regulation 2674/94/EC of 31 October 1994 imposing definitive AD duties on furazolidone from the PRC, OJ L285, 4 November 1994, p. 1 (recital 7).

[917] As long as there is sufficient competition on the market to ensure that the prices are representative, the absence of imports into the analogue country is not sufficient to render that market inappropriate. See Joined Cases C-305/86 and C-160/87 *Neotype Techmashexport GmbH v. Commission and Council* [1990] ECR I-2945 (paragraph 32).

[918] As was argued in, *e.g.*, Regulation 467/98/EC of 23 February 1998 imposing definitive AD duties on imports of certain footwear from China, Indonesia and Thailand, OJ L60, 28 February 1998, p. 1 (recital 43). The defendant argued that Thailand was not an appropriate analogue country on the grounds that the economic levels of China and Thailand were dissimilar. Therefore Indonesia was believed a better alternative. The Commission did not decide against the argument, but there were other factors to prefer Indonesia.

[919] The Secretary of Commerce of the US is directed to find a surrogate country that is comparable to that of the home market country in per capita gross national product and infrastructure development. If no such surrogate exists, than a surrogate will be selected and deficiencies adjusted. The US is the least preferable choice as a surrogate country. See 19 C.F.R. § 353.52(b) (1990). Furthermore, 19 U.S.C. § 1677b(c)(4) requires surrogate countries and those countries used for factors of production to be producers of comparable items in question and to be at a comparable stage of development. While the statute gives equal weight to economic comparability and merchandise comparability, the DOC gives priority to the former, but this preference does not apply in every case. See BOGARD and MENGHETTI, *o.c., supra* note 894, p. 248-49.

Among the criteria that the Commission favourably has considered is first of all the comparability of the products produced. This means that for the selection of the analogue country it is asked whether or not the products originating from the NME concerned, and those produced in the analogue country, are identical or similar as far as physical characteristics and applications are concerned[920]. Minor differences do not, however, preclude the selection[921]. Also the argument that products sold on the domestic market of the NME and those sold on the domestic market of the analogue country were different is not accepted, because the comparison will usually be made between domestic sales in the analogue country and export sales to the Community originating in the NME[922].

A second criterion is the comparability of production volume in the exporting NME country and the analogue country. The importance of this criterion should not be overestimated. It is in itself of minor importance[923]. More important is the representativity of the domestic sales to independent customers in the analogue country as compared to exports concerned originating in the NME. The decisive factor is whether during the investigation period there were a sufficient number of transactions to ensure the representative nature of the market in relation to the exports in question. Generally this is sufficient if such sales account for more than 5% of the exports in question[924]. However, the export volumes of some exporters in NMEs can be so substantial that it might be impossible to find producers in third countries whose domestic sales meet the 5% ratio. The question then arises whether the authorities would accept a figure clearly below this ratio. Some have suggested that at least the 5% ratio should be met with regard

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[920] Regulation 2477/93/EEC of 7 September 1993 imposing provisional AD duties on photo albums from China, OJ L228, 9 September 1993, p. 16 (recital 20). See also Regulation 3119/94/EC of 19 December 1994 imposing provisional AD duties on ferro-silico-manganese from Russia, Ukraine, Brazil and South Africa, OJ L330, 21 December 1994, p. 15 (recital 13).

[921] Regulation 1748/95/EC of 17 July 1995 imposing provisional AD duties on peroxodisulphates (persulphates) from the PRC, OJ L169, 19 July 1995, p. 15 (recital 15). See also imposing provisional AD duties on unwrought magnesium from Russia and Ukraine, OJ L312, 21 December 1995, *supra* note 914, p. 37 (recital 20).

[922] Regulation 550/93/EEC of 5 March 1993 imposing provisional AD duties on bicycles from the PRC, OJ L58, 11 March 1993, p. 12 (recital 20).

[923] MÜLLER, *et al., o.c., supra* note 811, p. 157.

[924] However, the sole fact that the production volume of the analogue country is below this level does not necessarily signify that the choice of that country is inappropriate or unreasonable. See Case C-16/90 *Detlef Nölle v. Hauptzollamt Bremen-Freihafen* [1991] ECR I-5163 (paragraphs 20 and 21), Case C-26/96 *Rotexchemie International Handels GmbH & Co v. Hauptzollamt Hamburg-Waltershof* [1997] ECR I-000

to the ratio of export sales over domestic sales of the cooperating producers in the analogue country to comply with Article 2 (2)[925]. The reasoning of the Court in *Nölle* is not without ambiguities, because the test was first expressed as a ratio between exports of the NME and domestic sales in the analogue country and then as a ratio between exports of the NME and production in the analogue country[926]. A lack of representative sales may also result from the fact that the majority of domestic sales are made to related companies and only an insignificant amount of sales is made to independent customers. In such cases the authorities may give preference to choose a country where no such circumstances prevailed and cooperation is found[927]. It should be noted that a failure to meet the 5% representativity test does not necessarily prevent the authorities to select such a country[928]. It may mean that in such cases the normal value in the analogue country will have to be determined by an alternative method[929]. Nonetheless it is important to strike a balance between the provisions of Article 2 (2) and 2 (7). On that basis even when the ratio of 5% is not met, the determination of normal value based on prices in the ordinary course of trade should still be possible if this is more in line with the underlying rationale of Article 2 (7).

Whether or not producers in the analogue country are subject to competition is another criterion considered by authorities in the selection process[930]. Usually a high number of

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(paragraph 23), and Joined Cases C-305/86 and C-160/87 *Neotype Techmashexport GmbH v. Commission and Council* [1990] ECR I-2945 (paragraph 31).

[925] MÜLLER, *et al., o.c., supra* note 811, p. 158-9. See, Regulation 771/98/EC of 7 April 1998 imposing an AD duty on imports of tungsten carbide and fused tungsten carbide from the PRC, OJ L111, 9 April 1998, p. 1 (recital 17).

[926] See MÜLLER, *et al., o.c., supra* note 811, p. 158. The latter test was also applied in Regulation 920/93/EEC of 15 April 1993 imposing provisional AD duties on magnetic disks from Japan, Taiwan and the PRC, OJ L95, 21 April 1993, p. 5 (recital 23).

[927] Provisional AD duties on peroxodisulphates (persulphates) from the PRC, OJ L169, 19 July 1995, *supra* note 921, p. 15 (recital 15), and Regulation 1783/94/EC of 18 July 1994 imposing provisional AD duties on furfuraldehyde from the PRC, OJ L186, 21 July 1994, p. 11 (recital 13).

[928] See, Regulation 2011/2000/EC of 18 September 2000 imposing a definitive AD duty on imports of fluorspar from the PRC, OJ L241, 26 September 2000, p. 5 (recital 20). The domestic sales of the South African producer were found to represent slightly less than 5% of the total Community imports from the PRC during the investigation period, while being generally above 5% during the period of enforcement of the measures. In light of these circumstances the Commission considered that the South African domestic sales were representative for Chinese imports.

[929] Take, *e.g.*, Regulation 2003/97/EC of 13 October 1997 imposing a definitive AD duty on imports of polyolefin sacks and bags from the PRC, OJ L284, 16 October 1997, p. 1 (recital 17 and 18).

[930] Case T-164/94 *Ferchimex SA v. Council* [1995] ECR II-2681 (paragraph 68). See also Regulation 1878/95/EC of 28 July 1998 imposing provisional AD duties on refractory chamottes from the PRC, OJ L179, 29 July 1995, p. 56 (recital 12), provisional AD duties on peroxodisulphates (persulphates) from the

producers are an indication of the existence of competition, which allows for reasonable but not excessive profits on the sales of the product concerned[931]. The sole fact of only two producers present in the analogue country does not in itself prevent prices from being the result of real competition[932]. And, of course, the existence of imports into the analogue country may also be an indication of competition[933]. The existence of embargoes[934], import quotas and the levels of customs tariffs may play a role in this context[935]. Under certain conditions the lack of competition in the envisaged analogue country did not preclude its selection. This was the case in *dead burned (sintered) magnesia from China*[936]. The costs of production were determined to be competitive, because of a widespread use of subcontractors, selected through a process of competitive tendering[937]. Another example is *dihydrostreptomycin from China*[938]. Because outside China there were only two other producers worldwide, one in Japan and one inside the Community, Japan had to be chosen due to a lack of other possibilities. The monopolistic situation was rectified by constructing a profit margin considered to be competitive[939]. In *Rotexchemie* it was upheld that in the absence of other alternative countries, it was not unreasonable to select a country with only one producer, which was also partially

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PRC, OJ L169, 19 July 1995, *supra* note 921, p. 15 (recital 17), and provisional AD duties on magnetic disks from Japan, Taiwan and the PRC, OJ L95, 21 April 1993, *supra* note 926, p. 5 (recital 23).

[931] See, *e.g.*, Regulation 892/94/EC of 21 April 1994 imposing provisional AD duties on calcium metal from the PRC and Russia, OJ L104, 23 April 1994, p. 5 (recital 14), and Regulation 2720/93/EEC of 28 September 1993 imposing provisional AD duties on isobutanol from Russia, OJ L246, 2 October 1993, p. 12 (recital 14).

[932] Case C-16/90 *Detlef Nölle v. Hauptzollamt Bremen-Freihafen* [1991] ECR I-5163 (paragraph 19). See also provisional AD duties on peroxodisulphates (persulphates) from the PRC, OJ L169, 19 July 1995, *supra* note 921, p. 15 (recital 17).

[933] Regulation 2463/93/EEC of 1 September 1993 imposing provisional AD duties on fluorspar from the PRC, OJ L226, 7 September 1993, p. 3 (recital 13).

[934] See provisional AD duties on furfuraldehyde from the PRC, OJ L186, 21 July 1994, *supra* note 927, p. 11 (recital 13).

[935] Regulation 2022/95/EC of 16 August 1995 imposing definitive AD duties on ammonium nitrate from Russia, OJ L198, 23 August 1995, p. 1 (recitals 21-23), and provisional AD duties on isobutanol from Russia, OJ L246, 2 October 1993, *supra* note 931, p. 12 (recitals 13- 14).

[936] Regulation 2800/92/EEC of 25 September 1992 imposing provisional AD duties on dead burned (sintered) magnesia from the PRC and Japan, OJ L282, 26 September 1992, p. 16 (recital 15).

[937] *Ibidem.*

[938] Regulation 2054/91/EEC of 11 July 1991 imposing provisional AD duties on dihydrostreptomycin from the PRC, OJ L187, 13 July 1991, p. 23 (recital 13).

[939] *Ibidem.*

protected by AD duties[940]. In *glyphosate from China*[941], proposed analogue countries such as Argentina, Australia, India and Malaysia were not considered valuable candidates, because their markets were largely dominated by companies related to the main complaining producer located in the Community[942]. Nonetheless, in *ferro-silico-manganese from China*[943] the Commission did not object that the two cooperating producers in the analogue country used for establishing normal value were owned by a mining company, which at the same time held shares in a European producer, because the sales were believed to be made on an arm's length basis[944]. In *certain aluminium foil from China and Russia*[945] Turkey was not considered a suitable analogue country because the cooperating producer did not have any domestic sales to unrelated customers[946].

The comparability of the production process or the structure of cost of production is another relevant criterion to be mentioned here[947]. It suffices to say, however, that the production process in the analogue country can be different, but this should not generate huge differences in the costs of production[948]. Even in cases where normal value in the analogue country has to be constructed, it is considered whether or not the cooperating producer has a reasonably efficient production process[949]. Cost efficiency in an analogue country should by no means be below world standards. Of course, the whole discussion about cost efficiency and price comparability between NME and market economy countries is turned upside down, if the only cooperating Indian producer is entirely state-owned and it can be argued that the prices of the product under investigation in the analogue country are controlled by the government. This was argued in *magnesium oxide*

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[940] Case C-26/96 *Rotexchemie International Handels GmbH & Co v. Hauptzollamt Hamburg-Waltershof* [1997] ECR I-000 (paragraphs 21-25). Similarly, see definitive AD duties on furazolidone from the PRC, OJ L285, 4 November 1994, *supra* note 916, p. 1 (recital 7).

[941] Regulation 368/98/EC of 16 February 1998 imposing a definitive AD duty on glyphosate from the PRC, OJ L47, 18 February 1998, p. 2.

[942] *Idem*, p. 2 (recital 15).

[943] Regulation 495/98/EC of 23 February 1998 imposing a definitive AD duty on imports of ferro-silico-manganese from the PRC, OJ L62, 3 March 1998, p. 1.

[944] *Idem*, p. 1 (recitals 55-56).

[945] Regulation 950/2001/EC of 14 May 2001 imposing definitive AD duties on certain aluminium foil from the PRC and Russia, OJ L134, 17 May 2001, p. 1.

[946] *Idem*, p. 1 (recital 31).

[947] Case T-164/94 *Ferchimex SA v. Council* [1995] ECR II-2681 (paragraph 68).

[948] Provisional AD duties on calcium metal from the PRC and Russia, OJ L104, 23 April 1994, *supra* note 931, p. 5 (recital 17).

from China[950]. However, the Commission took the view that the Indian SOE did operate in a market economy context and its domestic sales were made in competition with a number of companies, which did not belong to the Indian government. It was thus found that the state ownership did not result in any distortion of costs or prices charged[951]. Of course this case proves that a SOE can operate in a market context, and this precedent could be turned around to claim MET for Chinese SOEs. However, this case is also a good example of how ironical the choice of an analogue country can be, if one takes into account that a NME traditionally is characterised by state-owned production. Furthermore, in *certain aluminium foil from China and Russia*[952] the sole Chinese exporting producer was majority state-owned and the chairman of the board of directors was appointed by a state-owned entity. For these reasons it was concluded that it could not be granted MET[953]. In my opinion these last two examples show little consistency.

The comparability of access to components[954] used for the manufacture of the product concerned, as well as raw materials and energy[955], is also a criterion. As far as raw materials are concerned, the ECJ addressed this in *Nölle*, where it was held that the advantages resulting from access to raw materials could not be ignored simply because there was no market economy in the exporting country[956]. *In casu* it was argued that the analogue country, Sri Lanka, had to import a certain raw material necessary for the production of brushes, whilst China, the exporting country, accounted for practically 85% of the production of that raw material. *Nölle* rightly claimed that this would amount to differences in production costs. Nonetheless, differences in respect of access to raw

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[949] Provisional AD duties on unwrought magnesium from Russia and Ukraine, OJ L312, 23 December 1995, *supra* note 914, p. 37 (recital 20).
[950] Regulation 1334/1999/EC of 21 June 1999 imposing a definitive AD duty on imports of magnesium oxide originating in the PRC, OJ L159, 25 June 1999, p. 1.
[951] *Idem*, p. 1 (recital 22).
[952] Definitive AD duties on certain aluminium foil from the PRC and Russia, OJ L134, 17 May 2001, *supra* note 945, p. 1.
[953] *Idem*, p. 1 (recital 22). In particular the appointment of the chairman was important (recital 23).
[954] Regulation 1645/95/EC of 5 July 1995 imposing provisional AD duties on microwave ovens from the PRC, Korea, Thailand and Malaysia, OJ L156, 7 July 1995, p. 5 (recital 12), where fully integrated producers were found be benefiting from special cost advantages.
[955] Such as in provisional AD duties on refractory chamottes from the PRC, OJ L179, 29 July 1995, *supra* note 930, p. 56 (recital 12); Regulation 2581/93/EEC of 20 September 1993 imposing provisional AD duties on ferro-silicon from South Africa and the PRC, OJ L237, 22 September 1993, p. 2 (recital 17); and Regulation 2496/97/EC of 11 December 1997 imposing a definitive AD duty on imports of silicon metal from the PRC, OJ L345, 16 December 1997, p. 1 (recital 16).

materials do not necessarily exclude the selection of an analogue country. In *fluorspar from China* the Chinese advantage with respect of access to raw materials was taken into consideration by making a downward adjustment of the analogue country's selling prices[957].

Finally, the readiness of producers in the analogue country to cooperate with Community authorities is indirectly mentioned in Article 2 (7) as a criterion to be considered. The ECJ, though, has ruled that a serious attempt to obtain information has to be made, and that the authorities should not induce non-cooperation by requesting information within very short delays[958]. *Coumarin from China* is a good illustration of the problems that non-cooperation may create[959]. As the producers in Japan and India refused to cooperate, the Commission finally had no other choice than to select the US as an analogue country, notwithstanding that the US producer was related to the only existing complainant in the Community.

The need for selecting an analogue, or in the US surrogate, country has been prone to criticism[960]. The chief criticisms include that AD margins in analogue country cases are usually much higher than in standard AD proceedings. It is also often heard that the results of the case are absolutely unpredictable, and it is therefore impossible for a NME producer to price its goods to avoid the imposition of AD duties. Because analogue prices and costs are used, a NME with some demonstrable comparative advantage can never benefit in the price or cost computation from that advantage[961]. It is deplorable that authorities still return to this methodology after more than a decade of severe criticisms.

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[956] Case C-16/90 *Detlef Nölle v. Hauptzollamt Bremen-Freihafen* [1991] ECR I-5163 (paragraphs 24-26).
[957] Provisional AD duties on fluorspar from the PRC, OJ L226, 7 September 1993, *supra* note 933, p. 3 (recital 13); and Regulation 486/94/EC of 4 March 1994 imposing definitive AD duties on fluorspar from the PRC, OJ L62, 5 March 1994, p. 1 (recitals 10 and 11).
[958] Case C-16/90 *Detlef Nölle v. Hauptzollamt Bremen-Freihafen* [1991] ECR I-5163 (paragraph 34).
[959] Regulation 2352/95/EC of 6 October 1995 imposing provisional AD duties on coumarin from the PRC, OJ L239, 7 October 1995, p. 4 (recitals 14 and 15).
[960] This is especially true in the US, see *e.g.* KEARNEY and WANG, *o.c, supra* note 894, p. 257-284; BARCHEFSKY, *o.c., supra* note 866, p. 373-380; and ALFORD, W., "When is China Paraguay? An Examination of the Application of the Antidumping and Countervailing Duty Laws of the United States to China and other 'Nonmarket Economy' Nations", 61 *Southern California L. Rev.*, November 1987, p. 79-135.
[961] These criticisms are summed up very well by former USTR Barchefsky, see BARCHEFSKY, *o.c., supra* note 866, p. 375-76.

c. Methods of Determining Normal Value

According to Article 2 (7) the authorities would normally use domestic selling prices in the analogue country to establish normal value. Where the use of this method is not possible, they will resort to a constructed normal value in the analogue country. The two remaining methods listed in the provision – export prices from the analogue country to a third country, including the Community, and any other reasonable basis, including the price paid or payable in the Community for the like products – are rarely used[962]. When selecting one of the different methods of establishing normal value, the authorities enjoy a certain margin of discretion[963]. The ECJ even held that all methods could be combined if that would lead in fact to obtain a more reliable and representative result[964]. Such a combination of methods was used, *e.g.,* in *silicon carbide from inter alia China*[965] depending on the product type[966]. In contrast to the information regarding the selection of an analogue country, the authorities are not under an obligation to give out information to the parties of the method by which normal value is calculated when the proceeding is opened[967].

Producers in NMEs, based on antidumping practice in the US, have suggested other methods than those listed in Article 2 (7) of the Regulation. In *magnetic disks from Japan, Taiwan and China,* one Chinese producer argued that normal value should have been constructed by taking into account the real costs incurred by the Chinese producer concerned, as far as the components used to manufacture the product were sourced from related companies in market economy countries, *in casu* the US and Hong Kong. The

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[962] See Regulation 761/90/EEC of 26 March 1990 imposing provisional AD duties on tungsten ores and concentrates from the PRC, OJ L83, 30 March 1990, p. 23 (recital 11), which discussed but did not use the wholesale prices observed on international commodity markets. More often the price actually paid or payable in the Community for the like product is used, see Regulation 541/91/EEC of 4 March 1991 imposing definitive AD duties on bariumchloride from the PRC, OJ L60, 7 March 1991, p. 1 (recital 12); and Regulation 720/90/EEC of 22 March 1990 imposing provisional AD duties on silicon metal from the PRC, OJ L80, 27 March 1990, p. 9 (recital 11).

[963] Case T-164/94 *Ferchimex SA v. Council* [1995] ECR II-2681 (paragraph 66ff), Joined Cases 296/86 and 77/87 *Technointorg v. Commission and Council* [1988] ECR 6077 (paragraph 30).

[964] Case T-164/94 *Ferchimex SA v. Council* [1995] ECR II-2681 (paragraph 81ff). Although this judgment was delivered on the basis of the old Basic Regulation 2423/88, it can still serve as guidance under the new Regulation 384/96, as amended.

[965] Imposing AD duties on silicon carbide from *inter alia* China, OJ L125, 26 May 2000, *supra* note 915, p. 3.

[966] Where for crystalline silicon the price in the ordinary course of business was used, but for metallurgical silicon normal value had to be constructed.

remaining costs should nonetheless be established on the basis of the analogue market economy. Sadly the Community authorities rejected these suggestions, as they were not compatible with the relevant provisions of the Regulation[968]. In a much more recent case, *imports of urea from inter alia Belarus and Ukraine*[969], three Ukrainian producers argued also that their normal value should not have been based on the domestic prices and costs of an analogue country, but that the normal value based on domestic sales of a Ukrainian exporting producer, which was granted MET should have been used instead. However, again the Commission rejected. It argued that it is consistent practice, in line with Article 2 (7)(b), to determine normal value on the basis of paragraphs 1 to 6 of Article 2 only for those producers that can show that they operate in line with market economy conditions. For all other producers in the same country, normal value is determined on the basis of a price or constructed value in an analogue country, or on any other reasonable basis[970]. The same request for such treatment was also made, but not granted in *integrated electronic compact fluorescent lamps from China*[971]. Such alternative approaches would certainly come close to the "bubbles of capitalism" methodology previously used in the US, and would definitely mean progress. This method is explained below and has been used by the Commission, to a certain extent, in *zinc oxides from China*[972].

The "bubbles of capitalism" approach or also referred to as the "mix and match" approach was used before the market oriented industry method by the DOC[973]. Recognising that certain market forces were at work in China, the DOC announced that, in calculating normal value under the standard factors of production methodology, it would include the cost of factor inputs purchased under market conditions, whether they were foreign or PRC sourced, and obtain from surrogate countries the remaining factor

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[967] Case T-164/94 *Ferchimex SA v. Council* [1995] ECR II-2681 (paragraph 85).
[968] Provisional AD duties on magnetic disks from Japan, Taiwan and the PRC, OJ L95, 21 April 1993, *supra* note 926, p. 5 (recital 21).
[969] Imposing definitive AD duties on urea from Belarus, Bulgaria, Croatia, Estonia, Libya, Lithuania, Romania and the Ukraine, OJ L17, 19 January 2002, *supra* note 887, p. 1.
[970] *Idem*, p. 1 (recitals 44-45).
[971] Regulation 1470/2001/EC of 16 July 2001 imposing definitive AD duties on imports of integrated electronic fluorescent lamps from the PRC, OJ L195, 19 July 2001, p. 8 (recital 11).
[972] Only to its own advantage though. See *supra* p. 199.
[973] LAROSKI, *o.c., supra* note 865, p. 370-398; BELLOCCHI, L., "The Effects of and Trends in Executive Policy and Court of International Trade (CIT) Decisions Concerning Antidumping and the Non-Market Economy of the PRC", 10 *NY Int'l L. Rev.*, Winter 1997, p. 177-213; and LANTZ, *o.c., supra* note 891, p. 993-1073.

inputs for costs that were not market-driven[974]. Where a NME producer proved that factor inputs were purchased from market economies, the DOC would value them at the purchase price[975]. Even when it could show that factor inputs were purchased within the NME under market conditions, those sourced inputs would replace the surrogate country prices in calculating normal value[976]. Although this methodology was a giant leap forward, happiness was short-lived, because the DOC soon began to question the theoretical underpinnings of this approach[977]. The reason behind this moving away from this methodology was the fact that it opened the door for CVD petitions without injury test in the US and challenging the view that due to their economic nature NMEs could not be subjected to CVD law[978]. This author believes the "bubbles of capitalism approach" should be supported, because it could lead in fact to obtain a more reliable and representative result. In the EC, there should not exist any objection to use this methodology. In the US it would have been unnecessary to stop using it, had the US introduced the same injury standard as applied to CVD cases against market economies for NMEs. Definitely, in a case where MET has been granted, nothing should object to the use of information from the recognised market economy producer in the NME as a substitute for information of a NME producer of the same country.

According to the ECJ in *Technointorg,* the constructed normal value should be calculated in such a way that the results obtained are as close as possible to the normal value based on the analogue country's domestic prices. The differences in income levels and production methods in the NME and the analogue country in itself are not enough to make it necessary to construct the normal value instead of using the analogue country's domestic prices. Different production methods may require, however, adjustments when

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[974] Oscillating Fans and Ceiling Fans from the PRC, 56 Fed. Reg. 25,664, 25,667 (Dep't Comm. 1991). See also RICHARDSON and NIELSEN, *o.c., supra* note 894, p. 151-167.
[975] Oscillating Fans, *supra* note 974, p. 25,667.
[976] *Idem.*
[977] Chrome Plated Lug Nuts from the PRC, 56 Fed. Reg. 46,153 (Dep't Comm. 1991). See *supra* note 891.
[978] HORLICK and SHUMAN, *o.c., supra* note 893, p. 807-840; O'BRIEN, K., "The Applicability of the United States Countervailing Duty Law to Imports from Nonmarket Economy Countries", 9 *Fordham Int'l L.J.*, 1985/1986, p. 596-633; and STRONSKI, J., "Antidumping, Constructed Value, and Noncountervailable Subsidies: A Proposed Inclusion of Subsidies in Constructed Value after Al Tech Specialty Steel Corp. v. United States", 11 *Fordham Int'l L.J.*, Fall 1987, p. 208-231.

comparing normal value as established in the analogue country with the NME's export prices[979].

When the normal value is based on information derived from producers in the analogue country, which are related to complainant Community producers, it is absolutely vital for the authorities to check this information. The Community institutions should ensure that the link between the cooperating producer in the analogue country and the complainant industry does not influence the information on which the measures are based[980]. In *Ferchimex* there was only one cooperating producer in the analogue country, who was linked to the complainant industry. The ECJ found that the producer was not in a position to influence the sales prices because its production only represented 8.15% of the sales in the market under consideration, its sales were made at arm's length prices, and the market of that primary product was very competitive. It was further found that its prices were in line with those charged by competitors, and proper adjustments were made[981]. In a review proceeding concerning the measures before the Court in *Ferchimex*, the same sole cooperating producer was used by the authorities. It was established that its costs of production were increased due to exceptional depreciation. Since these costs were not incurred in the ordinary course of trade, Community institutions decided to deduct these costs as an adjustment[982]. Similarly, in *gas-fuelled, non-refillable pocket flint lighters from China* the only cooperating producer in the analogue country belonged to a group of companies of which a complainant Community producer was also member. The analysis of the costs of production as supplied by that cooperating producer showed that certain parts used for the production were bought from related parties and that additional costs were incurred. In order to make a reasonable and appropriate ordinary course of trade test, the additional costs in question were excluded in the cost of production[983].

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[979] Joined Cases 296/86 and 77/87 *Technointorg v. Commission and Council* [1988] ECR 6077 (paragraph 26ff).

[980] Provisional AD duties on refractory chamottes from the PRC, OJ L179, 29 July 1995, *supra* note 930, p. 56 (recital 10), where two producers cooperated in the analogue country, one of them being related to the complainant.

[981] Case T-164/94 *Ferchimex SA v. Council* [1995] ECR II-2681 (paragraph 71ff).

[982] Regulation 643/94/EC of 21 March 1993 reviewing AD duties on potassium chloride from Belarus, Russia and Ukraine, OJ L80, 24 March 1994, p. 1 (recital 13).

[983] Regulation 1006/95/EC of 3 May 1995 reviewing AD duties on gas-fuelled, non-refillable pocket flint lighters from the PRC, OJ L101, 4 May 1995, p. 38 (recitals 22 and 23).

Another factor that is known to play a role determining the normal value based on domestic selling prices or a constructed normal value in the analogue country is the rate of inflation. Pursuant to Article 2 (10)(j) the effects of inflation in the analogue country can be eliminated by using the appropriate exchange rates, which reflect the fluctuations of the value of the currencies in question. The authorities in this context generally use the official exchange rates on the basis of which international commercial transactions are carried out[984].

As was already indicated in the previous section, the failure to meet the 5% representativity test pursuant to Article 2 (2) may lead to the use of an alternative method of determining normal value. In this regard the representativity test is applied to both the total export volume of each cooperating exporter in the NME and its export volumes of the various product types in comparison with the corresponding domestic sales volumes of the cooperating producers in the analogue country[985].

Finally, it has occurred that, when products sold domestically have many additional features as compared to those exported to the Community, the most practical method considered can be the constructed normal value[986].

B. Determination of Antidumping Duties

Normally the calculation of the dumping margin is made for each cooperating company individually[987]. However, as a general rule AD authorities will not establish individual dumping margins, referred to as "individual treatment" (IT), for cooperating exporters located in a NME. They justify this practice on the grounds that NME companies have a very limited, if any, degree of independence in their relationship with importers in other countries, as they are unable to establish export prices and any other conditions or terms

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[984] MÜLLER, *et al., o.c., supra* note 811, p. 167.
[985] Regulation 1465/96/EC of 25 July 1996 imposing provisional AD duties on certain ring binder mechanisms from Malaysia and the PRC, OJ L187, 26 July 1996, p. 47 (recitals 29-31).
[986] Provisional AD duties on photo albums from the PRC, OJ L228, 9 September 1993, *supra* note 920, p. 16 (recitals 21 and 24).
[987] Regulation 384/96 addresses specifically the issue of whether individual or general duties may be imposed in two particular circumstances: (1) the situation of NME; and (2) where the Commission resorts to sampling.

of sales by themselves[988]. This may lead to circumvention of AD duties by channelling them through the NME producer with the lowest AD duty rate.

a. Individual Treatment

The concept of IT by calculating an individual dumping margin for cooperating exporters from a NME was initially introduced in *small screen television receivers from Hong Kong and China*[989], where individual duties were computed for two Sino-Japanese joint ventures which the AD authorities considered to enjoy a high degree of independence in so far as they were able to import components and export finished products without any control from the China Commercial Chamber or from any other body, and were able to transfer their profits out of China subject to certain requirements[990]. The issue of IT was, however, reconsidered in *bicycles from China*[991] where the Commission refused to grant IT to two Chinese producers with foreign investment participations. The argument was that IT is only appropriate in exceptional circumstances, because exports can be channelled by the state through whichever exporter has the lowest AD duty. *In casu* a Chinese manufacturer claimed to have become a joint stock company, and that the portion of its shares still owned by a state body had now fallen to only a minority shareholding by the state. The Commission considered, however, that even a minority shareholding confers on the state a significant influence on the management of the company, especially when combined with all other means of influence at the disposal of the state in China. Notwithstanding the difficulties for obtaining IT several importing producers were granted individual duty rates in later cases, such as *e.g.* in *leather handbags from China*[992]. In that case the companies under investigation were incorporated in Hong Kong, but exported leather handbags manufactured at operations in the PRC controlled by them. These operations were either entities without a legal identity

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[988] See VAN BAEL and BELLIS, *o.c., supra* note 811, p. 228.
[989] Regulation 2093/91 of 15 July 1991 imposing definitive AD duties on small screen televisions from the PRC and Hong Kong, OJ 1991 L195, 18 July 1991, p. 1.
[990] *Idem*, p. 1 (recitals 19 and 20).
[991] Provisional AD duties on bicycles from the PRC, OJ 1993 L58, 11 March 1993, *supra* note 922, p. 12; and Regulation 2474/93/EEC of 8 September 1993 imposing definitive AD duties on bicycles from the PRC, OJ 1993 L228, 9 September 1993, p. 1 (recitals 17-21).
[992] Regulation 1567/97/EC of 1 August imposing definitive AD duties on leather handbags from the PRC, OJ L208, 2 August 1997, p. 31, as amended by Regulation 2380/98/EC of 3 November 1998 amending Regulation 1567/97, OJ L296, 5 November 1998, p. 1.

of their own, producing on the basis of a so-called 'processing with foreign materials' agreement, or foreign-invested enterprises (FIE), such as sino-foreign cooperative joint ventures or wholly foreign owned enterprises (WFOE). It was considered that the authorities in the PRC would not have enough leverage to effectively influence the commercial behaviour of the exporters concerned, because the costs and procedures involved closing down the manufacturing operations are very limited. Consequently there was no genuine risk of circumvention via possible channelling[993]. Generally, the question whether an exporter in a state-trading country is acting with sufficient independence of the state for IT to be granted to him involves an assessment of complex factual situations. Judicial review of such an assessment is limited to whether the relevant procedural rules are complied with, whether the relevant facts have been accurately stated, and whether there has been a manifest error of appraisal of the facts or the misuse of power[994].

Since 1998, certain changes occurred, which were already discussed earlier, and which allowed NME producers to apply for MET. However, there was considerable overlap between the traditional IT criteria and the full market economy criteria[995]. This created the situation that only those exporting producers who could fulfil the requirements for MET could also qualify for IT. Given that the important issue for IT was that export transactions were not subject to state interference, it seemed logical and fair to refocus the criteria for IT on those areas having a direct impact on the export activities of the exporting producer, and not to make it solely dependent on MET.

Pursuant to the Commission's proposal[996] the exporter has to show that he is free to determine export prices and quantities, as well as their terms and conditions. The claim must be submitted together with the reply to the questionnaire. In this respect the following criteria are considered to be relevant in determining whether an exporting producer should be granted individual treatment: (1) exporters are free to repatriate capital and profits (as is usually the case for WFOEs and FIEs); (2) export prices and quantities, and conditions and terms of sale are freely determined, and the majority of the

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[993] Definitive AD duties on leather handbags from China, OJ L296, 5 November 1998, *supra* note 992, p. 1 (recitals 11-14).
[994] See Case T-170/94, *Shanghai Bicycle Corporation v. Council* [1997] ECR II-1383, paragraph 110.
[995] See COM (2000) 363 final, *o.c., supra* note 869, p. 14.
[996] See COM (2000) 363 final, *o.c., supra* note 869.

shares belong to genuinely private companies. State officials appearing on the board or in key management positions should be in a clear minority. The presumption is that a state-controlled enterprise cannot guarantee its independence from state interference, and the burden rests with the exporter to prove otherwise; (3) exchange rate conversions are carried out at the market rate; (4) state interference is not such as to permit circumvention of measures if exporters are given different rates of duty. As such, the proposal creates an option open to exporting producers who may not be able to meet the criteria for full MET, which can only be granted where an exporting producer can show that neither its domestic nor its export activities are subject to state interference.

In *certain footwear with uppers of leather or plastics from inter alia China*[997] one exporting producer was granted IT. Again it was a legal entity incorporated in Hong Kong, but with a manufacturing facility in mainland China that could persuade the Commission that the management and control of the factory, both in terms of production and marketing, was clearly in their hands and that their operations were sufficiently independent from the Chinese authorities. It was also established that export prices and marketing policies were determined by the Hong Kong company without interference from the Chinese state[998]. Likewise, in *solutions of urea and ammonium nitrate from inter alia Belarus, Russia and Ukraine*[999] one cooperating Russian exporter advanced the arguments that it determined the conditions and terms of its export sales freely, that the company's supervisory board was elected by the shareholders and all but one of the members were independent from the state, and that exchange rate conversions were carried out at the market rate. On these grounds the Commission reviewed the claim for IT and considered that the arguments were valid. Especially since the level of state interference was not such as to permit circumvention of AD measures if exporters are given different rates of duty, the company's claim was accepted, despite strong objections from the complainant industry[1000].

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[997] Regulation 467/98/EC of 23 February 1998 imposing definitive AD duties on imports of certain footwear from *inter alia* the PRC, OJ L60, 28 February 1998, p. 1.
[998] *Idem*, p. 1 (recitals 44-46).
[999] Regulation 1995/2000/EC of 18 September 2000 imposing definitive AD duty imposed on imports of solutions of urea and ammonium nitrate from Algeria, Belarus, Lithuania, Russia and Ukraine, OJ L238, 22 September 2000, p. 15.
[1000] *Idem*, p. 15 (recitals 21-23).

To ensure that circumvention is not taking place the Commission, *e.g.*, will have to check the exporter's capacity, because if its exports are higher this could be an indication that circumvention is taking place. Particular attention will be paid to exports made via traders. Any change in the business license may also indicate circumvention and must be reported by the companies concerned. If necessary a withdrawal of IT could ensue through an investigation[1001]. For the risk of possible future circumvention it is the Commission's practice not to grant IT when export transactions are made via trading companies[1002]. This reasoning has, however, not prevented the AD authorities from accepting undertakings[1003] from NMEs or from resorting to sampling[1004].

Generally speaking, IT like MET is still the exception rather than the rule in cases involving NMEs. On the basis of the information supplied, most companies are unable to demonstrate to the satisfaction of the Commission that they are sufficiently independent from state control or interference and, accordingly, see their claim for IT rejected[1005]. Perhaps it would not be a bad idea to reverse the presumption, and to allow IT in all cases, except if the Commission can demonstrate that there is actual state interference, that there is no factual or legal independence because of questions regarding ownership, management control and determination of commercial and business policies. This would change the burden of proof and would improve the position of transition economies.

[1001] See COM (2000) 363 final, *o.c.*, *supra* note 869, p. 15. See Regulation 192/1999/EC of 25 January 1999 imposing definitive AD duties on pocket flint lighters from the PRC, OJ L22, 29 January 1999, p. 1.

[1002] See, *e.g.*, Regulation 2402/98/EC of 3 November 1998 imposing AD duties on unwrought unalloyed magnesium from China, OJ L298, 7 November 1998, p. 1 (recital 17); ferro-silico-manganese from China, OJ L62, 3 March 1998, *supra* note 943, p. 1 (recital 54); and Regulation 1784/2000/EC of 11 August 2000 imposing definitive AD duties on certain malleable cast iron tube or pipe fittings from *inter alia* China, OJ L208, 18 August 2000, p. 8 (recital 58).

[1003] See, *e.g.*, Commission Decision 2001/602/EC of 26 July 2001 accepting an undertaking in connection with certain steel or iron ropes from *inter alia* Russia, OJ L211, (2001) p. 47; Commission Decision 2001/381/EC of 16 May 2001 accepting an undertaking in connection with aluminium foil from the PRC, OJ L134 (2001) p. 67; Commission Decision 2000/137/EC of 17 February 2000 accepting an undertaking in connection with seamless pipes and tubes from *inter alia* Ukraine, OJ L46 (2000) p. 34; Commission Decision 2000/523/EC of 10 August 2000 accepting an undertaking in connection with malleable cast iron tube or pipe fittings from *inter alia* China, OJ L208 (2000) p. 53; Commission Decision 2000/70/EC of 22 December 1999 accepting an undertaking in connection with certain seamless pipes and tubes from *inter alia* Russia, OJ L23 (2000) p. 78; and Commission Decision 1999/572/EC of 13 August 1999 accepting an undertaking in connection with steel wire ropes, OJ L217 (1999) p. 63.

[1004] See, *e.g.*, Definitive AD duties on leather handbags from China, OJ L296, 5 November 1998, *supra* note 992, p. 31.

[1005] See, *e.g.*, ferro-silico-manganese from China, OJ L62, 3 March 1998, *supra* note 943, p. 1; certain aluminium foil from China, OJ L134, 17 May 2001, *supra* note 945, p.3; and imports of urea from *inter alia* Belarus and the Ukraine, OJ L17, 19 January 2002, *supra* note 887, p.4.

Besides, as was discussed in the second chapter, the distinction between SOE and other types of enterprises has become increasingly blurred. Economic reforms have decentralised central government control over SOEs, though the enterprises remain state-owned in name. In the US the DOC accepted that the *de iure* control of exporting companies have shifted from the central government to the companies themselves. However, based upon information that these laws and regulations have not been implemented on a uniform basis, a *de facto* analysis is necessary in order to ascertain whether the companies are in fact free of government control[1006].

b. Dumping Margin and Adjustments

Actually there are no specific provisions governing adjustments when export prices from a NME are compared with the normal value established in the analogue country. However, in some of the cases mentioned in the sections above, the authorities, where necessary, take into account the fact that the method to establish normal value in an analogue country has shortcomings. However, for differences in the cost of production, which have their very origin in the fact that factor costs in NMEs are controlled by the state, is not compensated. An example of this are the lower wages in the NME. The ECJ has ruled that differences concerning wage and salary levels in the NME and analogue country as well as higher costs for components in the analogue country did not justify allowances[1007]. One can argue though whether the use of an analogue country should not truly reflect the comparative advantage of the NME. Definitely for a country like China, where low-skilled labour and certain components are abundant, the refusal to make such adjustments may come across as unfair. Nonetheless, at least one author agrees that comparative advantages, which are independent of the NME status and have a bearing on the comparison of the normal value with the export price, should be taken into account[1008].

[1006] See ALAGIRI, P., "Reform, Reality, and Recognition: Reassessing US Antidumping Policy Toward China", 26 *Law & Pol'y in Int'l Bus.*, Summer 1995, p. 1061-1091.
[1007] Joined Cases 296/86 and 77/87 *Technointorg v. Commission and Council* [1988] ECR 6077 (paragraphs 34-35), see also Regulation 2861/93/EEC of 18 October 1993 imposing definitive AD duties on magnetic disks from Japan, Taiwan and the PRC, OJ L262, 21 October 1993, p. 4 (recital 12), and provisional AD duties on bicycles from the PRC, OJ L58, 11 March 1993, *supra* note 922, p. 12 (recital 29).
[1008] MÜLLER, *et al., o.c., supra* note 811, p. 174-5.

Adjustments are made for differences in physical characteristics[1009], such as in *coumarin from China*[1010], a case in which the product concerned was of lower quality than the one sold by the cooperating producer in the analogue country. Similarly, in *dead burned (sintered) magnesia from China*[1011], it was found that importers and users of the Chinese product had to carry out themselves operations, such as an analysis of the product, monitoring of loading of the product, and removal of impurities. Exports from the analogue country did not require such operations. As a result an allowance of 6% was made[1012]. However, other factors may outweigh the differences in physical characteristics. For example the length of the production process and a higher consumption of raw materials may outweigh the cost benefits of using another type of raw material[1013].

Access to raw materials and energy efficiency, which have nothing to do with the specific determination of costs and prices in a NME, are taken into consideration when making a comparison[1014]. However, in *urea from Russia, Ukraine, Slovak and Czech Republic*[1015], the argument by Russian producers that adjustment for different prices in gas should be made was refused, because in the analogue country, *in casu* Slovakia, producers paid the market price, while Russian producers paid a price, which was not the result of market forces. It was argued that it is the very purpose of using an analogue country to eliminate the effect of such costs and prices[1016]. In one case, the authorities refrained from making any adjustment, because the cooperating producer in the analogue country was one of the most efficient in the world and it was considered that full account was taken of any

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[1009] See, *e.g.*, unwrought unalloyed magnesium from the PRC, OJ L298, 7 November 1998, *supra* note 1002, p. 3.
[1010] Provisional AD duties on coumarin from the PRC, OJ L239, 7 October 1995, *supra* note 959, p. 4 (recital 22).
[1011] Regulation 3383/93/EEC of 6 December 1993 imposing definitive AD duties on dead burned (sintered) magnesia from the PRC, OJ L306, 11 December 1993, p. 16 (recital 12).
[1012] *Ibidem.*
[1013] Review of AD duties on gas-fuelled, non-refillable pocket flint lighters from the PRC, OJ L101, 4 May 1995, *supra* note 983, p. 38 (recital 36).
[1014] Definitive AD duties on fluorspar from the PRC, OJ L62, 5 March 1994, *supra* note 957, p. 1 (recitals 10 and 11).
[1015] Regulation 477/95/EC of 16 January 1995 amending the definitive AD duties on imports from *inter alia* Russia and Ukraine, OJ L49, 4 March 1995, p. 1 (recitals 48-49).
[1016] *Ibidem.*

comparative advantage[1017]. Cases in which due account were taken for differences in access to raw materials and energy include, *e.g.*, *dead burned (sintered) magnesia from China*[1018] and *espadrilles from China*[1019].

IV. Final Observations

The European Commission has considered the April 1998 regime an adequate framework for case handlers to do an analysis against a background of the reform process in China. However, based on the case review in this chapter it should first of all be concluded that still only a minority of Chinese companies are successful in demonstrating that the criteria for MET and IT can be met. For those companies who are refused MET the main reasons are the many restrictions on selling on the domestic market. This, so argues the Commission, has proven to be one of the main tools employed by the Chinese Government to protect inefficient domestic industry from competition and this is more extensive than originally thought. Even where such restrictions are no longer specified in legal documents, the Commission believes they are still found to exist in practice in many instances[1020].

More Chinese companies should be able to meet the MET criteria in the future. It is difficult to establish an exact point in the reform process at which countries could be considered for inclusion under the regime currently applied to China, it was therefore a wise move to extend such treatment to every WTO member. But it should also be questioned whether it is still necessary to continue NME treatment *in se*. The categories of different markets are, after all, based on unexamined assumptions. It seems that they are not based on economic structure anymore, but rather on economic performance, and whether countries can indefinitely graduate from NME treatment is, above all, a political decision to be taken by the Council amending the relevant legislation. Frankly, there is no satisfactory solution to the problem of pricing production factors in NMEs. And the way

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[1017] Regulation 1808/92/EEC of 30 June 1992 imposing provisional AD duties on ferro-silicon from Poland and Egypt, OJ L183, 3 July 1992, p. 8 (recital 13).
[1018] Provisional/Termination of AD duties on dead burned (sintered) magnesia from the PRC and Japan, OJ L282, 26 September 1992, *supra* note 936, p. 16 (recitals 16 and 19).
[1019] Regulation 1812/91/EEC of 26 June 1991 imposing definitive AD duties on espadrilles from the PRC, OJ L166, 28 June 1991, p. 1 (recital 13).
[1020] See COM (2000) 363 final, *o.c.*, *supra* note 869, p. 7.

these methodologies are now used on transition economies such as China will harm the process of market economic reform, because it reduces the market access for these countries, for which export is nonetheless absolutely vital to implement further domestic economic reforms.

To a large extent, market reform has introduced market determined prices in China, though there still are market distortions left and communist holdovers, it should be added that market distortions also exist in mature market economies. Besides, the continued use of these non-market AD methodologies are preponderantly protectionist, based on politics rather than sound economics and should therefore be phased out soon. Moreover, AD is not a preferred method to enforce market access. AD should only be applied if the industries protected prove that in turn they are willing to adjust to increasing competition from China. China in the meantime should not be treated differently from other WTO members. Nowadays it still seems that the country is not given the full benefits of WTO accession.

For the time being, it is necessary to examine the consistency of MET and IT and to make some allowances or improvements. First, it would be better, *e.g.*, to allow the bubble of capitalism or mix and match approach so as to use directly as many data as possible from the NME, instead of referring too easily to a third country. Especially should it be allowed to rely on data from companies in the NME, which are granted MET and to use these data on companies from the same NME, which are not eligible for MET. Second, the AD authorities should start an *ex officio* inquiry, as whether the NME producers under investigation deserve MET, instead of demanding claims for such treatment from the producers under investigation themselves. This should definitely be so in expiry review cases, where it should be possible to adopt a changed and more market-oriented AD method than the method used in the original investigation, without question whether a parallel interim review may be needed. Finally, as far as IT is concerned, the EC authorities should automatically award IT to NME producers, unless it can prove that circumvention is highly likely. This would reverse the principle that NMEs as a general rule are awarded a single country duty rate, and would ease the burden of proof for NME producers, which under the current legislation have to convince the AD authorities that they deserve IT.

Chapter Five: Conclusion

From the onset in the first Chapter, one of the underlying sub themes has been that the integration of transition economies into the economic and legal international order presents special challenges to the Bretton Woods institutions. More specifically, one such challenge is the implementation of the WTO's multilateral trade rules in the domestic regulatory framework of transition economies, such as China, of which its recent accession to the WTO is one of the most significant international economic events in post-World War II history. This accession is unprecedented, because the Chinese market is massive and certain economic sectors, such as textiles, are well developed, whereas for other sectors China is still a developing country. China's accession is also special because of its often politically sensitive relationship with the West in both trade and non-trade issues, and above all, because of the state character of its economy. China has its own set of initial conditions and cannot escape its own historical and cultural environment replete with pre-existing social institutions. As a result, this country stands culturally remote from the Western legal and economic values that have traditionally underpinned the WTO, and differs in the practical application of legal and economic principles at home. Therefore, in order to allow a smooth integration of China in the WTO, and the "Multilateral Trading System" it embodies, it is necessary to reconcile the Chinese economy in transition with the economies of its most important trading partners. To this end, transition countries, such as China, are currently in the process of creating a regulatory framework to support the development and maintenance of a transparent and stable economic environment conducive to efficient private sector activities, and a transparent legal system with effective access to the judicial system. These domestic economic and legal-related reforms should be able to alleviate the possible trade friction that can arise between nations when their economies do not converge sufficiently.

Against this background, China accepted that the country should comply with rules, formulated with a particular Western economic and legal structure in mind. According to many Western, but also some Chinese scholars, China's economic, legal and political structures do not operate as yet in a manner the WTO contemplates how a country's

economic, legal and political institutions should operate. This, according to some scholars, is due to the fact that the 'old' state-track economy has not withered entirely away to create an entirely private economy due to the heavy social costs involved and the danger of creating political instability in such a process. In the opinion of this author, there should not be any problem, however, with continuing public ownership in the economy, as long as the legal system and corporate governance in the country can guarantee that state enterprises work according to market considerations by disentangling the government bureaucracy from vested business interests. Public ownership of the economy was once popular in many Western European countries a few decades ago and may work well in certain sectors of the economy. Besides, it is a sovereign right of each country to organise its economy according to its own political principles. In its continued efforts to create a "socialist market economy", the Chinese government tries hard to rationalise the remains of its state economy. Numerous legal measures have been designed to establish financially autonomous and competitive SOEs independent from bureaucratic overreaching, and to permit SOEs to make commercial decisions in line with market considerations as required by Article XVII GATT. In this process, it has been pointed out that weaknesses in China's corporate governance remain; but, because of the decentralisation in the Chinese economy, there no longer exists a significant danger for concerted economic policy action to undermine GATT/WTO obligations in view of Article XVII GATT. This does not mean, however, that bureaucratic interference is completely "rooted out" on the micro-economic level, because various levels of government still have vested business interests. Because of economic decentralisation, the danger for a deliberate centrally-planned economic action to disrupt Western markets has receded. Market disruption, in this context, is understood to be a centrally-planned economic action to inundate Western markets, with the purpose to "out compete" certain tactical Western industries, or to amass foreign exchange.

However, for the divestiture of state assets, for the disentanglement of the government bureaucracy from business interests, and for making public ownership of the economy work in a market economy setting, it is important for China to embrace the rule of law. As far as the implementation of the rule of law in China is concerned, a review of authors

has revealed that it is necessary to remain vigilant. Creating a legal system is more than increased legislative activity: the law and the legal system, as a whole, should also permeate the legal consciousness of the people living in the region under transition. Moreover, economic troubles often compound the problem of popular acceptance of the rule of law. And Western influence on this point also raises the concern of "transplantability" of Western social and political institutions in post-communist state building. Likewise, WTO integration is not just about the formulation of international economic law and the acceptance of international, liberal trade policies; but, it is for China enormously important to cast the foundations suitable to implement, monitor and possibly enforce the WTO standards. In this sense Article X GATT and related WTO provisions are important to show the way for China's implementation process.

As much as these reform efforts are helping the Chinese integration into the Multilateral Trading System, trading partners, such as the EC and the US, have taken the view, however, that these efforts may, for the time being, be insufficient to cabin the risks and the costs of integration, because they need time to take root. These trading partners, thus, may need a sufficient amount of flexibility to make swift adjustments to changing circumstances in their commercial relations with China, and the WTO also may need opportunities and time to find compromises when necessary. It is against this background that flexible safeguards come into play to ward off the possible risks and dangers of integration. The rise of new and large economies in Asia, Latin America and the former "Soviet block" may create new trade tensions with mature economies. The constant search for new export markets on international markets may pose a serious problem. The expansion of exports is often seen as the only factor in the long-term that determines the import prospects of any economy; and, the low cost structure of emerging and transition economies as a threat to more mature economies may slow down international co-operation. China's accession, in this regard, draws our attention to the tension between, on the one hand, the institutionalisation and rationalisation of world trade, and the empirical reality of global protectionism, on the other hand. In this regard, flexible WTO safeguards might serve as a "buffer zone" among opposite economic systems. Flexibility,

in this context, means a rule-oriented approach but with ample opportunity for negotiation-based action.

The WTO, as a rule-oriented institution, has certain safeguards in place, such as Articles VI and XIX GATT, to alleviate part of this tension. But the risk of damage to liberal trade in employing these safeguards remains immanent. This risk of protectionist abuse also emerges from certain provisions in EC trade policy instruments. These provisions are mostly holdovers from the Cold War, during which imports from non-market economies or state-trading countries were treated differently for fear of market disruption. Despite some changes in 1998, especially in antidumping legislation, these holdovers may still offer opportunities for protectionist abuse and may prevent China to benefit fully from its WTO accession. Because the transformation process from centrally-planned economy to market economy is built on illusive principles, which use long lists of preconditions for economic and legal guidance, and because there are no apparent and clear graduation criteria that mark the successful completion of the transition to a market economy, the risk exists that WTO members will continue to use state-trading or non-market economy methodologies for protectionist purposes. This thesis has argued that this bifurcated system, as far as China is concerned, should be thoroughly revised and abolished where necessary. Principally, the West should also open its markets to imports from transition economies, such as China's. It would be a mistake for Western countries to take the opening of the Chinese market to be nothing but an opportunity for increasing exports. However, the success of China's domestic economic and legal-related reforms is directly relevant for the application of these non-market economy policies. It is around the degree of the success of these reforms that much of the debate revolves.

International norms, like those created in the WTO framework, have played an important role in guiding the remodelling of the legal and economic system in China. The question remains, however, whether it is still necessary to apply a non-market economy trade policy *vis-à-vis* China. And more in particular, the question remains as to whether the EC trade policy instruments of antidumping and safeguards should be adjusted to the new economic circumstances. This non-market economy trade policy, a holdover from the

Cold War, and its continued application to China for a number of years to come is addressed in Sections 15 and 16 of the Protocol of Accession. These Sections allow the discriminatory treatment of Chinese imports by means of special safeguard actions and the use of nonmarket economy methodologies as far as antidumping and subsidies are concerned. With regard to textile products in particular, the prolonged use of a transitory safeguard on Chinese imports is justified in the Working Party Report. There are no clear criteria to let China graduate from this selective and discriminatory treatment other than that these provisions in the Protocol of Accession and in the Working Party Report will have to phase-out after a certain number of years. Nonetheless, It would be wrong for WTO members to apply nonmarket or state-trading methodologies to China over the next decade, if the country has completed its transition in the meantime. It is not inconceivable for WTO members to acknowledge China's progress and to treat the country's economy as a market economy before the transitory period has lapsed.

As far as safeguard provisions are concerned, the EC still uses discriminatory language along the historical lines of traditional state-trading countries. The safeguard provision in Regulation 519/94 is discriminatory and prevents China from being treated as a full member of the WTO. Even if it can be argued that this discrimination is largely academic, because it is unlikely to be ever applied against China, the language is there. The EC authorities should remove China's name from the list of countries in Annex II of that Regulation, and allow all imports from China to fall within the scope of Regulation 3285/94, dealing with imports from market economies, or subject the list of countries in Annex II to judicial review. In this regard, selective safeguard measures against Chinese exports would still be allowed under Article 5 (2) of the WTO Safeguards Agreement, or Article 16 (4)(b) of Regulation 3285/94, as far as "quota modulation" is concerned. In so doing, it would in the future not be necessary to rely on the Transitional Product-Specific Safeguard Mechanism as foreseen in Section 16 of the Chinese Protocol of Accession. Besides, it would have been more appropriate, had the Protocol of Accession used an express reference to allow quota modulation, as specified in Article 5 (2)(b) of the WTO Safeguards Agreement, to be used *vis-à-vis* China, and relaxed the criteria for the use of such selective safeguards, instead of introducing this Transitional Product-Specific Safeguard clause modelled on Section 406 of the US Trade Law. This Transitional

Product-Specific Safeguard Mechanism still makes clear reference to the historical divide between market economies and state-controlled economies by borrowing the exact language from Section 406 on market disruption of the US Trade Law of 1974. It will be interesting, however, to see how the WTO Dispute Settlement Body will interpret market disruption and the relationship between, on the one hand, Article XIX and the Safeguards Agreement, and the Protocol of Accession, on the other hand, because its interpretation of market disruption and the lesser injury standard that is derived from it might be quite different from the American interpretation in Section 406. This allusion on Cold War market disruption in the Chinese Protocol of Accession actually should belong to the past, because, as already mentioned, China's decentralised state economy is no longer in a position to inundate Western or international markets by way of concerted action under a planned economy.

With regard to quantitative restrictions on textiles, the EC, as a result of China's WTO accession, is phasing-out remaining quota restrictions on Chinese textiles, and is integrating Chinese textiles into the GATT regime through the transitional ATC. However, as far as Regulation 517/94 is concerned, the safeguard provisions in Title III of that Regulation are also discriminatory *vis-à-vis* China, in that they too use a different standard for state-trading countries mentioned in Annex II, including the PRC. It would be appropriate here too to remove China from this list, or subject that list to judicial review. Besides, as far as the quantitative restrictions in Annex IV of that Regulation are concerned, these were not notified to the Textiles Monitoring Body as of 1 August 2002. Article 3 ATC nonetheless requires that all quantitative restrictions, whether consistent with GATT or not, should be notified. These quantitative restrictions should be phased-out as soon as possible, because it does not befit the EC to treat certain Chinese imports, economically and politically, on the same footing with imports from North Korea.

Although Article XIX and the WTO Safeguards Agreement may be too narrow in scope to deal with the unique economic position China is in, it seems doubtful, however, that the safeguards designed in the Protocol of Accession will be reliable legal instruments to protect the European economy from undesired Chinese competition, as some pressure

groups may wish. Foremost, the EC needs a liberal economic policy that will allow Europeans to stay ahead of Chinese competition, instead of the rhetorical language of special safeguard provisions. It would be wise for the EC to take this a step further and to harmonise its many safeguard provisions. Treating China differently and applying safeguards is not going to make the Chinese economy less competitive, and European economic sufferance much lighter. Tough policy decisions will have to be made over the next couple of years, if European industries do not want to stay frozen in existing inefficiencies, as the result of increased protectionism. It would be better to continue the search and the struggle for remaining competitive strength. The relevant Community industries should realise that there is no turf that can be preserved forever for any country or group of countries. Only if the EC continues to respond to change, it need not fear of being converted into an industrial desert. To advance this aim, it is also crucial to alter trade policies instruments, such as antidumping legislation, in ways that would make them less conducive to seizure for protectionist purposes.

This volume has argued that a further relaxation of the EC trade policy instruments is timely, and the EC should further continue to phase-out the discriminatory treatment of Chinese imports. The absence of clear graduation criteria should not prevent this relaxation. Especially as far as antidumping is concerned, the nonmarket economy methodology is rife with opportunities for protectionism. In this regard it is already hopeful that the practice of "zeroing" was condemned in the *Bed Linen* Report[1021]. Although this practice was not limited to imports from nonmarket countries, it was a reprehensible practice whereby the Community did not take fully into account the entirety of the prices of some export transactions, namely, those where negative dumping margins were found.

As far as antidumping is concerned, the EC has considered the April 1998 regime as an adequate framework for the Commission to do an analysis against a background of the reform process in China. This framework allows the antidumping authorities to treat Chinese companies as market economy producers on a case-by-case basis and is already

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[1021] European Communities – Anti-Dumping Duties on Imports of Cotton-type Bed Linen From India, WT/DS141/AB/R.

a relaxation of the previously existing trade policy. However, based on a case review it should first of all be concluded that still only a minority of Chinese companies are successful in demonstrating that the criteria for Market Economy Treatment (MET) and Individual Treatment (IT) can be met. For those companies who are refused MET the main reasons are the many restrictions on selling on the domestic market. This, so argues the Commission, has proven to be one of the main tools employed by the Chinese government to protect inefficient domestic industries from competition, and this is more extensive than originally thought. Even where such restrictions are no longer specified in legal documents, the Commission believes they are still found to exist in practice in many instances. It can be argued, however, that as far as the EC authorities do not take into full account the present economic success of Chinese domestic enterprise and legal-related reforms, its antidumping strategies are protectionist.

More Chinese companies should be able to meet the MET criteria in the future. As it is difficult to establish an exact point in the reform process at which countries could be considered for inclusion under the regime currently applied to China, it was a wise move to extend the April 1998 regime to every WTO member. But, it should also be questioned whether it is still necessary to continue special treatment for so-called nonmarket economies *per se*. Most of these countries have profoundly changed and have moved away from the central plan. Besides, the categories of different markets along the historical divide of communism and capitalism are, after all, based on mostly unexamined assumptions, since no country can be identified with a strict market economy or strict planned economy. It seems that the divide between market and planned economies is not based on economic structure anymore, but rather on economic performance and export capacity. The maintenance of the categorisation of the Chinese economy as an overall nonmarket economy is protectionist and is maintained out of fear of heightened Chinese competition. Whether countries, such as China, can indefinitely graduate from nonmarket economy treatment is above all a political decision to be taken by the European Council, amending the relevant legislation. Frankly, there is no satisfactory solution to the problem of pricing production factors in nonmarket economies. And the way these methodologies are now used on transition economies, such as China, may harm the process of market

economic reform, this is so, because retention of this methodology reduces the market access for these countries, for which export is nonetheless absolutely vital to implement further domestic economic reforms. Although, in the opinion of this author, the use of antidumping measures should not be abolished altogether, it should be noted that antidumping is not a preferred method to enforce market access. Antidumping should only be applied if the industries protected prove that, in turn, they are willing to adjust to increasing competition from China.

In anticipation of further Chinese domestic reforms and the end of China's nonmarket economy status, which will have to end at the latest when the time periods in Sections 15 and 16 of the Protocol of Accession have lapsed, this thesis made some recommendations and suggestions for adjusting the European trade instruments.

As far as the antidumping provisions are concerned, it is necessary to examine the consistency of MET and IT and to make some allowances or improvements for a gradual relaxation of the European antidumping regime. First, it would be just to introduce the "bubble of capitalism" or "mix and match" approach so as to use as many data as possible from the nonmarket economy, instead of referring too easily to a third market economy country, or "analogue country". More in particular, it should be allowed to rely on data from companies in the nonmarket economy, which are granted MET, and to apply these data on companies from the same nonmarket economy, which are not eligible for MET. Second, the antidumping authorities should conduct an *ex officio* inquiry, as whether the nonmarket economy producers under investigation deserve MET, instead of demanding claims for such treatment from the producers under investigation. This should definitely be so in expiry review cases, where it should be possible to change the antidumping method used in the original investigation, if in the meantime a market-oriented change in the industry occurred, without question whether a parallel interim review may be needed. Finally, as far as IT is concerned, the EC authorities should automatically award IT to nonmarket economy producers, unless they can prove that circumvention is highly likely. This would reverse the principle that nonmarket economies, as a general rule, are awarded a single country duty rate, and would ease the

burden of proof for nonmarket economy producers, which under the current legislation have to convince the antidumping authorities that they deserve IT. In a couple of years time a similar approach to reverse the burden of proof could work for MET, whereby the EC antidumping authorities would automatically extend MET to Chinese producers, except in circumstances where evidence suggests that serious market distortions still exist. Over time, MET and IT should be considered to be the norm, where the Community institution is seeking to depart from the standard method of calculation, it should state its reasons for doing so in a manner sufficient to enable the courts to exercise its power of review and interested parties to ascertain the circumstances in which the Community antidumping rules were applied. In this regard the recent opinion of Advocate-General Jacobs in *Petrotub* is important[1022]. In overall terms the EU should show restraint in the employment of antidumping measures.

As far as safeguards are concerned, the EC already uses restraint in employing emergency safeguard measures for non-agricultural products. Safeguard action was taken in March 2002 on fifteen steel products, in response to the US safeguard action on steel imports. Notwithstanding the fact that European safeguard actions are very rare, this author would suggest to harmonise the multitude of safeguard provisions and clauses that exist today in EC trade policy instruments. First of all there are safeguard clauses in bilateral trade agreements between the EC and other trading partners, such as China. Secondly, there are the safeguard clauses in several of the EC import regulations. With respect to China in particular, it is important that some of these clauses are not a correct transposition of Article XIX GATT and the relevant provisions of the WTO Agreement on Safeguards, or Article 6 of the Agreement on Textiles and Clothing. They are neither correct transpositions of the relevant sections of the Protocol of Accession and the Working Party Report on the Chinese accession. As a result these clauses should be revised or harmonised. In this context, it would also be useful to negotiate a new bilateral trade and cooperation treaty with China to replace the 1985 bilateral agreement.

[1022] Case C-76/00 P, *Petrotub and Republica v. Council* [2002] ECR (not yet reported). According to this case, the EC antidumping authorities have to state clearly the reasons, for which they wish to use a particular calculation method.

With these suggestions for adjustments of the EC trade policy instruments in mind, it can be concluded that a nonmarket approach *vis-à-vis* China, as approved in the Chinese Protocol of Accession, should be gradually extinguished. The application of special safeguard measures and nonmarket methodologies in antidumping investigations are only a partial response to the insecurity of certain Community industries, and to the balance of trade deficit with China. In the end, the EC needs a liberal trade policy *vis-à-vis* China. Prolonged protectionism would run the risk for the EC of being frozen in existing inefficiencies, whereas it would be better to continue the struggle for competitive strength. Protected industries should realise that they cannot preserve their turf, unless they too face adjustments. The suggested adjustments to the EC trade policy instruments hopefully will make them less conducive to protectionist purposes. Of course, it should not be forgotten that the integration of China in the Multilateral Trading System needs a multi-faceted and dynamic response. In this regard, the response strategy of the EC should be one of many cooperation objectives, which should also encompass non-trade issues, such as education, environment, poverty, labour rights and human rights, because seeking sustainable development is linked to more issues than just trade.

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