



2023

## What Role for the WTO in Disciplining China's State-Dominated Economy?

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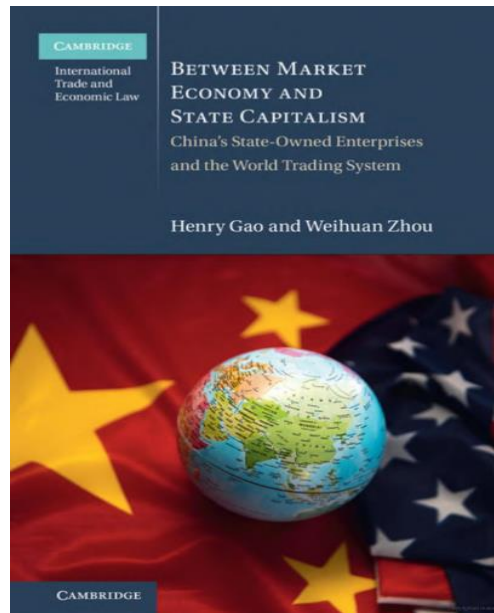
Journal of International Economic Law, Forthcoming.

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## BOOK REVIEW



### What Role for the WTO in Disciplining China's State-Dominated Economy?

**Between Market Economy and State Capitalism: China's State-Owned Enterprises and the World Trading System.** By HENRY GAO and WEIHUAN ZHOU, Cambridge University Press, 2022, ISBN 9781108908795, DOI: <https://doi.org/10.1017/9781108908795>

Reviewed by *Jennifer Hillman*<sup>1</sup>

Is the World Trade Organization (WTO) and its rules-based system capable of addressing the distortions in trade caused by the explosive growth of China's State-Owned Enterprises (SOEs)? If it is, why hasn't it been put to use? If the WTO rules are not up to task, where and how do they need to be changed? Those are the questions that Henry Gao and Weihuan Zhou answer in their thorough and compelling assessment of the current state of China's SOEs, the commitments China made when it joined the WTO and the relevance of the applicable WTO rules, *Between Market Economy and State Capitalism: China's State-Owned Enterprises and the World Trading System*.

The answers to those questions have taken on greater urgency in light of the Trump Administration's view, now largely adopted by the Biden Administration, that if the WTO is incapable of addressing the United States' concerns over China's increasingly non-market,

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Communist Party-dominated economy, then the WTO is not sufficiently valuable to bother investing in or working hard to reform. The answers are all the more important in light of the increasingly accepted view that trade with China is unfair and damaging to the United States.

Gao and Zhou build a solid foundation for addressing these questions, beginning with a reminder of the promises that China made when it joined the WTO and a comprehensive rendition of the evolution in China's approach to SOEs and state control over the economy. In tracing SOE reforms, Gao and Zhou underscore the magnitude of changes from an economy in the 1970s dominated by SOEs that were completely owned, managed and run by the government. As they walk through the implications of the devolution of corporate power and the increasing operational autonomy of SOEs, they also spell out the degree to which these changes were codified in Chinese law or formally adopted at plenum meetings of the Party Congress, with varying degrees of expectations that the changes would become near permanent features of the Chinese economic system. They provide an in-depth assessment of the timing and process for China's pivot from a centrally-planned to a more market-oriented economy that occurred in the run-up to China's accession to the WTO in 2001, with Deng Xiao Ping's ideation of China as a "Socialist Market Economy." They equally help pinpoint the moments, events and timing of China's U-turn away from market-orientation, focusing on the significance of the creation of national champions and of the March 2003 establishment of the State-Owned Assets Supervision and Administration Commission (SASAC) and many of the other elements that led to the establishment of, as Harvard Law scholar Mark Wu put it, "China, Inc."<sup>2</sup>

This detailed examination of the current (and likely future) place of SOEs in the Chinese economy and the Chinese legal system allows Gao and Zhou to explore whether it was the WTO rules themselves, naiveté on the part of those negotiating China's accession to the WTO or blatant backtracking on commitments by China that led to the failure to address the challenge of China's state capitalism to the global trading system. Gao and Zhou seem to place most of the blame at the feet of China and of the members of the WTO who largely failed to use the tools and the rules that were agreed upon when China joined the WTO. Relatively little fault is placed on the negotiators, as Gao and Zhou praise a number of the most critical commitments extracted as part of the accession process. Key among those underscored by the authors are:

*Regarding the Role of SOEs*—commitments ensuring that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations (e.g. price, quality, marketability and availability); commitments that the Government of China would not influence (even indirectly) the commercial purchasing decisions of SOEs or state-invested enterprises in terms of the quantity, price or origin of goods; and a promise that procurement by SOEs would not be carved out of the non-discrimination provisions of GATT

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<sup>2</sup> Wu, Mark, The 'China, Inc.' Challenge to Global Trade Governance (May 13, 2016). Harvard International Law Journal, Vol. 57, 1001-1063 (2016), Harvard Public Law Working Paper No. 16-35, Available at SSRN: <https://ssrn.com/abstract=2779781>

Article III or regarded as subject to the Government Procurement Agreement that China was not a party to.<sup>3</sup>

*Regarding Pricing Distortions*—a commitment to allow prices for traded goods and services in every sector (including sectors dominated by SOEs) to be determined by market forces; transparency commitments to publish the list of goods and services subject to state pricing; commitments that price controls would not be used for the purpose of protecting domestic industries; and acceptance of the use of non-market economy methodologies to calculate anti-dumping duty rates on imports from China.<sup>4</sup>

*Regarding Subsidies*—agreement that subsidies provided to SOEs that were the dominant recipients of such government largesse would be considered specific and therefore subject to the disciplines of the WTO’s Agreement on Subsidies and Countervailing Measures (SCM Agreement); and acceptance of the use of alternative benchmarks by those calculating the levels of countervailing duties applicable to Chinese imports.<sup>5</sup>

*Regarding Trading Rights*—a commitment that by 2004, all enterprises (including foreign enterprises) in China would have the right to trade all goods except for a specific list subject to state trading (grain, vegetable oil, sugar, tobacco, oil, fertilizer, cotton); a commitment that the import purchasing procedures of state trading enterprises would be fully transparent; and a commitment that the Government of China would not take any measures to influence or direct state trading enterprises decisions on the quantity, value or country of origin of goods purchased or sold.<sup>6</sup>

Their elucidation of these commitments woven into a subsequent analysis of the existing WTO rules begs the question: why did these well-thought out provisions fail to curb either the turn back to a state-dominated economy or the explosion of subsidized goods flooding world markets?

For Gao and Zhou, the answer lies in three places.

First is the broad nature of the commitments noted above, which required “significant gap-filling in their interpretation and application.”<sup>7</sup> Their book walks through a number of the key decisions of WTO panels and its Appellate Body that limited the capacity of these provisions to address SOE-related concerns. They note in particular the challenge of enforcement of transparency provisions, given the WTO’s limited mechanisms to induce implementation.<sup>8</sup> But their take-away is that WTO members are not solely reliant on these WTO-plus commitments, as the pre-existing SCM Agreement offers “a more workable mechanism for WTO Members to challenge Chinese industrial subsidies that are essential to its state capitalism.”<sup>9</sup>

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<sup>3</sup> Henry Gao and Weihuan Zhou, *Between Market Economy and State Capitalism: China’s State Owned Enterprises and the World Trading System* (Cambridge University Press, 2023) at 54-56

<sup>4</sup> *Ibid*, at 58-61. Paragraph 9.1 of China’s Protocol of Accession.

<sup>5</sup> *Ibid*, at 61-63.

<sup>6</sup> *Ibid*, at 64-66.

<sup>7</sup> *Ibid*, at 101.

<sup>8</sup> *Ibid*, at 95.

<sup>9</sup> *Ibid*, at 101.

Second, they note that “the WTO does not impose a comprehensive code of conduct on the anti-competitive behavior of *enterprises* including SOEs;” rather it prohibits *governments* from taking measures that undermine specific commitments to expected conditions of competition.<sup>10</sup> For Gao and Zhou, this distinction is an acknowledged limitation in the scope of their book, as they focus on one of the two essential policy responses to the challenges posed by SOEs. Their assessment is of the rules and tools to discipline the behavior and conduct of SOEs, particularly as the products of those SOEs are traded in world markets, rather than on the second (and broader) policy response of seeking competitive neutrality by constraining the privileged position of SOEs through rigorous competition laws. Their optimism on reliance on the WTO is rooted in part in their narrowing of the ambit of the WTO to a primary focus on stopping unfair trade in subsidized goods rather than the broader project of creating sufficient incentives to convince China to turn away from its “Socialist Market Economy” path to become a market economy.

But for Gao and Zhou, the primary reason for the failures “is not the lack of rules to tackle China’s state capitalism, but the lack of utilization of existing rules.”<sup>11</sup> Their book evinces an optimism that the WTO rules on industrial subsidies, coupled with China’s WTO-plus obligations, provide a sufficient defense against the “encroachment of Chinese SOEs beyond its own shores.” They find comfort in the fact that most Chinese subsidies “fall squarely within the ambit” of the WTO’s definition of a financial contribution and, because the favored sectors for state-intervention are spelled out in decisions and documents of the Communist Party, require little investigation to prove the existence of a financial contribution to a specific sector or SOE.<sup>12</sup> They also take issue with the often held view that the Appellate Body’s decision that subsidies are only those provided by a ‘government or public body’ and that a public body ‘must be an entity that possess, exercises or is vested with governmental authority’ created a loophole for subsidies granted through SOEs to circumvent WTO disciplines.<sup>13</sup> In their view, the authority-based approach was softened by a subsequent Appellate Body decision rejecting China’s claim that there must be a particular degree of connection in all cases between an identified government function and the specific financial contribution at issue.<sup>14</sup> As a result, once an entity is found to be a ‘public body’, all its conduct “is *directly* attributable to the government.”<sup>15</sup> When combined with explicit designation of authority to undertake government functions, at least for those SOEs categorized as Public Welfare SOEs, Gao and Zhou conclude that it is easier than previously thought to prove that SOEs are public bodies whose financial contributions are subject to the disciplines of the SCM Agreement.

Gao and Zhou also emphasize the underutilized (and permanent) provision in China’s Protocol of Accession permitting countries to use alternative benchmarks when judging whether a

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<sup>10</sup> Ibid, at 96.

<sup>11</sup> Ibid, at 125.

<sup>12</sup> Ibid, at 105 and 120-21.

<sup>13</sup> Ibid, at 111-14. Appellate Body Report, *United States-Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R, adopted March 25, 2011, paras. 317-18.

<sup>14</sup> Appellate Body Report, *United States—Countervailing Duty Measures on Certain Products from China—Resources in Article 21.5 of the DSU by China*, WT/DS437/AB/RW, adopted 15 August 2019.

<sup>15</sup> See Gao and Zhou, above n 3, at 113.

subsidy has resulted in providing a benefit to its recipient.<sup>16</sup> This provision provides a way around the difficulty of determining a market price in a market so distorted by government intervention as to render the terms and conditions of private transactions unreliable as a benchmark.

In addition, Gao and Zhou move beyond the WTO, exploring the options for addressing the rise of state capitalism under regional trade agreements, with a specific focus on the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CP-TPP) as the agreement providing the most specific rules directed at SOEs.<sup>17</sup> They conclude that the CP-TPP's definition of an SOE—entities 'principally engaged in commercial activities' that are owned or controlled by the government (or those where the government can appoint a majority of the members of the board)—is actually more limiting than the WTO provisions, which cover a wider variety of state entities.<sup>18</sup> With respect to the substantive obligations—to act in accordance with commercial considerations and to comply with most-favored nation (MFN) and national treatment non-discrimination rules—Gao and Zhou note that it remains to be seen whether these provisions, once applied, extend beyond the WTO accession commitment China made that state-owned and state-invested entities would make purchase and sale decisions based solely on commercial considerations. Similarly, with respect to the provisions on non-commercial assistance, the authors conclude that, with the exception of disciplines on services subsidies and enhanced transparency, the CP-TPP does not add substantial constraints beyond the WTO rules applicable to China. And in the area of exceptions and non-conforming measures, Gao and Zhou find that extensive exceptions permitted in the CP-TPP, if applied to China, would result in a substantial *reduction* in current disciplines.

The shortcomings of the SOE provisions in the CP-TPP lead Gao and Zhou back to their basic premise: while not perfect, the combination of existing WTO rules and the WTO-plus provisions in China's protocol of accession remain the best tools in the toolbox to address the rise of state capitalism in China. Their plea is for WTO Members to commence many well-coordinated countervailing duty investigations domestically along with bigger, more systemic challenges at the WTO accompanied by increased utilization of other WTO tools.

The remainder of their book focuses on *how* and *why* the WTO's multilateral tools should be the first best choice of those concerned with the rise of China's state capitalism and the growth of the size, power and reach of its SOEs.

*How?* Gao and Zhou focus on three primary ways to use WTO tools: 1) strategic WTO litigation challenging China's systemic violation of its commitment that prices for traded goods and services would be determined by market forces and that SOEs would make purchase and sale decisions solely on a commercial basis; 2) increased use of unilaterally-imposed, WTO-consistent countervailing duties; and 3) multilateral negotiations to amend both the substantive and the procedural WTO subsidies rules, along with negotiations permitting increased differentiation

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<sup>16</sup> Ibid, at 118-19.

<sup>17</sup> Ibid, at 133-47. Gao and Zhou assess five elements of the CP-TPP's SOE chapter: 1) the definition of SOEs, 2) the substantive obligations, 3) the provisions on non-commercial assistance, 4) transparency, and 5) exceptions and non-conforming measures.

<sup>18</sup> Ibid, at 143.

among countries depending on their level of development. On the litigation front, the authors provide guidance to get around the perceived difficulties in challenging China’s state capitalism and suggest ways in which evidence of subsidies to support either WTO challenges or the imposition of countervailing duties can be more readily obtained in light of the changes they document to China’s SOE practices. Their discussion of negotiating options and priorities recognizes the concerns of countries such as the United States that regard the existing WTO rules as being insufficient, offering specific ideas for how the rules might be “fine-tuned” to be more productive.<sup>19</sup> They also caution against a “gang up against” approach to China, with clubs of like-minded countries agreeing upon rules that are then forced upon China, as doing so will backfire and destroy needed faith by China in multilateralism. They draw hope that China is willing to engage constructively in reform discussion from a number of important recent statements and speeches by Chinese President Xi Jinping.<sup>20</sup>

*Why?* The conclusions in the book and indeed its very premise speak to why a multilateral approach is preferable. First, for Gao and Zhou, unilateral approaches have been demonstrably ineffective. The Trump Administration imposed massive unilateral tariffs on imports from China and negotiated a Phase One deal under which China committed to purchase \$200 billion in additional American exports while the deal “barely touched on systemic issues.”<sup>21</sup> The response from China was little in increased purchases and mostly the imposition of retaliatory tariffs on American imports—a signal that China won’t be bullied into changes to its economic system by the actions of any one WTO member, even one as large as the United States. Second, Gao and Zhou understand China as still desirous of being considered a member in good standing at the WTO and one that complies with rulings issued against it. Third, the authors see a multilateral approach as having the best chance of reining in the harm done in world markets by China’s state capitalism. Finally, Gao and Zhou, as committed multilateralists, see using the WTO early and often as a way to save the WTO in the process—proving to the world that the WTO has an important role to play in taking on the challenges presented by China’s state capitalism and that its dispute settlement system must be fixed to enable it to do so.

In the end, Gao and Zhou present a hopeful account—that the combination of changes making China’s approach to SOEs more transparent and easier to prove, recent developments in WTO jurisprudence, the nascent use of the Multiparty Interim Appeal Arbitration Arrangement (MPIA) with China as a member (but, notably, not the United States) and reform efforts underway in the lead-up to the 13<sup>th</sup> Ministerial Conference in February 2024, means the WTO can and should re-emerge as the best and most effective tool to take on the rise of state capitalism in China. Their book presents a compelling roadmap to follow. Whether their hopeful vision can be realized will depend on WTO members accepting the challenge of using the rules and the tools in place at the WTO now even while working to improve and expand their reach. For the sake of the WTO and its multilateral, rules-based system, let us hope that countries venture down the road suggested.

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<sup>19</sup> Ibid, at 154.

<sup>20</sup> Ibid, at 189.

<sup>21</sup> Ibid, at 186.