

China, Trade and Sustainable Development Series



A Decade in the WTO

Implications for China and Global Trade Governance

Edited by
Ricardo Meléndez-Ortiz, Christophe Bellmann and Shuaihua Cheng



International Centre for Trade
and Sustainable Development

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LIST OF ABBREVIATIONS AND ACRONYMS

ACP	African, Caribbean and Pacific
AD	Anti-dumping
AFT	Aid for Trade
APEC	Asia-Pacific Economic Cooperation
APT	ASEAN Plus Three (China, Japan and South Korea)
ASEAN	Association of Southeast Asian Nations
BRIC	Brazil, Russia, India and China
C-J-K-FTA	China-Japan-Korea Trilateral Free Trade Agreement
CKD/SKD	Completely and semi-knocked down automobile kits
DDA	Doha Development Agenda
DFQF	Duty free, quota free
EAS	East Asia Summit
EC	European Community
ECFA	Economic Cooperation and Framework Agreement
EIA	Environmental Impact Assessment
ETS	Emission trading system
EU	European Union
EVRET	Export VAT rebate and export tax
FAO	Food and Agriculture Organization
FDI	Foreign direct investment
FOCAC	Forum on China-Africa Cooperation
FTAs	Free trade agreements
GATT	General Agreement on Tariffs and Trade
GHG	Greenhouse gases
IMF	International Monetary Fund
ICT	Information and Communication Technology
IPR	Intellectual property rights
LCE	low carbon economy
LDCs	Least-developed countries
MDGs	Millennium Development Goals
MNC	Multinational Corporation
MOFCOM	Ministry of Commerce of the People's Republic of China
NAFTA	North American Free Trade Agreement
NAMA	Non-agricultural market access
NIE	Newly industrialized economies
NIIPA	National Indigenous Innovation Products Accreditation
NME	Non-market economy

NTBs	Non-tariff barriers to trade
ODI	Outward direct investment
OECD	Organisation for Economic Co-operation and Development
PTA	Preferential trade agreements
RTAs	Regional trade agreements
SACU	South African Customs Union
SCM	Subsidies and countervailing measures
SED	Strategic and Economic Dialogue
SEZs	Special economic zones
SIA	Sustainability Impact Assessment
SOE	State-owned enterprises
SPS	Sanitary and phytosanitary measures
SVE	Small, vulnerable economies
TBT	Technical barriers to trade
TPP	Trans-Pacific Partnership
TRIMS	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade Related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNFCCC	United Nations Framework Convention on Climate Change
VAT	Value-added tax
WTO	World Trade Organization

FOREWORD

China's 10 years of membership in the WTO has taken place against a backdrop of dynamic change in the world economy. Indeed, China's participation in the WTO and the implications of its membership have both been key factors in that change. China's membership today is as essential for the WTO as it is for China.

The difficulties in closing the Doha Round are related to the challenges of managing the tension brought about by change - including transitioning to a world regime on trade that fully involves China, other emerging economies and the underlying shifts in growth centres and new forms of organization of production.

Moving onward at the WTO requires effective fine-tuning and resolution of the adjustment turbulence currently affecting the economic and social fabric in the United States of America and Europe. It will also require nimble but enabling responses from the international community to China's efforts to juggle and rebalance development among regions and sectors, both rural and urban, and to consolidate social policies and institutions.

The implementation of the 12th five-year plan may be a game-changer. Once the economic and developmental and environmental objectives set in the plan are achieved by 2016, the world may be in for yet more change in the global economy and China's participation therein.

The current economic governance system, with its trade policy tools, was conceived at a time when the problem to be solved was "poverty in the midst of potential plenty" to quote James Meade (Meade, J.E. 1937. *Economic Analysis and Policy*). Beyond the short term, looking at demographics and trends in consumption and demand, the world will be entering into uncharted waters.

The hope is that the international community will act collectively, through cooperation, guided by a "command of conscience seasoned by a rational examination of consequences", paraphrasing Professor Wilson at Harvard. A sustainable future will require robust and effective governance regimes. China's participation in crafting the evolution of the trade regime in the next 10 years will be as critical as it has been over the past 10 years.

It is in this context that the ICTSD China Programme took this initiative to invite key policymakers and researchers to prepare think pieces on the implications of WTO membership for China and global trade governance. The authors participated in a dialogue entitled "A Decade in the WTO: Implications for China and Global Trade Governance" held on 29 June 2011 in Geneva, organized by the ICTSD in partnership with the Friedrich-Ebert-Stiftung Geneva Office and the China Society for WTO Studies.

ICTSD's China Initiative is aimed at facilitating dialogue and research with a view to leveraging China's constructive role in global economic governance for the purpose of sustainable development.

This book is composed of four parts. It begins with an insightful overview given by Xiaozhun Yi and Harsha V. Singh. Yi highlights the profound impact of China's embrace of WTO principles of non-discrimination, transparency and rule of law on the modernization of its economy and society. Yi also shares his thoughts about China's strategies to develop a consumption-driven economy and foster shared vision with other WTO members. Singh puts China's accession to the WTO into a broader context and stresses the emergence of a new global significance of China after the financial and economic crisis in 2009. In his paper, Singh argues China should and is able to take the responsibility of strengthening multilateral institutions and contributing to world peace and common prosperity while building a modern China.

In the second part, authors “zoomed in” and looked into implications of China’s membership for the WTO. Paul Blustein reviews China’s involvement in the Doha Round with clear evidence and anecdotes. His paper argues it was not China that blocked the Doha negotiations from reaching a consensus in the summer of 2008; however, China could offer more in the latter stage of the negotiations and should take greater initiative and realize that much of its future prosperity depends on the health of the WTO.

Zhenyu Sun is focused on China’s participation in non-Doha areas, including China’s efforts to implement its commitment and obligation, China’s strategy to tackle textiles and Article 31 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), and criticisms from other WTO members.

Henry Gao addresses specifically China’s role in the WTO dispute settlement system in the past decade and explains how and why China has turned from a passive rule-taker to an active rule-maker.

Razeen Sally gives an overview of China as the driving force of free-trade agreements (FTAs) throughout Asia. He argues that China’s FTAs are very “light”, as they rarely go beyond tariffs and hardly touch on barriers to investments, and China is interested in foreign policy and asserting its power, not necessarily motivated by commercial considerations.

Scott Kennedy describes contrasting perceptions taken by Chinese and westerners about the status of China after its 10 years in the WTO. China still sees itself as a developing country that can exert quiet leadership in Geneva but that must keep its focus on solving domestic economic challenges. Western countries would like China to take on a role and be more open to concessions that are consistent with its growing economic strength and dynamism.

In the third part, China’s trade relations with the US, Africa, least-development countries (LDCs) and Brazil are discussed, as examples of its bilateral dynamics. Gary Hufbauer and Jared Woollacott elaborate three main tensions in Sino-US trade and economic relations, namely widening imbalance, deepening dependence and dispute intensity. The authors argue the main role for the WTO, as between China and the US, will be its role as home for the dispute settlement mechanism and handling future cases concentrated on the rough edges of the Chinese brand of capitalism. As for massive trade imbalances between China and the US, these should be resolved by a combination of currency (renminbi) appreciation, fiscal discipline in the US, and consumption spending in China.

In his article, Faizel Ismail argues that Sino-Africa trade has increased Africa’s leverage on global governance, as China’s participation in the global system has added to the negotiating power of developing countries. The challenge remains that China now needs to rebalance its trade patterns with African countries to support these countries in the development of their high value-added goods. He suggests that, otherwise the China-Africa trade pattern will fall to the same fate as that between Europe and Africa.

Debapriya Bhattacharya reviews the implications of China’s accession to the WTO for other developing countries, pointing, in particular, to two areas. In the goods and services markets, there will be increased competition from Chinese exporters in the world market as well as increased export opportunities in China. In the international capital market, competition for foreign direct investment (FDI) is likely to intensify as the Chinese market becomes more open to foreign investment and further diverts investment away from other developing countries. In general, industrial countries and the more advanced developing countries in Asia gain from China’s accession to the WTO, while the less advanced developing countries tend to lose, although most only marginally. In his paper, Bhattacharya suggests fuller implementation of duty-free, quota-free (DFQF) access to LDCs by China, and the need to change

the structure of exports from the LDCs to China in favour of more manufactured products, which could be promoted by well-oriented new Chinese investment.

Roberto Carvalho de Azevedo describes that the Sino-Brazil bilateral trade pattern is marked by Brazilian exports of commodities and imports of industrial goods, especially machinery, equipment and electronics. Such a trade pattern has raised concerns from the Brazilian side, particularly the undermining of Brazilian industrial competitiveness. Transition towards more balanced trade can certainly be bumpy and will require smooth negotiations, the author pointed out.

The fourth part of this collection discusses what comes next. Xinkui Wang argued that in the aftermath of the financial crisis, the world economy and trade will have to be faced with competition and cooperation at the same time, a situation of both confrontation and interdependence. Therefore, the WTO must adapt to the new landscape of global production and the new picture of global trade. It must be able to push forward trade liberalization and provide new trading rules.

Jean-Pierre Lehmann gives an analysis of the disconnect between the global market and global trade governance and argues that a dysfunctional multilateral system of world trade is likely to emerge in the short- and medium-term future, if the trust issues of trade negotiations cannot be solved. If Chinese leaders can go beyond the rhetoric of harmonious world (*hexie shijie*) to make it a reality - and of course other societies are prepared to adhere to these principles, the 2021 *harmony scenario* will materialize.

Tao Hu, Jun Pang and Lili Wang give an overview of the huge environmental costs embodied in China's foreign trade and provide a framework of environmental measurement of balance of trade accounting to estimate such costs. When goods are exported to other countries, the pollution remains in China, which becomes an environmental subsidy to the production of traded goods. The possible reasons for the environmental deficits are the structure of trade, inefficiency of traded goods, and larger scales of trade. Unless the WTO allows China to take an even more stringent strategy of green trade, the authors argue, the current trend of pollution is not likely to reverse.

Xin Wang addresses the issue of how China can introduce market-based instruments to contribute to consolidating international efforts for addressing climate change. He suggests the use of an explicit export carbon price in China as a transitional measure until domestic carbon prices reach an internationally comparable level.

In the last article, Shuaihua Cheng discusses three key sustainability challenges China may be faced with for a decade ahead, i.e. domestic institutional reforms, tensions between trade and pollution, and "fear of China". He suggests that institutional backwardness shall be addressed such as through non-discriminatory treatment among state-owned enterprises (SOEs) and private firms. He then discusses how domestic policies and international rules can be coordinated to undo and prevent environmental pollution behind the soaring exports. In his paper, Cheng also summarizes international debates about the negative impacts of China's trade growth and suggests China take more international-development-friendly policy tools for a sustainable common future.

I hope you will enjoy this reading and attend this joint exercise to provide intellectual support for closer cross-boundary cooperation in addressing systemic and emerging opportunities and challenges related to China, governance and sustainable development.



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**PART I:
IMPLICATIONS FOR CHINA AND GLOBAL TRADE**

1. A DECADE IN THE WTO, A DECADE OF SHARED DEVELOPMENT

Xiaozhun Yi

Permanent Mission of China to the WTO

In the history of the multilateral trading system, 10-year is a relatively short time. However, the last ten years is a significant period for China. The country has transformed from an observer gazing from the outside into a player sitting in the room. More importantly, it is also a period that has seen ever greater deepening and strengthening of China's reform and opening.

During these 10 years, the Chinese economy grew rapidly and brought tangible benefits to the Chinese people. It also injected strong impetus to the global economy and offered chances for the rest of the world.

- China's GDP growth rate averaged 10.5 percent annually, almost quadrupling the size of the economy from USD 1.3 trillion to USD 4.98 trillion, upgrading its ranking from the sixth to the second-largest economy in the world.
- Household income increased from about USD 800 to USD 3,300, marking an annual growth of 10 percent. More than 200 million people were successfully lifted out of poverty. And each year, 10.4 percent more rural people have been urbanized.
- China has also grown from the sixth to the second largest trading country in the world. Its imports have increased by nearly five-fold over the past 10 years, not only greatly diversifying domestic consumption, but also creating enormous job opportunities for others. In 2010, China became the largest import destination for Australia, Brazil, Japan and South Africa, the second largest for the European Union (EU) and the third largest for the US. Between 2000 and 2009, China's imports from the LDCs increased 24 percent annually. Furthermore, since 2008, China has become the largest export destination of the LDCs, absorbing roughly 23 percent of their total exports.

- On trade in services, China's exports and imports stood at USD 170 billion and USD 192 billion, respectively, in 2010, ranking as the fourth largest exporter and third largest importer of services in the world.
- The accumulated utilized FDI exceeded USD 1 trillion, and 34,700 new foreign enterprises have been set up in China. Almost half of China's exports are contributed by foreign-funded enterprises.
- Under the "Going Global" strategy, China's accumulated overseas investment has reached USD 300 billion. These outgoing investments have brought new jobs, greater production capacity and up-to-date technologies to the recipient countries, mostly developing ones.

To contribute toward the common development objective, China has been actively participating in the South-South cooperation, such as the WTO Aid-for-Trade (AFT) initiative, to enhance the LDCs' capabilities in engaging in global trade. Starting from July 2010, China began to provide DFQF treatment to the LDCs at 60 percent in terms of product coverage and 98.2 percent in terms of the LDCs' export value to China. Moreover, China is ready to increase that product coverage to 95 percent¹ in a few years.

During these 10 years, the Chinese economy grew rapidly and brought tangible benefits to the Chinese people. It also injected strong impetus to the global economy and offered chances for the rest of the world.

In light of the above, the most profound impact brought by China's accession is that the country has now fully embraced the rule-based spirit upheld by the WTO. Concepts, such as non-discrimination, transparency and rule of law are no longer trade jargons, but common words for

¹ At the G20 Cannes Summit this November, Chinese President Hu Jintao announced that China would further open its market to the LDCs by extending DFQF treatment to 97% of total tariff lines in the next few years.

The most profound impact brought by China's accession is that the country has now fully embraced the rule-based spirit upheld by the WTO. Concepts, such as non-discrimination, transparency and rule of law are no longer trade jargon, but common words for the general public.

the general public. It is by this shift in mindset that China has successfully deepened its market-oriented reform, embraced a more predictable trade regime and fostered a more investment-friendly environment. It is by the guidance of this spirit that China has abolished, revised and promulgated more than 3,000 laws and regulations at the central government level and 190,000 at the local government level, the largest-ever legislative revamp in history to establish a WTO-consistent legal system.

These achievements and contributions would not have been possible without the support of the multilateral trading system. It has offered an institutional guarantee to shared development both for China and the rest of the world. In the wake of the global financial crisis, we have witnessed the indispensable role that the WTO plays in curbing protectionism. We believe that it will play an even more important role in safeguarding the smooth recovery of the world economy. Now, it is clear to all that we are at the most critical moment in the history of the multilateral trading system. Members are collectively working toward a fruitful early harvest, focusing on core concerns of the LDCs by the 8th Ministerial Conference in

December. We must also keep pushing for the successful conclusion of the Doha Development Agenda (DDA) that is development-oriented at the earliest date possible. At this important juncture, China remains determined and ready to work constructively to achieve these objectives.

Looking forward, China shall remain fully committed to continuing its course of reform and opening. We are aware of the many daunting challenges ahead. Meanwhile, we also firmly believe that, only through further reform and opening, could we face up to and overcome these challenges.

In the future, we will shift to a consumption-driven economy, which means more demand for imported products and technologies. It is envisaged that our imports will be further doubled in five years.

We will encourage more Chinese enterprises to "go out", to bring capital, jobs and growth to the host counties, especially developing ones. In five to six years, China's overseas investment is expected to reach the same level as its inbound FDI.

China will increase its trade with other developing nations, striving to build a "Southern Silk Road" in the future. Meanwhile, China is ready to provide more aid to the LDCs through the South-South cooperation.

The past 10 years have witnessed shared development between China and the rest of the world. In the coming decades, China will remain open, and the rest of the world can benefit.

2. WTO MEMBERSHIP: IMPACT ON CHINA AND GLOBAL TRADE

Harsha V. Singh

World Trade Organization

Recently, I came across an interesting quotation from Confucius, that: “*Everyone eats and drinks; yet only few appreciate the taste of food*”. For me, this wise statement shows the general prevalence of our limited perception when we are actually participating in any important event, including epoch-changing episodes whose significance becomes clearer only to future historians.

Three such turning points in global history have occurred in the last 30-some years, involving China: first, the opening up and the adoption of a market-economic approach by China in 1978; second, China’s accession to the WTO in December 2001; and, third, the emergence of a new global significance of China after the financial and economic crisis in 2009. Thus, today in discussing China’s WTO membership, we are actually looking at an epoch-changing event.

On 11 December 2001, China officially became the 143rd Member of the WTO. One of the 23 original signatories of the GATT in 1947, China soon left the system. In 2001, China was re-joining the multilateral trading system after over half a century, following about a decade and a half of intense and onerous accession negotiations. China accepted the tough negotiation conditions as it realized the benefits of WTO Membership for growth and domestic reform. As mentioned in a recent Article in the *Asian Development Review* by Quingqing Chen et. al., this

was partly due to the belief of the PRC’s leaders -- Premier Zhu Rongji believed that WTO membership was an agent for reform, as the domestic sectors would be exposed to substantial foreign competition and investment. It could bring about administrative and governance reforms that would instill confidence among domestic and international investors, encourage innovative small- and medium-sized enterprises to enter the PRC market, and facilitate dynamic and globally competitive businesses.

Following China’s accession to the WTO, the country’s growth accelerated, which transformed the economy and enabled China to reduce poverty by a historically unprecedented extent. Open markets and international trade played a substantial role in this transformation. For a growing China to manage the vast changes required, it was important to have a stable international regime with open and predictable international markets, within a system with mechanisms to reduce trade tensions, namely the WTO system.

By 2010, the merchandise exports and imports of China grew to reach almost six times their respective levels in 2001. From being the sixth largest merchandise exporter and importer in 2001, China is now the largest exporter and the second largest importer in 2010. It is a major global presence also in the area of commercial services.

This experience was accompanied by a diversification of China’s trade relations. Compared with 2001, China’s share of both merchandise exports and imports in 2010 to/from the US, EU (27) and Japan has declined by about 10 percentage points. This reflects more widespread trade relations providing potentially greater economic stability to all concerned. China’s large and growing economic presence has changed the nature and content of economic dialogue, and has:

- given rise to an additional growth pole in the world,
- served as an aspirational model for others,
- added greater weight in international discussions and negotiations to issues conventionally associated with developing countries, and thus
- provided the beginnings of questioning the prominence of erstwhile positions of power in international institutions.

Those main players need to develop ways of getting greater and more effective engagement, strengthening the decision-making process to get tangible results so that the multilateral trading system, which is a crucial public good, can be improved and stays ever more relevant.

For China, implementing the WTO accession conditions involved major market opening, greater transparency through the WTO notifications and committee process, and more intensive engagement with the international community.

In the period up to 2001, when China was negotiating its WTO accession, its average tariff fell from about 43 percent to about 15 percent. In 2001, China bound its tariffs under the WTO, with its simple average final bound tariff at 10 percent. It made extensive commitments for the non-tariff regime; its services commitments are broader than most Uruguay Round participants; and it has made among the largest number of transparency-related WTO notifications.

China's participation in the WTO has been evolving, from a focus on being more reticent but learning about the process, to one of much more active participation. The focus on learning about the process and systemic interest can be seen for example from the fact that China has been the most frequent third party in WTO disputes, being a third party in 79 disputes.

Just as the world considers China's economic prowess differently after the economic crisis, we have seen an emergence of a more active China in the multilateral trading system. This will imply more intense engagement to address the concerns and important emerging issues emphasized by various WTO Members.

What about the rest of the world and international trade? China is a key reason the centre of gravity of economic activity has started shifting toward Asia, and for a change in the global power structure. Since China's growth has also

been accompanied by growth in its science and technology base, the world has seen the emergence of new standards for products and technologies, for example, in telecom and in solar technologies. Over time, we have seen businesses not just locating in China, but also developing products and techniques to better suit the Chinese markets. Production processes have adapted to take advantage of supply chain opportunities, hastening the emergence of many new value chains.

The impact of China's growth, both directly and indirectly, has encouraged other developing countries to focus on international trade for their development opportunities. This has meant a relatively faster growth of south-south trade. The strong demand for natural resources has changed the potential pattern of international trade and increased the importance in global international relations of economies supplying natural resources. A number of them also seek much fairer rules in the multilateral trading system, and over time these concerns will only become stronger. There is also a greater felt need for technical assistance and AFT so that the poorer countries can benefit from the international trading system. The technical assistance mechanisms within the multilateral institutions help develop systemic synergies, and economically stronger nations, including China, need to give them greater emphasis.

With the developments I have just described, we have seen the emergence of more intricate trade relations, which involve several countries, interests, and multiple goods and services. These developments have also linked us all deeply together, showing the crucial role of good global governance for addressing our increasingly common concern, because:

1. recognizing the greater opportunities through international trade, many countries now look more closely at others' policies affecting international trade. They also expect others to contribute much more in terms of taking forward the process of augmenting trade opportunities,

2. we need to address the difficulties that have arisen because of the changing power structure and resistance to making adjustments to deal with dynamic product cycles that normally determine trade patterns,
3. countries have started focusing on factors outside the conventional set of policy measures associated with trade policy,
4. employment, environment, food prices and fairness in international trade regime are among the factors that will increasingly arise in the process of global governance of international trade, and,
5. while trade negotiations are normally based more on local and limited production concerns, trade is increasingly taking place through investment linkages or through technological changes and inter-linked value chains that span across nations.

These factors are partly responsible for the stalemate in the present Doha Round, which has progressed considerably and has already placed a lot on the table. The focus instead is on getting more through FTAs. However, FTAs will not deal with a number of concerns that only the Doha Round can address. Moreover, in an era of supply chains, FTAs only partially cover the chain and thus add further complexity. The diverse rules of origins create difficulties, especially for small and medium enterprises. Ultimately, special efforts would be required to multilateralize their main disciplines. For that we would need to keep the multilateral process

strong, and getting a positive result in the Doha Round is part of that exercise.

The existing several gaps and pressure points have implications for the main players in the global system. They need to develop ways of getting greater and more effective engagement, strengthening the decision-making process to get tangible results so that the multilateral trading system, which is a crucial public good, can be improved and stays ever more relevant. This is required as soon as possible, because world trade and investment will continue to grow within the prevalent system with non-level playing fields in several areas that need to be addressed through multilateral negotiations, such as the Doha Round. If more combined and considered attention is not given, global developments have a major potential for generating further tensions over time, eroding the value of the system which has made possible the major transformations that we have seen in China and will hopefully be witnessing for several others as we go through the 21st century.

There is a famous Chinese saying (qian li zhi xing, shi yu zu xia), meaning “*Any journey of thousands of miles starts with the first step*”. The 15 years of WTO accession negotiations was a long journey. China completed it successfully. The Chinese people are now on an even longer journey of building a modern China that also strengthens multilateral institutions and contributes to world peace and common prosperity. I wish China, and all of us, success in achieving these important objectives.

PART II:

**HOW HAS CHINA INFLUENCED THE WTO AS AN
INSTITUTION?**

3. CHINA'S IMPACT ON THE DOHA ROUND

Paul Blustein

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In assessing China's role in the Doha Round, two seemingly contradictory statements can be made, depending on how the issue is framed. One way of looking at the issue is to ask whether China's behaviour at key meetings of trade ministers bears a substantial portion of blame for the deadlock that has befallen the negotiations; the answer that I draw from my research is, "No". From another standpoint, however, a more subjective question can be asked: "Should China have been significantly more forthcoming, and should it now offer major new concessions to keep the Round from failure?" My answer to that question is, "Yes".

Inconsistent though those assertions may appear at first glance, they are not, because China's role in the Round can, and should, be examined from different levels.

3.1 China at the Negotiating Table

The simplest and most straightforward way to look at the issue is to consider what Chinese representatives actually did at the negotiating table, especially at WTO ministerial meetings that collapsed. On this score, the evidence strongly suggests that Beijing deserves little if any condemnation—and certainly less than some of the other major WTO Members.

In the early stages of the Round, China took a rather passive role, which was understandable. The Chinese were "new kids on the block" in the WTO, and they also felt—with some justification—that they had made a massive number of concessions just to gain admission. It must be recalled that the market-opening commitments China accepted as the price of WTO membership went far beyond those required of any other new entrant. Moreover, the process was arduous and sometimes even humiliating—the most notable example being the trip that then-Premier Zhu Rongji took to Washington in April 1999, thinking

that a deal was at hand, only to have his hopes dashed by US President Bill Clinton. Although a case can be made that, in retrospect, China should have been asked to do even more, the Chinese view was that, if anything, Beijing had kowtowed all too often to US demands.

In any case, China was not a key player, and had few major interests at stake in the disputes that plagued the Round in its first few years. That is apparent from a brief look back at the major meetings that ended in breakdowns. At the September 2003 ministerial in Cancun, for example, the primary issues dividing WTO Members concerned the so-called Singapore Issues (a proposal to extend WTO rules to matters, such as corporate investment and government procurement), and US cotton subsidies. Although China held views on those matters, it was other developing countries that led the fight against the Singapore Issues, and sub-Saharan Africa that was the aggrieved party on cotton subsidies.

The next big meeting to fall apart, a gathering of ministers in Geneva in the summer of 2006, mainly involved a fight between the US and the EU regarding the openness of Europe's agriculture markets. A failed effort to patch things up in Potsdam in 2007 did not even include Chinese representatives, only ministers from the "G-4" (Brazil, the EU, India, and the US) were there.

The one meeting at which China came under fire for its conduct was the tumultuous gathering of ministers in Geneva in July 2008, which ended with no agreement after nine days (and almost as many long nights) of haggling. A number of media accounts of the meeting depicted China as a key spoiler, together with India and (in some reports at least) the US.² Therefore, this episode merits in-depth scrutiny.

3.2 The July 2008 Meeting

A brief recapping of events is necessary to set the stage. With the negotiations making no progress in the first several days, WTO Director-General Pascal Lamy took matters into his own hands on

2 "China Casts a Dismaying Veto on Global Free Trade", *The Washington Post*, July 30, 2008.

the fifth day, a Friday, by presenting a one-page outline of terms that he believed stood a chance of winning acceptance among an inner circle of major WTO Members; his hope was that if they agreed, the rest of the membership would go along, and other disputes would also be settled. This inner circle, dubbed the “G-7”, included China’s trade minister Chen Deming—a historic first for the Chinese. After a flurry of excitement, however, the Lamy proposal began to come unstuck amid bickering among the G-7. The U S publicly accused China of having reneged on an initial acceptance of the deal, and the media picked up the cudgels. “China wanted a seat at the big kids’ table”, the *International Herald Tribune* quoted one anonymous US official as saying. “They got it, they agreed to the text, and now they are trying to walk that text back”.³

This was an extraordinarily serious accusation—not only of obstructionism, but also of bad faith. Was it merited? The following account suggests not, based on interviews with numerous participants in the meeting from all the G-7 and members of the WTO Secretariat, some of whom furnished notes they had taken.⁴

When Lamy made his proposal to the G-7, Minister Chen complained about a number of its provisions (as did the others), and expressed reservations about some wording he found difficult to understand. However, he did not reject it outright; the only participant who did so was Kamal Nath, Chen’s Indian counterpart. Even though India’s opposition alone could have killed the proposal, given the WTO’s tradition of consensus decision-making, the hope was that if the Indians could be isolated, they might be pressured eventually into going along. Susan Schwab, the US Trade Representative, also expressed reservations but said, according to notes of the meeting: “As a package, I can do this...pull one thread and it all unravels. We should be close enough on the basis of this paper to close this”.

As the meeting headed into the weekend of July 26-27, however, representatives of the US private

sector—lobbyists and association executives from both industry and farm groups—were up in arms, because they felt the Lamy package simply did not offer sufficient opening of foreign markets to US goods. Many of them gathered on Saturday morning in the lobby of a landmark Geneva hotel, where the prevailing sentiment was hope for rejection of the Lamy package. As one of them put it, “The best thing now would be for this whole thing to blow up”. They conveyed that message to powerful members of the US Congress, most notably Sen. Max Baucus (D-Mont.), the chairman of the Senate Finance Committee, who in turn phoned Schwab from Washington to let her know that, as it stood, the deal stood no chance of winning congressional approval. Schwab’s response was that if she were given some time, she might be able to improve on the terms and make it acceptable.

During the weekend, Schwab dispatched a negotiating team to the Chinese mission to the WTO—because the prospect of greater openness in the massive Chinese market, she believed, might make the difference between a deal that could fly and one that could not. Accordingly, her deputies asked that China promise to cut its tariffs on cotton (or more precisely, to promise not to put cotton on a list of products that would be exempt from deep tariff cuts). They also asked for another couple of concessions, the most politically sensitive of which was a request for China to pledge that it would enter into negotiations aimed at eliminating tariffs in certain industrial sectors, such as chemicals and machinery. These actions were not required under the Lamy text; they were, in effect, sweeteners that Schwab needed to sell the deal back home.

The requests were denied. Chinese negotiators pointed out that their country’s cotton farmers were overwhelmingly poor and mostly from ethnic Muslim minorities living in the northwest; in other words, leaving them exposed to foreign competition was politically unacceptable. The request regarding industrial tariffs was also

3 “U.S. blasts China and India over trade talks”, *International Herald Tribune*, July 29, 2008.

4 Paul Blustein, *Misadventures of the Most Favored Nations: Clashing Egos, Inflated Ambitions, and the Great Shambles of the World Trade System* (New York: PublicAffairs, 2009), Chapter 13; Blustein, “The Nine-Day Misadventure of the Most Favored Nations: How the WTO’s Doha Round Negotiations Went Awry in July 2008”, the Brookings Institution, http://www.brookings.edu/~media/Files/rc/articles/2008/1205_trade_blustein/1205_trade_blustein.pdf.

denied, because China's chemical and machinery industries had already endured steep tariff reductions as the price of entry into the WTO in 2001, and they had been promised that they would not have to endure such reductions in their barriers again.

As a result, virtually all hope was lost of generating enthusiasm among US farm and industry groups. After that point, the US negotiating team—which had at first seemed eager to strike a deal—took a much tougher stance toward various compromise proposals that were put forward in an effort to bring all parties together.

Could China have saved the meeting by agreeing to the concessions that the US was seeking? Perhaps, but it is important to recognize that those concessions were “extras”, not required by the terms of the Lamy proposal. In other words, the US had no moral standing to condemn China for “walking away” from that proposal. If anything, the Americans themselves could plausibly be accused of having touted the Lamy proposal and then walking away by demanding extra concessions from China as part of the deal.

3.3 The Impact of China's Prowess in Export Markets

The above explains my conclusion that China does not deserve anything like the lion's share of the blame for any of the several failures at ministerial meetings during the Doha Round. Nonetheless, that is much too narrow a standard for assessing China's role in the Round. The issue must be examined at a broader level.

It would be no exaggeration to say that the most important impact China has had on the Doha Round has not been at the negotiating table, but rather on the factory floor—that is, the growth in competitiveness that fuelled a breathtaking surge in China's exports of manufactured goods. In 2001, when China joined the WTO and the Doha Round was launched, Chinese merchandise exports totalled USD 266 billion; in 2010, the total was USD 1.6 trillion. China's WTO membership made many foreign firms much more comfortable

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about investing in the country and using it as a prime base for their manufacturing operations. That has been wonderful for China, and the accompanying rise in Chinese living standards has been a boon for the whole world. However, it has not been good for the Doha Round.

On the contrary, China's extraordinary success in export markets has weighed on all major parties in the negotiations—most notably Beijing's ostensible allies in the developing world, such as Brazil, Indonesia and South Africa. It has rendered them much more resistant than they would otherwise be to opening their markets to manufactured goods—and their reluctance to open their markets has become one of the Round's most serious stumbling blocks.

This fear-of-China factor was at times the subject of open and frank discussion during key negotiations. At the 2007 meeting in Potsdam, for example, Celso Amorim, the Brazilian foreign minister, responded to a demand from his US and EU counterparts to lower tariffs on industrial goods in countries like his, saying: “We cannot even think of doing the numbers by the US and EU” because that would risk “deindustrializing Brazil”. Brazil, he argued, needed to keep “policy space for dealing with China”.⁵

One of the most controversial aspects of this problem, of course, is China's exchange rate policy, which many economists cite as a prime reason for the success of Chinese products in export markets. In fact, a provocative policy brief published in May 2011 by the Peterson Institute in Washington makes the case that the undervalued renminbi is the main reason for the stalemate in the Doha Round because of the impact it has on the willingness of developing countries to lower their tariffs on manufactured goods.⁶

5 Blustein, *Misadventures of the Most Favored Nations*, Chapter 11.

This argument is overstated, in my view. It is unlikely that Brazil, Indonesia, South Africa and other countries are concerned about Chinese competition solely or even mainly because of the exchange rate issue. Even so, there should be no question that concern about Chinese competition is the single most important reason why these countries are taking a hard line in the Doha talks on manufactured goods. The Peterson Institute policy brief contains some striking figures showing how the growth in import penetration of Chinese products in many countries has been particularly rapid in sectors where tariff protection is highest. Obviously, that will render emerging-market countries much less willing than they would otherwise be to reduce manufacturing tariffs, because they will be understandably worried that some of their domestic industries will be completely wiped out.

3.4 Conclusion: China Should Do More

The above facts lead me to draw the following conclusion. Even though it may be unfair to fault Chinese negotiators for having caused the failures at the Doha Round's key meetings, China should have done more to foster the Round's success, especially in the latter stages of the negotiations. In support of this conclusion are two arguments—and though these points are not universally accepted, Chinese policymakers would be foolish to ignore them.

First, consider what would happen if, as now appears quite likely, Doha fails or ends in a “Doha Lite” outcome that is widely perceived as only marginally better than a total breakdown. Opinions differ, but in my view, the consequences for the WTO will be extremely serious. The institution would not fall to pieces overnight; but, if the WTO appears to have no future as a negotiating forum, its authority as a rule-enforcing, dispute-settling body would erode. Which country depends more than just about any other on a healthy WTO promoting a strong, multilateral rules-based system? The answer is self-evident: it is China.

Second, many prominent observers are increasingly questioning whether letting China into the WTO was a good idea—or to put it another way, whether China is “killing the WTO”.⁷ These observers cite factors, such as China's indigenous innovation programme and the subsidies that Beijing provides some of its industries through its opaque arrangements between industry and local governments. Some of this criticism is hypocritical; after all, Westerners are in a poor position to complain about subsidies to Chinese industries after the huge bailouts that the US and European countries gave to some of their leading auto companies during the financial crisis. Still, some of the concerns that are being raised about China's behavior are legitimate. One particularly disturbing episode was Beijing's suspension of exports of rare-earth elements to Japan during the 2010 dispute over a chain of small islands. If a major country, such as China, can use its leverage to declare economic warfare on another country over so minor a geopolitical issue, the survivability of a rules-based trading system will be in doubt.

Many Chinese consider these concerns misplaced and unfair, as do many trade experts in Europe and the US. Even so, the result is further erosion of confidence in the WTO, and that is a phenomenon that Chinese policymakers would be unwise to disregard. It is manifestly in China's national interest to take all possible steps to counter the dangers that threaten to undermine the WTO's authority. For this reason, China should have done more to give the Doha Round a better chance of success and should consider doing more now that the Round appears to be reaching its terminal stage.

China is hardly unique in this regard; all countries, big and small, could have been more forthcoming during the Round, and all stand to lose a great deal if the Round fails and the WTO is weakened. Yet, China, more so than any other, will find reason for regret that it did not take greater initiative to shore up an institution upon which much of its prosperity has been built, and on which much of its future prosperity depends.

6 Aaditya Mattoo, Francis Ng, and Arvind Subramanian, “The Elephant in the Green Room: China in the Doha Round”, Policy Brief 11-3, Peterson Institute for International Economics, May 2011, <http://www.piie.com/publications/interstitial.cfm?ResearchID=1830>.

7 Susan Ariel Aaronson, “Is China Killing the WTO?” *The International Economy*, Winter 2010; see also a blog entry by Claude Barfield, “Should China be in the WTO?” <http://blog.american.com/2011/03/should-china-be-in-the-wto/>.

4. CHINA'S EXPERIENCE OF 10 YEARS IN THE WTO

Zhenyu Sun

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Ten years have passed since China joined the WTO. What impact has China's membership in the WTO had on the organization and its other Members? What challenges are China and the other members facing now? What are the future prospects for China and the WTO over the next 10 years? These questions are in many people's minds, and I have been trying to find some answers since I left Geneva at the end of last year.

Many people will remember the mixture of moods that resulted from the news of China's accession to the WTO. The agreement on China's accession is a formidable document. It is the result of tough negotiations that took place over 15 years. In the document, there are clearly-defined rights and obligations for China. However, there are also quite a few WTO-plus requirements. On top of that, there are articles of a discriminatory nature that some academics in China felt were embarrassing; they criticized the Chinese government for accepting them. There was also concern, particularly among people in China's agricultural and automobile sectors about their ability to compete with imported agricultural products and automobiles.

China was not the only country that was under challenge by its accession. Many of its trading partners had the same concerns about China's accession. How would China's competitive edge in some sectors affect their own exports? Would China implement its commitments? Would China observe the rules and regulations of the WTO? What role would China play in fighting trade protectionism? How would China participate in the Doha Round negotiations? These were common questions people kept asking at the time.

After 10 years as a member in the WTO, we are glad to see that China's membership has created a win-win situation for all. Generally speaking,

China has integrated into the international community successfully, and China's role in the WTO has been positive. All members have gained through increased trade and economic development.

4.1 What Has China Done to Fulfil its Commitments over the Past 10 Years?

The first thing that the Chinese government did after joining the WTO was to implement seriously the commitments that it had agreed on during the accession negotiations. It was by no means an easy job. Domestic resistance was strong, since not everybody was happy with the result of the accession agreement. In spite of vigorous domestic opposition, China cut tariffs on over 5,000 products according to the time schedule, and average tariffs were brought down from 43.2 percent in the early 1990s to 9.8 percent after the transitional period. A typical example is soya beans, the tariff on which was brought down from about 60 percent to 3 percent. While there were some complaints about the enforcement of intellectual property rights (IPR) protection or about technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) standards during the transitional review of China's implementation of its commitments, there were no complaints about China's implementation of its tariff-reduction commitments, the only exception being the tariff on auto parts. In fact, China had already brought its tariffs on automobiles down from 200-250 percent to 25 percent after its accession and those on auto parts down from 100-150 percent to 10 percent. The complaints were aimed at measures taken by Chinese customs to prevent importers from paying tariffs for auto parts while they are actually importing complete automobiles in the form of completely and semi-knocked down kits ("CKD/SKD kits"). China complied with the rulings of the Dispute Settlement body on auto parts, and it has now become the largest automobile market in the world.

In the field of the commitments on opening the market on service trade, China took all relevant measures to make sure that more than 100 subcategories out of the total 160 were open and that within those subcategories, foreign investors could have a majority stake and even 100 percent ownership in many companies. Even in the most sensitive sectors, such as telecommunications and insurance, China accepted joint-venture companies with foreign partners owning up to 49 percent and 50 percent of the stake. During the transitional review on China's implementation, most of the complaints were beyond China's accession commitments and were related to the further opening of the service sector. These were complaints that should have been addressed during the negotiations of the Doha Round.

Intellectual property rights protection was an issue that garnered a great deal of attention among many developed countries during China's accession negotiations. China has made every effort to ensure its legislation was commensurate with international standards and has joined all the important international conventions for protecting IPR. During the transitional review, some members raised the issue of enforcement of IPR protection. It is a problematic issue not only for China, but also for all governments. No country can claim to be perfect on IPR enforcement. In a country like China, which had its first law on protecting tangible private properties only in 2005, legislation on protecting intangible private property represented a great step forward in the right direction. In the field of enforcement, China's practice is unique in the world. On top of the judicial procedures that IPR owners may take to protect their rights, which are similar to those of other countries, China has taken additional administrative measures to protect IPR, deploying half a million local staff to monitor and impose punitive fines on offenders. The situation will be improved further as more Chinese companies are having their patents and trademarks registered, and awareness of IPR protection continues to improve.

The most difficult part of China's implementation of its commitments was the thorough review and amendments of its trade laws and regulations.

To ensure that all its trade laws and regulations were WTO-consistent, China set up a special body under the State Council with all relevant ministries participating as members. This special body reviewed more than 2,000 laws and regulations at the central level alone and abolished more than 500 of those found to be inconsistent with WTO rules. Many other regulations were amended, and if one includes laws and regulations at the provincial level, the total number of reviewed pieces exceeded 90,000. This was unprecedented in China's history. It is a difficult task for any country; for instance, we all know how hard it is for the US Congress to amend even a single article in current laws.

The substantial progress made in implementation would not have happened without the strong political will of China's leaders and the concrete measures taken by the State Council. In order to implement China's commitments, a week-long training programme for WTO rules was sponsored, with the participation of ministers and governors throughout the country. Mr. Jiang Zemin, the former President, and Mr. Zhu Rongji, the former Premier, were present at the opening ceremony and delivered important speeches. WTO centers were set up in Beijing, Shanghai, Shenzhen and many other cities to carry out studies on WTO rules, to provide training for enterprises and local government officials and to contribute to local legislation, trade remedies and trade dispute settlement cases. More than 3,000 different types of books on the WTO and its rules were published in China in 2002, and a nationwide contest on WTO knowledge was organized in 2003, with more than 5 million people participating. The final session of the contest was broadcasted live on China Central Television, and the winners were sent to Geneva to meet Dr. Supachai and his staff at the Secretariat and to have a celebration in China's WTO Mission.

4.2 The Impact of China's Membership on the WTO and the Rest of its Members

It is very clear that China has benefited a lot from its accession to the WTO. Over the past 10 years, China has maintained its high-speed economic

growth. It became the second-largest economy and the biggest exporter in the world. At the same time, it is clear that all other WTO Members have also gained to various extents from China's membership. Here, I would like to highlight some of the benefits for the other members and for the organization.

China is now an import market of more than USD 1.2 trillion, second only to the US market. Many WTO Members have benefited from China's economic growth, particularly among the Association of Southeast Asian Nations (ASEAN) and East Asian economies, most of which have trade surpluses with China.

China's membership makes the WTO a real international organization. Without China, with its 1.3 billion people and enormous market as a major trading nation, the WTO would be incomplete. Before China joined the WTO, there was a very popular saying: "China needs the WTO and the WTO needs China". When one-fifth of the world's population joined the WTO and observed its rules and regulations, the organization became stronger, more universal and more authoritative.

As a major developing country, China's membership in the WTO helps raise the voice and influence of developing countries. The days are gone when a couple of major developed countries would set the tone, and the rest of the members had no choice but to accept the result, as was the case with the Blair House Agreement. China's participation in the agricultural groups of the G20 and the G33, and its strong support for the legitimate positions of the LDCs, African, Caribbean and Pacific countries (ACP), the African Group and other groupings of developing countries makes the WTO a more balanced organization. It makes sure that whatever decisions the WTO makes are going to be development-friendly. It should aim at narrowing the gaps between the rich and the poor and create an environment in which poorer countries could develop faster, which would eventually lead to a safer, more stable and more prosperous world. A decision that seeks to protect the interests of developed countries and addresses their concerns only, while ignoring the voice of the developing countries, particularly

the LDCs, would make the poor poorer and the rich richer. A further polarization between the rich and the poor would be a nightmare for the world.

China has participated actively in the WTO dispute settlement process, played by the rules and complied with whatever rulings the panels and the Appellate Body made. The Dispute Settlement Mechanism is the jewel in the crown of the WTO and makes the WTO unique among international organizations. China's active participation helps to enhance the authority of the mechanism, which provides a guarantee to an open, fair and stable trading system. While there is still room for improvement, the Dispute Settlement System is on the whole doing well and should be further strengthened.

China's determination to continue its policy of opening and reform contributes to world economic prosperity. As a new member of the WTO, China is always ready to learn. The trade policy review process gave China the opportunity to listen to comments and complaints from other Members, which helped identify areas where further reform and improvement were needed. At the same time, through the trade policy reviews of other Members, China has learned from their successes and drawn lessons from their setbacks. China's recent emphasis on expanding domestic consumption and encouraging imports, as well as its encouragement to Chinese enterprises to invest abroad in its next five-year development program, are no doubt good news for all WTO Members.

As a developing country, China has been a major recipient of foreign aid. At the same time, China has been providing aid to many poor countries in Africa, Asia and Latin America, particularly to the LDCs. After joining the WTO, China's aid to other developing countries has increased greatly, with the establishment of many major programmes, such as the China-Africa Forum, Mekong River Delta Sub-regional Co-operation, etc. China has been active in AFT and in improving infrastructure in Asian, African, and Latin American countries, building schools and providing medical services and technical assistance for agricultural projects.

China has committed itself to providing DFQF treatment for the LDCs. The recent publication of a white paper on China's foreign aid is a good reference for people to find out more about what China has done in this area.

4.3 Criticisms Currently Levelled Against China

I must admit that the picture is not as rosy as I have painted in the last section. In reality, nothing could possibly be perfect. China's membership did indeed bring challenges to all members of the organization. During my stay in Geneva, I heard quite a few complaints about China, particularly during the trade policy review and transitional review on China's performance. The most frequent complaints are on issues like the exchange rate of the renminbi, the "buy local" policy in government procurement, the indigenous innovation program, the export tariffs and restrictions, and the subsidies for China's enterprises. I would like to make a few comments on these complaints and try to explore the reasons behind them.

The IMF is the institute of authority on issues related to the exchange rate. The policy of China's Central Bank is to keep the Chinese currency stable to facilitate trade and investment. It is trying to avoid any major fluctuation of the currency, which would be disruptive both to trade and investment activities. That is the reason the Central Bank resisted pressure from within the country to devalue the renminbi during the Asian financial crisis; it is also the reason it resisted pressure from outside the country to revalue the renminbi over the past few years. The debate is now focused on when the renminbi will become a convertible international currency. I believe China's Central Bank is working to move in that direction, although it could be a long and complicated process.

With respect to the "buy local" policy, China has not yet joined the Agreement on Government Procurement. Once China joins the Agreement, the "buy local" policy will no longer be valid. There have been several rounds of negotiations,

There are misunderstandings about China's policy of encouraging indigenous innovation. The Chinese people are very good at learning, and they learn things quickly, but they may not be so creative and innovative.

and China has improved its offer on several occasions. I believe there will be further efforts to accelerate the process of negotiations, and I hope the US, EU and other parties will be more realistic. Failure to appreciate the great value of what is already on the table could risk missing a great opportunity to close the deal.

Therefore, there is nothing wrong with the Government encouraging local people and enterprises to be more creative and innovative. This policy does not exclude foreign companies from operating in China, as they are treated as local companies. Their innovations are taken as local innovations and enjoy the same treatment. It is a legitimate concern for foreign invested companies to expect national treatment in all areas, and the Chinese government is making efforts in that direction.

With respect to export tariffs and restrictions, China's restriction on exporting coking coal, rare earth minerals and other commodities was criticized by some countries. The Chinese government had no choice but to implement this policy. Due to poor excavation technology, the process of producing coking coal and rare earth minerals caused serious pollution to the environment and consumed a lot of energy. Moreover, these resources are exhaustive. For instance, China holds about 30 percent of the world's rare earth deposits, but its exports of rare earth minerals account for 90 percent of the total world trade. In adopting the restrictions, China observes the following principles:

1. Take measures to reduce both domestic production and domestic consumption.
2. Encourage other countries to increase their domestic production and their market shares.

3. Seek technical co-operation with other countries to protect the environment and raise energy efficiency during the process of production.

The provision of subsidies for Chinese enterprises is a very complicated issue. Theoretically, subsidies run counter to the principle of free trade, of which the major developed Members of WTO have been the cheerleaders for decades. In practice, however, these Members provide huge subsidies annually to their agricultural products; industrial products, such as aircraft; and in times of crisis, to their banking sectors. In reality, however, which countries need more subsidies on their road of economic development? Of course, the developing countries! The developed countries have enjoyed the policy space related to subsidies for decades. Yet, when the developing countries try to follow their example, they say, "Sorry, it is against the rules of the WTO". I am sure the debate on subsidies will continue within the WTO, and the future rules and regulations should take into account of the history and the growing needs and concerns of the developing countries.

4.4 Future Prospects Both for China and its Trading Partners

What are the prospects over the next decade? I personally have the following expectations:

- China will become a more active Member over the next decade. After 10 years in the WTO, China has learned a great deal and has more professional people with sufficient experience to support its performance in the WTO. In the future activities of all the WTO bodies and in future negotiations, there will probably be more proposals coming from China or joint proposals from China and its partners.
- China will take more responsibilities as a major player in the WTO. However, the responsibilities should be commensurate with its current level of economic development. It will not be realistic to expect China or Brazil and India to be treated the same as a developed country. This is not because China's per capita GDP is only USD 4,000, or about one-tenth of the average for developed countries, but because of the huge gaps in education, science and technology, economic and industrial structure, the environment situation, social and medical safety nets and so forth. The huge rural population and the 150 million poor people living under USD 2 a day prevent China from assuming the same responsibilities and obligations as the developed countries. This is a fundamental principle that China will stick to and there is no room for bargaining and trade offs.
- Will China continue its policy of reform and opening? The answer is yes. This is reflected in its current five-year economic development program. Personally, I do not believe there could ever be a backtracking or reversal of this fundamental state policy. As the experience of the late Qing Dynasty 150 years ago and the Cultural Revolution in the last century have demonstrated, there are no alternatives for China. China will have to continue with the policy of opening and reform in social, political, economic and other areas. The only issue is the speed of the reform. It could not happen tomorrow morning. It will not be a smooth process either, as it would involve the redistribution of interests within society. China's further opening will help the process, and the pressure from international organizations, such as the WTO, and from its trading partners could be translated into an impetus for its domestic reform.
- China will continue to play a positive role in the DDA and any future negotiations. As a major trading nation, China will continue to be a strong supporter of the multilateral trading system. It will make its share of contribution compatible with its own level of economic development in order to conclude the Doha Round. It will join other Members in future negotiations on issues that are of common concern to all Members under the current situation. China is not a strong advocate for FTAs and regional trade agreements (RTAs). China would prefer to focus on multilateral arrangements to ensure the proper functioning

of the WTO. However, since the Doha Round is not going to conclude soon, and since other Members are busy negotiating their own FTAs and RTAs, China has no choice but to explore its own bilateral and regional arrangements. I believe this trend could be checked through an earlier conclusion of the Doha Round and a possible start of a new Round afterward.

- China is fully aware that, as the world's largest exporter, it will have to face trade protective measures and Dispute Settlement cases from its trading partners. China has learned a great deal through its practice over the last 10 years and is more mature in terms of dealing with these challenges. It would be happy to treat these cases within the framework of WTO rules. It will try hard to avoid the possibilities of politicizing the cases and to understand the domestic political situations of its trading partners. At the same time, China will defend its own economic interests by adopting measures consistent with WTO rules. China will do everything in its power to ensure the normal function of the multilateral trading

system and to show respect for the authority of the Dispute Settlement Mechanism.

- China, as a developing country, will continue to work very closely with Argentina, Brazil, India, South Africa and other emerging economies in the effort to make the WTO a more development-friendly and more balanced international organization. It will continue to work closely with the LDCs, small, vulnerable economies (SVEs), as well as the ACP, African Group, and other developing country groupings and lend support to their long-standing positions and demands. I believe that while China will continue to participate actively in whatever small groups there might be, either G5 or G7 or G11, the final decisions have to be the result of inclusive participation of all WTO Members. All Members have to be kept informed and have their voices heard and considered in all forms of negotiations. This may lead to some delays in final decision-making, but it will guarantee that the WTO serves as an international organization that represents the interests of all its Members.

5. CHINA IN THE WTO DISPUTE SETTLEMENT SYSTEM: FROM PASSIVE RULE-TAKER TO ACTIVE RULE-MAKER?

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According to the Marrakesh Agreement, the WTO has three main functions: trade negotiation, trade policy review, and settlement of trade disputes. As a new Member, China found that its ability to participate in the first two activities was subject to severe constraints. For trade policy review, the restriction is formalized through the Transitional Review Mechanism in Section 18 of the Accession Protocol, which mandates Chinese commitments to be reviewed once every year for the first eight years, with a final review in the tenth year after accession. One may argue that such a review is different from the normal trade policy review in the WTO, as both the scopes of the review and the bodies conducting them are different. Moreover, in reality, the additional burden made it difficult for China to participate in normal trade policy review activities. During the 15-year long accession negotiations, the existing WTO Members pressed China for far-reaching commitments in each area of the WTO mandate. As a result, China's concessions on both trade in goods and services greatly exceed those of other WTO Members, most of which have not changed since the conclusion of the Uruguay Round. Therefore, when the Doha Round was launched, China could not participate as effectively as other WTO Members as most of its bargaining chips had largely been spent during its accession process. This is why China's negotiating proposals in the Doha Round mostly cover systematic issues rather than substantive market access.

In contrast, WTO dispute settlement is the only area in which no restriction was imposed on China's participation from the very beginning. Because of this, many commentators predicted that the Chinese accession would overburden the WTO dispute settlement system with cases

both against and by China. However, China's participation in the dispute settlement system did not turn out exactly as predicted. At least for the first five years, China tried to stay away from formal dispute settlement activities; and only in the second half of the last decade did it emerge as a major player. This note will review China's transformation from a reluctant player into an aggressive litigant in WTO dispute settlement activities, which took place in three stages.

5.1 Rule-Taker

From the time of its accession to early 2006, China took a cautious approach towards WTO litigation. As a newcomer unfamiliar with the WTO legal rules, China put more emphasis on learning WTO rules than on winning specific disputes. In an effort to discourage litigation, China usually settled the dispute quickly with the complainant once a case was filed or threatened, even if it might have had good arguments to defend its actions.⁸ For example, in a matter concerning value-added tax rebates on integrated circuits, the US made a request for consultations in March 2004, and the dispute was settled just four months later. The same period also saw China cave in only two months after the EC threatened to bring a formal WTO complaint against China's export quota regime on coke, an essential raw material for the production of steel. The climax of this approach was reached in the Kraft Linerboard case, in which the US complained of inconsistencies with the Anti-dumping (AD) Agreement when the Ministry of Commerce, People's Republic of China (MOFCOM) imposed AD duties on US Kraft Linerboard imports in September 2005. On Friday, 6 January 2006, the US finally threatened to file a formal WTO complaint. On the next working day—i.e., Monday, 9 January 2006—the Chinese government made an announcement to scrap the AD duties in this case.

8 For a review of China's approach towards WTO dispute settlement in this period, see: Gao, H. 2005. 'Aggressive Legalism: The East Asian Experience and Lessons for China', in *China's Participation in the WTO*, Gao, H. and Lewis, D. (eds.). London: Cameron May: Pp. 315-351.

5.2 Rule-Shaker⁹

To build a better understanding of the dispute settlement process, China started to actively participate as a third party in real WTO cases shortly after its accession. From August 2003 to 2006, for example, China joined almost every panel established during the period as a third party. Through its participation as a third party, China gained invaluable understanding of the WTO dispute settlement system and boosted its confidence in participating in the system as a main party. Such enhanced confidence was well illustrated by the remarks of Minister Bo Xilai of MOFCOM in May 2005. When asked whether China would bring complaints in the WTO against the countries that imposed restrictions against Chinese textile exports, Minister Bo Xilai responded:

First, China has the right to resort to WTO dispute settlement mechanism. We should not hesitate to use this right when needed. Second, while bilateral consultation has its own benefits, if each side sticks to its own view, the problem won't be solved as there is no neutral arbiter. Thus, in addition to one-to-one consultations, sometimes it's more effective to have the disputes reviewed in the multilateral setting. Third, the restrictions against Chinese products are inconsistent with WTO rules and discriminatory. We strongly oppose such measures. Of course, it's up to us to decide whether to take any legal action against such measures and when to do so.

Some of the thinking that informed China's more-aggressive new strategy in WTO litigation is revealed in the following analysis of Mexico's litigation strategy in the *Soft Drinks* case¹⁰ by Dr. Ji Wenhua, an official in charge of dispute settlement activities at China's WTO Mission in Geneva. In the article he published in the July 2006 issue of the *China WTO Tribune* - a monthly

journal on trade policy published by MOFCOM and edited by Dr. Zhang Xiangchen - then Director-General of the Treaty and Law Department of MOFCOM, Ji noted that Mexico fought an uphill battle in the case brought against it by the US, but made a good effort defending its case. According to Ji:

In this case, Mexico's legal position was rather *weak*, but it has made an *unrelenting* effort by raising many arguments which are *tenuous at best* and *fighting a losing battle*.

While we should not publicly *praise* such litigation strategy and attitude, this case still offers us some worthy lessons: under certain circumstances, we should try to employ some strategies, including resorting to *sophistry* and *delay tactics*.

As a respondent, we should try to come up with as many factual and legal arguments as possible. Even if such arguments are mere sophistry, or made for purposes such as creating artificial difficulties for the panel, gaining sympathies, diverting the attention of other parties, or delaying the progress of the case, they are justified so long as they serve to protect our own interests (Emphasis original. Original in Chinese. Translated by the author).

Equipped with this enlightened new attitude toward the WTO dispute settlement mechanism, China has taken a markedly different approach since then. The turning point came in March 2006, when Canada, the EU and the US brought a joint-complaint against China in the Auto Parts case.¹¹ The complainants accused China of violating WTO obligations by treating some imported automobile parts as whole-car imports and imposing additional charges equivalent to the difference between the higher tariff for whole-car imports and the lower tariff applicable

⁹ For a review of China's shift in strategy, see: Gao, H. 2007. 'Taming the Dragon: China's Experience in the WTO Dispute Settlement System', *Legal issues of Economic Integration* 34(4): 369-392.

¹⁰ Panel Report, Mexico - Tax Measures on Soft Drinks and Other Beverages, WT/DS308/R, adopted 24 March 2006, as modified by Appellate Body Report WT/DS308/AB/R, DSR 2006:I, 43.

¹¹ Panel Reports, China - Measures Affecting Imports of Automobile Parts, WT/DS339/R, WT/DS340/R, WT/DS342/R and Add.1 and Add.2, adopted 12 January 2009, upheld (WT/DS339/R) and as modified (WT/DS340/R, WT/DS342/R) by Appellate Body Reports WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R.

to automobile parts. Legally speaking, this is a rather simple case as the illegality of the Chinese measure seems to be quite obvious, especially as China has made specific commitments to impose no more than 10 percent tariff on automobile parts imports in its accession package. However, rather than continuing the old practice of settling the dispute privately, China decided not to concede defeat without a good fight. Over the next two and half years, the case would go all the way from the Panel to the Appellate Body until the Appellate Body finally issued its report in December 2008.

The same aggressive approach was taken in several other cases, especially the TRIPS case¹² and the Publications and Audiovisual Products case.¹³ In all these cases, China tried to shake or even bend the existing rules by aggressively making legal arguments that put its position in a better light. This strategy was reflected not only in the extensive substantive legal arguments China made, but also in its sophisticated use of procedural objections. As all good lawyers know, while procedural matters may seem mundane, they are of no less importance than substantive claims: if used well, they can even save a hopeless case. Judging from its performance in these cases, China has mastered the ‘sophistries’ very well. In the TRIPS case, for example, China attacked the complainants on such procedural grounds as the admissibility of certain evidence¹⁴ and the correct scope of the measures at issue.¹⁵ Similarly, in the

In its first decade in the WTO, China has successfully made the transition from a Member that was reluctant or even afraid to use the dispute settlement system to one that is increasingly confident and skilful in using it to advance its legitimate interests.

Publications case, China’s procedural arguments included the failure of the US to establish a prima facie case,¹⁶ the evidentiary standards,¹⁷ and the appropriate scope of the Panel’s terms of reference.¹⁸

5.3 Rule-Maker

As observed above, while China accepted some rather harsh terms as the price for its WTO accession, it is likely to be difficult for China to change these terms through the multilateral negotiation process. This has left China with only one option: trying to challenge them and soften their negative impacts through creative interpretation in WTO dispute settlement proceedings.

Among the six cases filed by China since September 2008, four (US - Anti-Dumping and Countervailing Duties;¹⁹ EU - Steel Fasteners;²⁰ US - Tyres;²¹ and EU - Footwear²²) were aimed at changing the rules,

12 Panel Report, China - Measures Affecting the Protection and Enforcement of Intellectual Property Rights, WT/DS362/R, adopted 20 March 2009.

13 Panel Report, China - Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products, WT/DS363/R and Corr.1, adopted 19 January 2010, as modified by Appellate Body Report WT/DS363/AB/R.

14 Panel Report, China - Measures Affecting the Protection and Enforcement of Intellectual Property Rights, WT/DS362/R, adopted 20 March 2009. Paras. 6.14-37.

15 Ibid., at paras. 7.1-19.

16 Panel Report, China - Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products, WT/DS363/R and Corr.1, adopted 19 January 2010, as modified by Appellate Body Report WT/DS363/AB/R. Paras. 7.458-460.

17 Ibid., at paras.7.620-632.

18 Ibid., at para. 7.63.

19 United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, DS379, Request for Consultations received on 19 September 2008.

20 European Communities – Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China, DS397, Request for Consultations received on 31 July 2009.

21 United States – Measures Affecting Imports of Certain Passenger Vehicle and Light Truck Tyres from China, DS399, Request for Consultations received on 14 September 2009

22 European Union – Anti-Dumping Measures on Certain Footwear from China, DS405, Request for Consultations received on 4 February 2010

especially the provisions in China's Accession Protocol. For example, in the US – Anti-Dumping and Countervailing Duties case, China challenged the decision by the US authorities to impose both AD and countervailing duties against several products imported from China. In addition to the usual claims under the General Agreement on Tariffs and Trade (GATT), the Anti-dumping Agreement, and the Agreement on Subsidies and Countervailing Measures (SCM), two claims made by China are particularly interesting and are described in more detail below.

The first claim is that the US violated China's Accession Protocol by failing to follow the proper methodology for the determination of the existence and amount of subsidy benefits. Under Section 15(b) of China's Accession Protocol, in subsidy investigations, other WTO Members could "use methodologies for identifying and measuring the subsidy benefit which take into account the possibility that prevailing terms and conditions in China may not always be available as appropriate benchmarks". Similar to subparagraph (a) of the same Section, which allows other WTO Members to use surrogate prices in AD investigations against Chinese firms, this provision was introduced to address the concern that prices in China do not reflect the true cost as China is not yet a full market economy. However, unlike the non-market economy (NME) status in AD investigations, which is scheduled to expire 15 years after China's accession, the alternative benchmark methodology does not have an expiration date. Thus, theoretically speaking, the alternative benchmark methodology could be invoked even 100 years after China's accession to the WTO. As discussed above, it would have been very hard for China to try to change this provision in its accession terms through negotiations in the WTO. Instead, China decided to limit the applicability of the provision by giving teeth to some seemingly innocuous terms in the provision: first, the US failed to make a finding that there were "special difficulties" in applying the prevailing terms and conditions in China as the basis for the determination of the existence of

benefits; and second, the US failed to notify the SCM Committee of the methodologies it used. This is a very clever way to try to reduce the utility of the provision. Unfortunately, during the Panel proceeding, China decided to not pursue this claim.²³ However, if the issue arises again and a future Panel indeed chooses to give a strict interpretation of the term "special difficulties", this might greatly reduce the attractiveness of the provision and even effectively render it void.

The second claim is that the US violated the relevant provisions in the Anti-dumping and Safeguards Agreements through its dual application of both AD and countervailing duties against the same products. While the same product may be subject to both AD and SCM investigations, in practice, the US has always avoided the imposition of both AD and countervailing duties for the same products if they are imported from market economies. However, non-market economies do not receive the same treatment and may be subject to both AD and countervailing duties. Under Article VI.5 of the GATT, WTO Members are prohibited from applying both AD and countervailing duties to the same products in the same case. However, the same provision also states that the prohibition of dual application only applies to cases of export subsidies and does not include actionable domestic subsidies, thus inapplicable to the alleged subsidies to Chinese products. However, one may also argue that to the extent that the dual application results in over-compensation, this might result in inconsistencies with the "lesser duty rule" under both the AD and SCM Agreements. In summary, the rules as they currently stand are unclear. Therefore, China hopes to clarify the rules or even make new rules through this case. As the expiration date for non-market economy status in AD investigations draws closer, subsidy investigations will become the main problem facing Chinese firms. Hopefully, through the clarification of these terms in dispute settlement activities, China will be able to change the rules in its favour so that its firms will have an easier time when this issue arises in the future.²⁴

23 Panel Report, United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/R, adopted 25 March 2011, as modified by Appellate Body Report WT/DS379/AB/R, paras. 10.9-10.12.

24 This was confirmed by the Appellate Body. See Appellate Body Report, United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China, WT/DS379/AB/R, adopted 25 March 2011, paras. 592-610.

Similarly, both the tyres safeguard case against the US and the two AD cases against the EU involve claims of violation of the individual clauses authorizing the respective trade remedy measures in China's Accession Protocol. While China has only scored mixed success in these cases, they still help to clarify the ambiguous terms used in the Accession Protocol. It is not unlikely that, in future cases, these provisions could be interpreted in a way that would restrict the utility of these provisions in the future. Should this be the case, China would have effectively changed the rules through the WTO dispute settlement process.

5.4 What Lies Ahead?

As can be seen from the discussion above, in its first decade in the WTO, China has successfully made the transition from a Member that was

reluctant or even afraid to use the dispute settlement system to one that is increasingly confident and skilful in using it to advance its legitimate interests. Will this trend continue into the future? I think this is highly likely. In a way, this is simply the continuation of established patterns in the WTO: over the history of the GATT/WTO, it is rare to find cases in which the two largest Members, i.e., the US and the EC, are not involved in some capacity. It is only natural that we would find China, the next big trader, receiving the same treatment. While some commentators might lament the extra burden these cases would add to the WTO dispute settlement system, I would argue that they should be viewed in a more positive light: as history has shown us, it is much better for the big players to fight the legal battle within a rule-based multilateral framework than to try to take justice in their own hands by resorting to unilateral measures.

6. CHINESE TRADE POLICY A DECADE AFTER WTO ACCESSION

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6.1 Introduction

So much has changed since China joined the WTO in late 2001. China has powered through the global financial crisis with a turbo-charged fiscal and monetary stimulus equivalent to almost 45 percent of GDP in 2009. It is the leading contributor to post-crisis global growth. Other countries around the world export raw materials and capital goods to power China's continuing industrial revolution. That is also true of other east-Asian economies, who, in addition, export parts and components to China for assembly and export elsewhere. Increasingly, they are also gearing up to export finished goods to a booming Chinese consumer market. More than ever, the rest of Asia revolves around China. Gradually, China is asserting itself in international organizations. Its footprint is ever-more visible elsewhere in the non-Western world - in its east-Asian backyard, and in south Asia, central Asia, Africa and South America. In the past decade China has become the leading regional power in Asia, and is on its way to becoming a "great power" in the wider world, alongside the US. These trends have clearly accelerated in the wake of the global economic crisis.

China is now one of the "big three" in the global economy, along with the US and the EU. Until recently, it imported "global order", absorbing policies, rules and institutions that materialized from decisions made elsewhere. China still imports global order; but, given its market size, it now exports global order as well. Decisions made in China reverberate around the world. And they do so to a much greater extent than decisions made in the other BRICS (Brazil, Russia, India, China and South Africa). China accounts for about 60 percent of the BRICS' output, two-thirds of its foreign-exchange reserves and exports and one-third of its inward investment. China plays in its own

league among emerging markets. The other BRICS play in an inferior league; they are still much bigger net importers of global order.

This transformation, within a decade, represents a shift in what could be called China's policy terms of trade. Trade economists from Robert Torrens and John Stuart Mill to Harry Johnson would not be surprised. When China joined the WTO, it regarded itself as a "price-taker" in the world trading system; it acted rather like a small- or medium-sized open economy that could only adapt to the international terms of trade. Unilateral liberalization, reinforced by strong WTO commitments, was the policy prescription. Now, Chinese policymakers think of China as a member of a club of three: like the US and the EU, it can influence international terms of trade and world prices - or so it believes. That shifts the policy inference away from unilateral liberalization to reciprocity. But, given the speed and scale of this transformation, China has evident difficulty in acting like a rule-setter and system-shaper - in other words, like a *leader* (or co-leader) of the world trade order. That causes problems for China and its trading partners; it creates uncertainty and instability, and it increases the risk that China might be a "spoiler" in trade policy.

That is the broad context for assessing Chinese trade policy a decade after it acceded to the WTO. The following sections cover China's "multi-track" trade policy: its record in the WTO; its FTAs and its unilateral trade and FDI measures.

6.2 China in the WTO

China's "reform" and "opening" started in 1978. But, its decisive external opening, and with it sweeping industrial and agricultural restructuring, belong more to the post-Tiananmen phase, especially since 1994. China undertook enormous trade and FDI liberalization during the 1990s - before WTO accession in 2001 - followed by another big dose of liberalization in line with its WTO commitments. Its WTO

commitments are very strong; they exceed those of most other developing countries by a wide margin. It is important to note that the primary liberalization thrust, especially in the 1990s, was domestic and unilateral, coming from the Beijing leadership. The latter used WTO accession negotiations as a strategic lever to consolidate and accelerate national reforms. China's WTO commitments, and its participation in the WTO after accession, can be read as more the consequence than the cause of its sweeping unilateral reforms. In essence, China's external opening, crowned by WTO accession, has allowed it to successfully exploit comparative advantage in labour-intensive manufactures; and it has done so with a tight interlock between trade and FDI. Both increased dramatically after WTO accession.

Similarly, there is much positive news to report of China's record a decade into its WTO membership. The strength of China's unilateral reforms and WTO commitments and its integration into the world economy have made it keenly aware of its stake in well-functioning multilateral rules - especially compared with most other developing countries. It has become a strong WTO stakeholder. It has been very active in the WTO's regular committees, particularly on core rules issues. Arguably, the embedding of China in the WTO has defused manifold international trade tensions that might otherwise have gotten out of hand; and it has smoothed China's rapid integration into the world economy. In short, China's accession is the WTO's biggest success by far, and the world trading system's most important milestone since the end of the Uruguay Round. It contrasts very favourably with continued deadlock in the Doha Round. Nevertheless, China's record in the WTO has not been without controversy - not surprising given such a huge and complicated accession.

China's record of implementing its huge WTO commitments is mixed. It has implemented the bulk of its commitments on border barriers (import tariffs and non-tariff barriers) in a timely fashion. However, the US, in particular, accuses China of breaching its WTO commitments in

several key areas, mainly concerning export restrictions, subsidies, product standards (SPS and TBT measures), customs valuation, trade-related investment measures (TRIMS), TRIPS and services regulation. With the exception of export restrictions, these concern non-border regulatory barriers. To the Chinese government's critics, the underlying problem is the wide *de facto* discretion given to officials to apply laws and regulations selectively and opaquely at all levels of government (national, provincial and municipal).

China has been very active in dispute settlement. For the first five years of its WTO membership, China and other major players exercised mutual restraint in taking China-related cases to court. China viewed dispute settlement as a political-diplomatic mechanism to resolve differences through compromise and conciliation, before adversarial legal procedures kicked in. The US, the EU and others also generally refrained from testing China in court.

Mutual restraint seemed to end in about 2006. The US launched a raft of cases against China. Recent cases illustrate that China and its major trading partners have become more forceful in their use of dispute settlement. The US has initiated cases that go to the heart of Chinese industrial policies and related domestic regulation. In addition, China has become less wary of letting cases proceed to legal contest. On balance, this is healthy. China should be challenged in situations when it might well be in breach of its WTO obligations. At the same time, China should test the legal mechanics of WTO dispute settlement - to develop its trade-related legal capacity, defend its rights and indeed to initiate cases when faced with infractions from its trading partners.

In contrast, China has been a conspicuously passive and marginal player in the Doha Round. Non-activism means that it has not stepped on developed and developing-country toes, and avoided extra pressure to further open its own markets through even stronger WTO commitments. However, this has come at the cost of not forcefully pursuing its "offensive"

interests, particularly to open other markets for its manufactured exports, and secure stronger disciplines on AD duties and other “trade remedies”.

China belatedly played an up-front role in WTO negotiations - at the July 2008 Ministerial - but it proved to be defensive rather than pragmatic and middle-of-the-road. Overall, China’s trading partners now expect it to be proactive - to assume co-leadership in the WTO; and China is no longer comfortable as a willing, almost unquestioning taker of rules made by others. Nonetheless, its default position is still to be reactive in WTO negotiations, leaving other big players to take initiatives. This pattern dovetails with a slowdown of liberalization at home and other defensive measures in China’s trade policy, especially in the last three to four years.

6.3 China and FTAs

China has been very active in negotiating FTAs - in contrast to its Doha Round passivity. It is the driving force of FTAs in East Asia. By 2010, it had 11 Preferential Trade Agreements (PTAs) on the books, with 11 others under negotiation or proposed. Clearly, China is more comfortable with proactive bilateralism than proactive multilateralism. With the former, it feels it can better shape its external order, especially in its east-Asian neighbourhood.

China’s FTAs are driven more by foreign-policy “soft power” - diplomacy and relationship-building - than hard economic strategy.

However, China’s FTAs are pretty weak; they are “trade light”. Its flagship FTA - with ASEAN - is indicative. There has been progress in eliminating tariffs on trade in goods. However, little progress has been made on non-tariff barriers (NTBs) in goods, services and investment (both relatively

weak agreements), and other issues. China has stronger “WTO-plus” FTAs with Hong Kong and Macau (both admittedly special cases). More recently, it signed an Economic Cooperation and Framework Agreement (ECFA) with Taiwan. Nevertheless, much remains to be done: ECFA is a “framework agreement” with initially limited liberalization. Many of China’s other FTAs follow the China-ASEAN pattern: a focus on tariff elimination, but with “paper-tiger” commitments on trickier NTBs and regulatory barriers. Yet, other existing or planned FTAs (e.g. with Pakistan, Mercosur and the South African Customs Union (SACU) are even shallower - mostly preferential tariff reductions on a limited range of products. China gives unilateral tariff preferences to 41 LDCs. It has pledged to give duty-free access to 95 percent of imports from LDCs, though by an unspecified date.

Overall, China’s FTAs are driven more by foreign-policy “soft power” - diplomacy and relationship-building - than hard economic strategy. This conforms to the broad pattern of FTAs in Asia, and indeed in other developing-country regions.

In addition to bilateral PTAs, China is at the heart of regional economic integration initiatives in East Asia. An “ASEAN Plus Three” PTA (the “three” being China, Japan and South Korea) has been touted, as has a three-way Northeast-Asian PTA (China, Japan and South Korea) and an “ASEAN Plus Six” PTA that might include India, Australia and New Zealand.

So far, this talk is loose and without much substance. The odds are still stacked against region-wide PTAs, especially ones that will be more than trade-light. Countries are at widely different stages of development with competing producer interests, significant barriers to trade with each other, and without a culture of deep cross-border cooperation. Moreover, bitter nationalist rivalries - especially between China, Japan and South Korea, and between China, India and Pakistan - will continue to stymie east-Asian and pan-Asian regional integration efforts for a long time.

Perhaps the best that can be expected is gradually stronger “soft cooperation” in regional institutions, such as Asia-Pacific Economic Cooperation (APEC), ASEAN, APT and the East Asian Summit (EAS). These can be chat forums, a gradual improvement in mutual surveillance and transparency, promotion of trade facilitation and “best-practice” measures, and (at best) a cementing of unilateral liberalization to help prevent its reversal in difficult times. Inevitably, China will be the most important player in these institutions; no stronger cooperation, hard or soft, will work without its lead.

6.4 China and Unilateral Trade Measures

China’s policy shift over the past decade is most evident in its *unilateral* trade policy - trade measures undertaken at home rather than in the WTO or FTAs. Here the big news is that China’s historic opening to the world economy has stalled since about 2006. There has been paltry unilateral liberalization beyond China’s WTO commitments. The Hu-Wen leadership is much more cautious than its Jiang-Zhu predecessor. Anti-liberalization interests - ministries, regulatory agencies and resurgent SOEs - are more powerful. Policy-making is more complex and tends to take place in regulatory silos. Economic nationalism in government and the Communist Party is more influential than it was in the 1990s, especially after the global economic crisis and in the run-up to the leadership transition in 2012. Finally, as China’s global economic clout has grown so quickly, so has the temptation to resort to more assertive mercantilism. That translates into an unwillingness to open markets unilaterally, haggling hard over reciprocal concessions (especially with the US and the EU), and stepping up industrial-policy interventions to promote favoured domestic sectors. This reflects the shift in China’s policy terms of trade - from systemic price- and rule-taker to leveraging its much greater bargaining power. However, it is still far from being an active, constructive rule-setter and system-shaper.

Stalled liberalization is of a piece with greater industrial policy intervention, aimed at promoting a hard core of about 120 SOEs, mainly in “strategic” manufacturing and resource-based sectors, and eight state-owned banks and insurers that dominate the financial system.

Protectionist trade policy and *dirigiste* industrial policy meet at several junctions. Export restrictions on raw materials and agricultural commodities have increased. The decision to cut export quotas on rare-earth metals - in which China has over 90 percent of world production - by 40 percent is a blatant attempt to shift international terms of trade - to raise world prices and lower domestic input prices. Tax incentives, subsidies and price controls, as well as administrative “guidance” on investment decisions, are used to favour domestic sectors over imports. China-specific standards, such as those on 3G mobile phones, can create high compliance costs for foreign enterprises. Services barriers, notably in financial and telecommunication services, have come down very slowly.

Internet restrictions have increased, benefiting local providers, such as Baidu, over foreign competitors, such as Google. Foreign investment restrictions have been tightened in a range of sectors where SOEs operate. Discriminatory government procurement and intellectual property policies, as well as joint-venture and technology transfer requirements, are tools for “indigenous innovation” - code for promoting domestic technology companies at the expense of foreign counterparts. These measures are used to promote national champions in high-speed rail, electric cars and renewable-energy sectors, to name a few examples. Finally, “investment nationalism” extends to China’s “Go Out” policy. Resource-based SOEs, in particular, are buying up foreign assets with cheap capital provided by state-owned banks.

These patterns are but a reflection of China’s hybrid domestic economy. Despite massive product-market liberalization, factor markets, particularly for land, capital and energy, remain

tightly controlled. That goes far to explain SOE dominance of capital and resource-intensive sectors. Over-saving and over-investment accompany repressed consumption. Externally, surplus savings plus an undervalued exchange rate spill over into large current-account surpluses and generate extra trade tensions, especially in post-crisis conditions of depressed global demand.

China's crisis response was a supercharged fiscal and monetary stimulus, mainly directed to SOEs via state-owned banks. It bolsters the public sector and state power at the expense of the far-less-subsidized private sector. It exacerbates China's structural fault-line of over-investment and under-consumption. Its command-and-control mechanisms take market reform backwards. Moreover, there is the real risk of surplus manufacturing capacity flooding into anaemic export markets in Europe and North America, thereby inviting protectionist retaliation against China.

Chinese trade-restrictive measures increased in the wake of the global economic crisis, such as on exports, government procurement, standards and AD duties. But, this was not dramatic or at least not to the extent of reversing a 30-year liberalizing trend. Indeed, China does not figure in *Global Trade Alert's* list of top 10 offenders on crisis-related trade-restrictive measures; by contrast, the EU-27, Brazil, India and Russia do figure in this list. Overall, the Beijing leadership has not rocked the boat during or after the crisis: it has not resorted to aggressive mercantilism. Recent trade conflicts with the US and the EU over the measures mentioned above, as well as exchange-rate tensions, should not be exaggerated: they do not amount to a trade war. Protectionist responses have been heavily constrained by China's already deep integration into the world economy, particularly through processing trade and global manufacturing supply chains, and by its strong WTO commitments.

6.5 Looking Ahead

China has a clear-cut stake in open and stable global markets. As one of the "big three", its

policy signals are now critical. If it does not contain its own protectionism, neither will others contain theirs. Hence, it is in China's own interests to restrain its industrial-policy activism and its protectionist spillover.

On WTO implementation, China needs to improve its enforcement of the TRIPS, TRIMS, SPS, TBT and SCM agreements, and have better WTO notification of its subsidies. Better enforcement of WTO agreements requires stronger restrictions on regulatory discretion at national and sub-national levels, especially on official "encouragement" and "guidance" of measures that are clearly incompatible with WTO obligations. More transparency is also needed. For example, draft laws and regulations should be freely and promptly circulated to interested foreign enterprises, allowing them sufficient time for comment. That said, limits to regulatory discretion will prove very difficult in a country that still has not completed its journey from plan to market and which has large, complex bureaucracies at the national and sub-national levels.

China should also proceed with "WTO-plus" reforms. It could further reduce applied import tariffs, especially on industrial goods. It should reverse export controls on raw materials and agricultural commodities. Nevertheless, its more substantial - and politically very tricky - challenge is to tackle high trade-related domestic regulatory barriers in goods, services, investment and public procurement.

Ideally, China would reduce measures to promote capital-intensive, SOE-dominated sectors at the expense of imports; align national standards with international standards, alongside a more active role in international standard-setting bodies; restart services liberalization by easing capitalization requirements, equity restrictions, and licensing and operating procedures; lower foreign-investment restrictions by narrowing lists of sectors in which foreign investment is banned or discouraged, and not applying antitrust provisions to block foreign transactions in favour of national champions; limit online and high-tech protectionism; and gradually

liberalize markets in government procurement and energy.

The primary thrust of trade-related reforms must be unilateral, outside trade negotiations, and hitched firmly to domestic reforms to improve the business climate and to “rebalance” the economy - to make it more consumption - and less investment - oriented, with more freedom for the private sector and less public-sector control. China should also move to the foreground in the WTO and play an active co-leadership role, especially to finish the Doha Round and construct a viable post-Doha agenda. It should also clean up its weak FTAs and make them more compatible with multilateral rules.

At the same time, it behoves China’s main trading partners - especially the US -- to strengthen “constructive engagement” with China, while containing protectionist forces at home. This will encourage Beijing to step up economic reforms at home. The US obsession with a quick fix on the renminbi exchange rate and the Chinese current-account surplus, with threats of retaliation, do not display constructive engagement; they are misguided and dangerous.

Realism tells us that most of this wish list is not on Beijing’s current agenda. It is not minded to curtail industrial policy and proceed with WTO-plus reforms. The latter are “second-generation” reforms “behind the border”. They concern factor markets as much as product markets. They lie at the heart of domestic economics and politics. They are much more difficult politically than “first-generation” reforms, such as the earlier phase of trade and FDI liberalization “at the border”. In China, needed reforms go to the core of the Communist Party-government-public

sector nexus and its grip on power. It is unlikely to happen soon.

These are all symptoms of stalled reforms and even reform reversal - up to a point. It is easy to exaggerate and paint a black-and-white picture. The picture is much more mixed; it has many patches of light and shade. Contrary to sensationalist claims, China is not about to disengage from the West, and especially the US. It is not about to make a sudden switch from exports to reliance on domestic consumption. “State capitalism” is not about to take over the economy. And China is not about to “rule the world” - to become an aggressive leader in Asia and the wider world. There are powerful countervailing forces. China’s dynamic private sector, economic globalization, embeddedness in multilateral rules and institutions, and regional and bilateral trade relationships, all hem in aggressive mercantilist tendencies. Fundamental market reforms, including external liberalization, have not been reversed - at least not yet. FDI continues to increase.

At the core, the Beijing leadership remains pragmatic and internationally engaged. It does not want to “rock the boat” too much. However, stalled trade and FDI liberalization, the absence of domestic structural reforms and creeping protectionism threaten future trade tensions. They also diminish China’s ability to look outward and exercise leadership in the regional and world economies.

Hence, pro-market reformers should work to make the wish list above tomorrow’s, or the day after tomorrow’s, agenda - so that it can be achieved, however partially and patchily, when political conditions are ripe.

7. CONTRASTING HISTORY AND A COMMON FUTURE

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When China entered the WTO in December 2001, optimism seemed universal. Chinese leaders Jiang Zemin and Zhu Rongji used the stick of WTO entry to push through and solidify domestic economic reforms. China's trading partners waxed poetic about the business opportunities that would emerge as a result. Looking from 10,000 meters, it is clear that China's accession has been hugely beneficial for China and the rest of the globe, but what is amazing is the growing contrast in perspectives on China's entry and its behaviour during the first decade in the WTO. The gap between China's own self-image and that of foreign observers, especially in advanced industrialized economies, appears to be growing by the day. These differences are reflected often in contrasting statements by officials and observers, and were on full display during the ICTSD's very informative June conference.

The Chinese believe its negotiators made unprecedented concessions to join the WTO, sharply reducing tariff and non-tariff barriers and accepting special "WTO-plus" provisions not typically required of average members: the transitional review mechanism, the designation of China as an NME for the first 15 years of its membership, and giving China's trading partners the right to institute "special safeguards" when they felt threatened by imports from China. The Chinese believe that these requirements made them second-class citizens in a multilateral system where everyone should be treated equally. By contrast, many of China's trading partners believe China got a sweetheart deal when it acceded and there are many sectors of China's economy that are only partially open to foreign competition. An undervalued exchange rate, limits on investment, insufficient access to certain markets, inadequate protection of intellectual property, unfair subsidies, etc., are regular complaints made by multinational companies and their parent governments; they

The gap between China's own self-image and that of foreign observers, especially in advanced industrialized economies, appears to be growing by the day.

believe a stronger protocol would have led these problems to be much more manageable today.

Others also believe that, in part as a result of not pushing further on such requirements, China's economy has benefited disproportionately from globalization. Outsiders see a colossal trading giant that imports raw materials and exports a large chunk of the globe's manufactured goods that belie the label of "developing country". Shanghai and Beijing look more like Tokyo and London than they do sub-Saharan African countries.

The Chinese certainly are proud of their country's economic accomplishments during the last decade, but they are increasingly aware of the problems and challenges they face. Yes, China is a huge trading country, but it is just one part of the global supply chain, and the large majority of value-added in "Chinese" products go to non-Chinese companies. The "to-do list" for China's rulers is long and difficult: maintaining rapid growth, moving up the value-added chain through greater innovation, spurring private consumption, improving the environment, and creating a social safety net for an aging population. If you head west from the bright lights, tall buildings and fast cars of coastal cities, you will find that most of China's population is still relatively poor and far from enjoying the middle-class lifestyles of their cousins in the US, Europe or even Taiwan.

Finally, there are different analyses of China's behaviour within the WTO. The Chinese believe that they have come a long way. They started as observers, struggling to understand the basic rules and procedures and to do so in English. A decade later the Chinese are far more

sophisticated, having a clear understanding of both the written and unwritten rules of the game. Once an outsider, since about 2008 China has been one of the core negotiators of the Doha Round. China is now far more comfortable in the regular committee work, high-level negotiations and dispute settlement system.

Although foreign observers recognize these developments and have high regard for China's WTO delegation, some believe that China could do much more to help achieve a successful conclusion to the Doha Round. This would involve both greater concessions by China in a variety of areas and also in pushing India and other developing countries to give ground in the name of the broader mission of strengthening the multilateral trading system.

These differences in perceptions have grown precipitously since the financial crisis erupted in 2008. Western economies have suffered, and increasingly see China over their shoulders and moving up fast. At the same time, the imbalances within China's economy have become clearer at home. The past and future take on a particular colour when viewed from 2011 as opposed to a decade ago. Looking back, if China's application to join the WTO was being considered today, it is quite possible that a deal could not be reached. The US and the EU, as well as many developing countries that compete more directly with China, would have demanded even stiffer concessions on market access and protection against Chinese exports. Conversely, China likely would not accept any WTO-plus commitments that make it feel less than an equal among peers. It even might see the costs of other parts of the accession protocol as unacceptably high.

Looking ahead, it appears that expectations of what role China should play are also diverging.

China still sees itself as a developing country that can exert quiet leadership in Geneva but that must keep its focus on solving domestic economic challenges. Western countries would like China to take on a role and be more open to concessions that are consistent with its growing economic strength and dynamism.

As entrenched as these perspectives seem to be, one hopes that, to some extent, they are in part negotiating positions of the two sides looking to gain advantage in a high-stakes game. Even if they do not often say it, China's leaders know that WTO membership has been central to its economic success of the last decade, and leading Western countries know that China is more open than a decade ago and that its growth has brought benefits to their own companies and consumers. Although the global financial crisis created new challenges or crystallized existing domestic problems, one can also hope that all sides see that their interests lie in reaching some sort of successful conclusion to the Doha Round. A comprehensive package is unlikely, but even a smaller agreement would be beneficial to China and others if only because it would reinforce the legitimacy and relevance of the multilateral trading system at a time when other elements of global governance, particularly in the financial realm, are under severe strain. The WTO can be a ballast in the global economy, and no one more than China needs this system to endure.

Hopefully, China and its trading partners recognize this, and the recent trend in conflicting perceptions will soon be supplanted by a recognition of their common interest in preserving and improving the WTO. It would be nice if when December 2011 arrives, there could be a celebration for both China's tenth anniversary and for a concluded trade round.

PART III:

TRADE RELATIONS WITH OTHER WTO MEMBERS

8. THREE TENSIONS IN SINO-US ECONOMIC RELATIONS

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8.1 Introduction

The Great Recession of 2008-2009 widened fractures in Sino-US economic relations. Differences do not yet amount to a chasm, but they are growing. Both countries, to be sure, have gained from the massive expansion of trade, investment and reserves since China joined the WTO in 2001. Two-way merchandise trade, valued at USD 129 billion in 2001, reached USD 667 billion in 2010, the US direct investment stock in China nearly reached USD 50 billion, and China's official holdings of foreign exchange (mainly US dollar assets) exploded from USD 0.2 trillion to USD 2.5 trillion.²⁵ China enjoyed a decade of export-led growth and a surge in economic power, while the US enjoyed a decade of easy credit and low inflation.

These benefits proved to be too much of good things. Rising inflation and surplus capacity have become central concerns in China, while the US confronts an alarming debt-to-GDP ratio and worrisome unemployment. The US criticizes the massive imbalance in commerce as fostered by an undervalued renminbi. It is equally troubled by aggressive features of the Chinese economic model: an emphasis on home-grown technology, subsidies to high-tech industries, and weak enforcement of intellectual property rights (IPRs). Informed Chinese observers blame US trade deficits on outsized US fiscal deficits, and characterize

Chinese industrial and innovation policies as necessary spurs to a developing economy.

In this essay, we identify three tensions in the Sino-US economic relationship, and suggest policy tools for managing, if not resolving the conflicts ahead. To preview our essay, the three tensions are: massive trade imbalances, the special brand of Chinese capitalism, and rocky prospects for mutual liberalization.

8.2 Massive Trade Imbalances

The foremost tension is the huge trade imbalance between China and the world, of which the China-US imbalance is a substantial part. Over the past decade (2001 through 2010), China has cumulated a global trade surplus of USD 1.3 trillion, of which USD 1.1 trillion is attributable to surpluses with the US.²⁶ Though imbalances have recently narrowed, it is unlikely that this will persist as a durable feature of the post-recession global economy.²⁷ Despite the slimmer 2011 trade surplus of USD 100-120 billion anticipated by Chinese officials, US-reported data indicate a possible Sino-US imbalance of USD 250 billion.²⁸ Curbing trade imbalances will require substantial changes in exchange rates between China and its partners, starting with the US. It will also require significant adjustment in national profiles of saving and investment. Imbalances are foremost fiscal and monetary issues, and should be mediated by the institution designed for that purpose, the IMF. In our view, the WTO is ill-suited for the twin tasks of managing exchange rates and adjusting public finances,

25 Trade data are from UN Comtrade (<http://comtrade.un.org>). Foreign direct investment data are as of 2009 (latest available) from the US Bureau of Economic Analysis, "U.S. Direct Investment Position Abroad on a Historical-Cost Basis" (<http://www.bea.gov/international>). Estimates of PRC foreign exchange reserves are from the State Administration of Foreign Exchange, People's Republic of China (www.safe.gov.cn).

26 Trade data are from UN Comtrade as reported by China. PRC reported data differ from US reported data. According to the United States, the 2001-2010 cumulative trade deficit with China was USD 2 trillion.

27 See Lardy, Nicholas, "China's Exchange Rate Policy and Trade Imbalances", Testimony before the Hearing of the Senate Committee on Banking, Housing, and Urban Affairs Subcommittee on Economic Policy, April 22, 2010; (available online at <http://www.piie.com/publications/testimony/testimony.cfm?ResearchID=1552>).

28 The 2011 China-World trade imbalance is as estimated by China central bank adviser Li Daokui; see, "China PBOC adviser sees 2011 trade surplus at \$100-\$120 bln", Reuters News, May 15, 2011. Data for the estimate of China-US trade deficit is extrapolated from US-reported quarter one 2011 data (available online at <http://www.census.gov/foreign-trade/balance/c5700.html>).

and should not be asked to resolve the tension over massive trade imbalances.

Wide gaps between domestic savings and domestic investment persist in both countries, and these gaps are expressed in trade surpluses (China) and trade deficits (United States). One tool for closing such gaps is aggressive fiscal policy, but this tool comes with high political costs. In the US, deficient savings are centred in the federal budget, although state budgets make their own contributions. The US fiscal position, characterized by runaway deficits as far as the eye can see, is unsustainable, and as Herbert Stein plainly put it, “if something cannot go on forever, it will stop”.²⁹ Nearly all US political leaders call for a halt, but forecasting the timing and nature of fiscal responsibility is not easy. Only when crisis strikes? By slashing spending? By hiking taxes? In China, the problem is deficient consumption and excessive private savings, partly the result of retirement fears and partly the consequence of financial repression. China’s leaders welcome a transition to higher consumption, but have yet to mount effective fiscal policies.³⁰ Under its new leadership, perhaps the IMF will accelerate constructive policies. The past record does not inspire confidence that the IMF will nudge its “big boys” into doing the right thing, and China and the US are the two biggest boys on the block. However, the global imbalance problem is sufficiently severe, and US and Chinese fiscal policies are sufficiently out of whack, that this time might be different.

To complement reformed fiscal policies, exchange rates must be realigned so that Chinese exports are more expensive on world markets and US exports are cheaper. Cline and Williamson estimate that the equilibrium

exchange rate for the renminbi is about CNY 5.0 to the US dollar, by comparison with the current value of about CNY 6.4 to the US dollar, implying room for appreciation by nearly 25 percent.³¹ Exchange rate policies are clearly within the purview of the IMF, but again, the IMF has not so far been equal to the task. In frustration, many US legislators have called for trade retaliation in the form of across-the-board tariffs on imports from China, or countervailing duties to offset the “subsidized” renminbi. If enacted, these measures would inevitably land at the doorstep of the WTO, in the form of a monster trade case. This would be unhealthy for the WTO.

Accordingly, if the IMF continues to shirk its duty, we have an alternative suggestion. The US should announce that, unless the renminbi appreciates at a rapid rate toward a level where Chinese global trade surpluses virtually disappear, the US will impose a withholding tax on interest paid on US securities held by official Chinese bodies. Such a policy, as outlined by Gagnon and Hufbauer, is possible with six-month’s notice of cancellation of the Sino-US tax treaty and suitable legislative action to bring the policy into force.³² The long lead-time is a desirable feature in that it sends a credible signal to which China can respond prior to actual implementation of the tax. The US Treasury has a semi-annual procedure for identifying instances of currency manipulation; the Treasury has yet to declare that China is manipulating its currency, but the latest semi-annual report comes close. Our proposed withholding tax should be preceded by a clear statement in the next report that China is manipulating the renminbi and a preview of the future withholding tax should be presented.

29 As quoted by Stanley Fischer, former First Deputy Managing Director of the IMF, January 2, 2001. Available online at: <http://www.imf.org/external/np/speeches/2001/010601.htm>.

30 In 2004, China announced that it was setting a course for more sustainable growth premised on a transition to a less export dependent, more consumption driven model. For further discussion, see Lardy, Nicholas, “China: Toward a Consumption-Driven Growth Path”, *Institute for International Economics*, Policy Brief PB06-6, 2006. Available online at: <http://www.piie.com/publications/pb/pb06-6.pdf>

31 Cline, William, Williamson, John, “Estimates of Fundamental Equilibrium Exchange Rates, May 2011”, *Peterson Institute for International Economics*, Policy Brief 11-5, 2011.

32 Gagnon, Joseph, Hufbauer, Gary, “Taxing China’s Assets, How to Increase U.S. Employment without Launching a Trade War”, *Foreign Affairs*, April 25, 2011.

8.3 China's Brand of Capitalism

China's special brand of capitalism creates its own set of tensions, and these will likely persist even if massive trade surpluses disappear. The brand embodies a mix of support for "indigenous innovation", public subsidies for high-tech industries and casual enforcement of IPRs. In several respects, the Chinese brand seems at odds with the market-oriented rules of the WTO. However, we think WTO success in resolving Sino-US trade disputes during the first decade of China's membership (the period 2001 to 2010) augurs well for managing tensions arising from the Chinese brand, even though past disputes seem modest compared with disputes on the horizon.

It is worth taking a short retrospective glance at the Sino-US record of disputes handled in the WTO, and Table 1 summarizes the record.³³ Since China joined the WTO in 2001, it has lodged 6 cases against the US and defended 11 cases lodged by the US. Chinese complaints

have exclusively addressed US border measures that targeted imports of particular products. By contrast, US complaints have addressed broad behind-the-border measures designed to support Chinese industry through preferential tax and financing terms, monopolistic practices, and lax enforcement of IPRs. The US has invited other WTO Members to join its complaints against China, while China has mounted solo challenges against the US. Broadly speaking, Chinese policies that prompt US complaints are designed to promote sunrise industries, while US policies that prompt Chinese complaints are designed to guard mature industries.

Cases in both directions are clumped in recent years, averaging three to four disputes a year since 2007. The outcomes have been decided both by memoranda of understanding and Appellate Body rulings. All in all, the WTO's Dispute Settlement Mechanism (DSM) has proven to be an effective institution, one which can handle bigger challenges in the decade ahead.

³³ This summary draws on a more extensive review published elsewhere: Hufbauer, Gary, Woollacott, Jared, "Trade Disputes between China and the United States: Growing Pains so Far, Worse Ahead?" Forthcoming, *European Yearbook of International Economic Law*, Vol. 3, January 2012.

Table 1. Sino-US Trade Disputes in the WTO

Request Date	Summary	Trade flow at Issue (\$ Billion)	Current Status	
Complainant: United States				
1.	Mar-04	Value-Added Tax on Integrated Circuits	\$ 2.6	Settled by parties, agreement implemented
2.	Mar-06	Measures Affecting Imports of Automobile Parts	0.5	DSB recommendations to be implemented
3.	Feb-07	Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments	N/A	Settled by MOU
4.	Apr-07	Measures Affecting Trading and Distribution Services for Certain Publications and Audiovisual Entertainment Products	0.4	DSB recommendations to be implemented
5.	Apr-07	Measures Affecting the Protection and Enforcement of IP Rights	N/A	DSB recommendations to be implemented
6.	Mar-08	Measures Affecting Financial Information Services and Foreign Suppliers	0.9	Settled by MOU
7.	Dec-08	Grants, Loans and Other Incentives	N/A	In Consultations
8.	Jun-09	Measures Related to the Exportation of Various Raw Materials	0.1	Panel Composed
9.	Sep-10	Countervailing and Anti-Dumping on Grain Oriented Flat-rolled Electrical Steel from the United States	0.3	Panel Composed
10.	Sep-10	Certain Measures Affecting Electronic Payment Services	N/A	Panel Composed
11.	Dec-10	Measures concerning wing power equipment	N/A	Request for Consultations
Total trade flow at issue:		\$ 4.8		
Complainant: China				
1.	Mar-02	Safeguard Duties on Imports of Certain Steel Products	\$ 0.3	DSB recommendations implemented
2.	Sep-07	Anti-dumping Duties Imposed on Coated Free-Sheet Paper from China	0.4	In Consultations
3.	Sep-08	Anti-dumping Duties Imposed on Certain Products from China	2.9	Appellate Body Reports Issued
4.	Apr-09	Measures Affecting Imports of Poultry from China	N/A	DSB Reports Issued
5.	Sep-09	Safeguard Measures Imposed on Certain Tyres from China	1.9	DSB Reports Issued
6.	Feb-11	Anti-Dumping Measures on Certain Frozen Warmwater Shrimp from China	0.1	Request for Consultations
Total trade flow at issue:		\$ 5.5		

Note: Trade flows represent the dollar value of one-way trade in the product(s) alleged to be impacted by the contested measures in the year of the dispute. It was not possible to estimate the flows at issue for all cases. See text for additional detail.

The complex of support embodied in China's National Indigenous Innovation Products Accreditation (NIIPA) programme exemplifies the bigger challenges ahead. As part of China's science and technology development plan, NIIPA screens manufacturers on several criteria to receive preferences when they bid for government procurement contracts. NIIPA does not explicitly state that preferential treatment will be limited to domestic producers, but that is how implementation could work in practice. In the bilateral Strategic and Economic Dialogue (SED) meetings held in Washington, D.C. in May 2011, the US received assurances that Chinese government procurement would not disadvantage foreign suppliers. Time will tell whether assurances translate into contracts. Meanwhile, a variety of subsidies help Chinese firms, especially SOEs, to compete in international markets. All these practices are grist for WTO cases in the coming years.

Intellectual property rights are another hot-button issue for Sino-US trade relations. The true extent of copyright and patent violations is unknown, much less the scope of industrial espionage. However, Microsoft Chief Executive Steve Ballmer recently revealed that, despite nearly equal sales of personal computers in China and the US, Microsoft collects a slim fraction of US revenues (just 5 percent) from the Chinese market, indicating that the scale of piracy in China is exceptional.³⁴ Moreover, many US firms, most notably Google, claim that the extent of Chinese hacking goes well beyond anything ever experienced.³⁵ In a WTO case, the US successfully challenged one facet of China's IPR law (dealing with the conditions for granting a cinema copyright), but made little legal headway on enforcement issues. Even though Chinese courts have adjudicated

many more IPR cases in recent years, violations of WTO norms are still pervasive.³⁶ Putting an optimistic outlook on the situation, we think that WTO cases, one-by-one, might nudge China into better compliance.

Nevertheless, a strategic choice faces the US: whether to pursue subsidy and IPR complaints one-by-one, or whether instead to launch a comprehensive Nullification or Impairment case (GATT Article XXIII). We think the case-by-case approach is less abrasive to overall Sino-US relations and should be pursued first. Accordingly, we would hold an Article XXIII case in reserve, at least until the case-by-case approach is tried and fails. However, if the US eventually decides to launch an Article XXIII case, it should cite the undervalued renminbi as an additional grievance that upsets the balance of Chinese rights and obligations under the WTO system.

8.4 Rocky Prospects for Mutual Liberalization

China has become a unique obstacle to completing the Doha Development Round. China's share of manufactured exports has posted unprecedented gains since it joined the WTO in 2001; by 2009, China sold approximately 20 percent of US imports of manufactured goods, and 10 percent of world imports.³⁷ As Mattoo, Ng, and Subramanian argue, China's role as a massive exporter to the world has meant that few developing countries will agree to lower their applied tariffs, fearing a further deluge of Chinese manufactured goods, especially since China has deliberately undervalued its exchange rate.³⁸ Meanwhile, the US and the EU demand that China open its own service markets to commercial access by Western firms (Mode 3 in GATS), and slash

34 Fletcher, Owen, Dean, Jason, "Ballmer Bares China Travails", *The Wall Street Journal*, May 26, 2011. Note that this margin likely also reflects lower prices and potentially higher use of alternate operating systems in China.

35 See for example: Areddy, James "Beijing Fires Back at Google", *The Wall Street Journal*, June 3, 2011; Markoff, John, Barboza, David, "U.S. to Investigate Google China Hacking Claims", *International Herald Tribune*, June 3, 2011.

36 Sepetys, Kristina, Cox, Alan, "Intellectual Property Rights Protection in China: Trends in Litigation and Economic Damages", National Economic Research Associates, 2009.

37 Data are from UN Comtrade.

38 See Mattoo, Aaditya, Ng, Francis, and Subramanian, Arvind, "The Elephant in the 'Green Room': China and the Doha Round", *Peterson Institute for International Economics*, Policy Brief PB11-3, May 2011. Available online at: <http://www.piie.com/publications/pb/pb11-03.pdf>

The main role for the WTO, with respect to the US and China, will be as home for the dispute settlement mechanism, handling future cases concentrated on the rough edges of the Chinese brand of capitalism.

its tariffs to OECD levels (under 4 percent on average), concessions that China is unwilling to make, despite its huge trade surpluses.

As a consequence, even if Doha negotiations drag to a shallow conclusion, the prospects for mutual trade liberalization between China and the world (including the US) seem rocky. One forecast is that China and the US will go their separate ways with preferential trade agreements. The US will likely put its bets on the Trans Pacific Partnership (TPP), eventually trying to engage all Pacific countries in the TPP venture -- except China. China will likely develop a global network of PTAs, placing most emphasis on its Asian neighbours. Indeed, talk of the fabled China, Japan, Korea PTA is again in the air.³⁹

Another forecast is that, in the post-Doha era, WTO negotiations will focus on “clubs”, illustrated by the Government Procurement Agreement: liberalization only between WTO members that choose to accept club rules. For example, clubs might be formed between members that agree to liberalize environmental goods and services; or between members that agree not to subsidize fossil fuels; or between members that agree to liberalize a range of services or between members that agree to mutual recognition of certain product

standards. China might seek membership in some of the clubs, and the US in others - but it is hard to identify clubs that both China and the US would find it advantageous to join.

8.5 Conclusions

Selected trade and investment flows may be liberalized between the US and China in the decade ahead. But, this will happen as a consequence of unilateral liberalization by each country in its own self-interest, or liberalization in the context of PTA liberalization that spills over to the entire world,⁴⁰ rather than reciprocal liberalization between China and the US in the WTO, trading concession for concession.

The main role for the WTO, with respect to the US and China, will be as home for the dispute settlement mechanism, handling future cases concentrated on the rough edges of the Chinese brand of capitalism. In addition, of course, China will challenge US trade restrictions that go beyond the boundaries of the WTO rule book.

As for massive trade imbalances between China and the world (including but not limited to the US) these should be resolved by a combination of currency (renminbi) appreciation, fiscal discipline in the US and consumption spending in China. If the IMF fulfils its own mandate, it will forcefully encourage both countries to take essential steps to curb their dangerous imbalances. The worst outcome, but one that cannot be ignored, is the possibility that massive imbalances will erupt in trade restrictions that do severe and permanent damage to the multilateral trading system.

³⁹ Monahan, Andrew, Fletcher, Owen, “Japan, China, South Korea Eye Trade Pact”, *The Wall Street Journal*, May 22, 2011.

⁴⁰ “Spill over liberalization” often happens when countries liberalize Mode 3 service markets in a PTA; the reason is that strict rules of origin are not applied to service firms established in partner countries.

9. CHINA'S RISE – OPPORTUNITIES AND CHALLENGES FOR AFRICA

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9.1 Introduction

In 2010 China became the second largest economy in the world, surpassing Japan in terms of nominal gross domestic product.⁴² In the same year China regained its former title as the leading manufacturing nation. In March 2011, the *Financial Times* reported, “China has become the world’s top manufacturing country by output, returning the country to the position it occupied in the early 19th century and ending the US’s 110 year run as the largest goods producer”.⁴³ China has the largest trade⁴⁴ and current account surpluses in the world and the world’s largest foreign exchange reserves valued at about USD 2.6 trillion in January 2011.⁴⁵

The rise of China has changed the geography of world trade. An analysis of the recent data on global trade flows reveals at least five significant new trends. First, the rise of China has resulted in the relative decline of the traditional economic powers, such as the US; European powers, such as France, Germany and the UK; and Japan. Second, the rise of China has been accompanied by several other major developing countries, such as Brazil and India. Third, China’s rise has created major trade and current account imbalances between itself and the two major economic powers, the US and the EU. Fourth, the rise

of China has created a structural shift in the pattern of trade flows for Japan. Japan’s trade with both the major economic poles of the US and the EU has declined and much of this trade has shifted to China. Fifth, China’s rising surpluses with the US and the EU have been accompanied by increasing trade deficits between itself and East Asia. These trends will be elaborated in section 9.2 below.

A recent study describes the new form of global production that has been shaping these trade trends.⁴⁶ This increasingly dominant form of production has witnessed a shift of production from the traditional factory floor of the 19th century to a network of suppliers specialized in specific phases of the production process creating a global value chain. This new trend in production was given impetus by the acceleration of globalization during the 1990s. Globalization was characterized by increased flows of trade, investment and technology in the global economy. However, the rapid advances in information technologies and the reduction of transport costs in the 1990s created the basis for an expansion of globalization in the 1990s. The fall of the Berlin Wall, the re-integration of Eastern Europe into the world economy and the accession of China to the WTO in 2001 have created the basis for the further expansion and deepening of globalization. These factors together laid the basis for a major historic shift of global production, placing China at the centre of global supply chains.

41 Faizel Ismail is the Ambassador Permanent Representative of the South Africa to the WTO. This paper is written in his personal capacity. The paper is based on a presentation made on 29 June 2011 to an ICTSD Dialogue. The author is thankful to Xavier Carim, Rorden Wilkinson, James Scott and Bonapas Ongugloo for very helpful comments on an earlier draft.

42 WTO, “Trade patterns and global value chains in East Asia: From trade in goods to trade in tasks”, IDE-JETRO and WTO, 2011.

43 Marsh, P., “China noses back ahead as the top goods producer to halt 110-year US run”, *Financial Times*, 14 March 2011. The article recorded the leading manufacturers since the Dark Ages as follows: 500-1700, China or India; 1700-1850, China; 1850-1895, Britain; 1895-2010, US; China, 2010. China last year (2010) accounted for 19.8 percent of world manufacturing output, fractionally ahead of the US with 19.4 percent”

44 China’s total trade surplus was estimated to be about USD 1.3 trillion in 2010 and about USD 1.1 trillion of this surplus was with the US according to Hufbauer, G., and Woollacott, J., “A Decade in the WTO: Implications for China and Global Trade Governance”, 29 June 2011. Think Piece prepared for the ISTSD.

45 *Financial Times*, “Why China hates loving the dollar”, 26 January 2011

46 WTO, “Trade patterns and global value chains in East Asia: From trade in good to trade in tasks”, IDE-JETRO and WTO, 2011.

China's rise has transformed global production and trade patterns. The most dramatic of these changes has been the shift of global supply chains with Japan at the centre in the 1990s to China as the new locus of production in the first decade of the 21st century. This shift has taken place both within the context of East Asia, putting China at the centre of the final production and export base for East Asia, and for the global economy. This historic transformation in the world economy has had two significant effects on other developing countries. First, the huge demand created by China as the final centre of production and assembly increased the prices and values of commodities. Second, this change had the effect of turning the terms of trade against low value-added manufactures. Thus, developing countries producing commodities, such as coal and oil, to agricultural products such as soybeans, made significant gains, while developing countries that produced low value-added manufactures, such as textiles and footwear, made significant losses. In addition, the rise of China as the "factory of the world" raised the level of competition in low value-added manufactures, and the developing countries that were competing directly with China in these products suffered major losses in production and employment.⁴⁷ This shift in the underlying forces of production has been responsible for the dramatic changes in trade flows described above. We discuss this in more detail in section 9.2 below.

However, China's rise has led to a number of myths and misconceptions about its development status, its export prowess and its "capture" of African natural resources. Each of these issues is discussed in section 9.3 below. We argue that while China has become the second largest economy in the world, it still has very significant development challenges, and even when it overtakes the US as the world's largest economy by 2050, it will have a per capita income about one-third that of the US. Second, we argue that new research on the value added in production has revealed that China (as the final assembler of the production

process) adds very little of the value of its final export products, and thus the data on trade flows will need to reflect this more accurate description of China's role in global exports. Third, we argue that the image of a rapacious China capturing the bulk of Africa's natural resources, particularly in the oil and gas sector, needs to be moderated by the reality that China remains a minor investor in Africa compared with the major industrial economies.

In section 9.4 (a) of this paper, we discuss China's trade and economic relationship with Africa, one of the poorest regions of the world, in the context of the broader changes to the world economy discussed above. We argue that China's new role in the global economy offers both new opportunities and challenges for African economies. The new opportunities for Africa are discussed in section 9.4 (b) below. These include; as a source of finance, foreign direct investment, export market, partner for development cooperation and increased leverage to improve global governance.

However, the rise of China also presents significant challenges for its trade and economic relationship with Africa. China's trade with Africa has overtaken its trade with the European countries and the US, to become Africa's top trading partner in 2009. However, the composition of trade between China and Africa reflects a similar pattern to that between Africa and the advanced developed countries. Africa's exports to China constitute mainly raw materials, about 70 percent of its export basket, while its imports from China constitute mainly manufactured products, about 80 percent of its import basket. Thus, this pattern of trade threatens to reproduce the existing pattern of uneven and imbalanced trade that has characterized the trade between Africa and the advanced industrial economies over the past century. In addition, the rise of China as the leading producer of low value-added manufactures and the change in the terms of trade against low-value manufactures has created significant development challenges

⁴⁷ Weil Liang, "Trade Diplomacy: China's Engagement with the Global South in the New Century", Graduate School of International Policy Management, Monterey Institute of International Studies, Monterey, California. Unpublished paper.

for African countries. It will be argued that China can contribute to the development of Africa by addressing these challenges in at least three ways: increase financial aid to build infrastructure and industrial capacity, increase the imports of beneficiated manufactured products and manage its exports of low-value manufactures to Africa. These challenges will be discussed in section 9.4 (c).

The concluding section calls for a new type of partnership between China and Africa - one that is characterized by greater balance, equity and sensitivity to the development challenges of Africa than has been exhibited by the major developed countries in the past few centuries. It is argued that the abundant natural resources of Africa, the growing consumer power of Africa's middle class and high growth rates offer China and Africa the opportunity to build a more sustainable and mutually beneficial relationship in the next decade. Both Africa and China must seize this opportunity.

9.2 The Rise of China and its Underlying Causes

The fall of the Berlin Wall in 1990, the re-integration of Eastern Europe and the increasing openness and accession of China to the WTO in 2001 created the impetus for the expansion and deepening of globalization in the 21st century.

The pattern of trade between China and the rest of the world since its accession to the WTO in 2001 has been dramatic and transformational. For Africa to take advantage of the opportunities associated with the rise of China, the particular features and characteristics of China's new role in the world economy need to be understood. In this section we provide some detailed figures to illustrate the rise of China. We then discuss the underlying structural and productive forces that provide an explanation for these dramatic changes.

In 2009, China overtook Germany as the lead exporter of merchandise while the US remained the world's leading importer. By 2010, China accounted for 10.4 percent of world exports. China also became the world's second largest importer.⁴⁸ China is also the world's largest importer of several commodities, such as iron ore, nickel ore, soybeans, coal, copper ore, aluminium ore and oil.⁴⁹ The rising share of China has been accompanied by the falling shares of the major G7 economies, such as the US, Germany, Japan, France, and the UK, as reflected in Table 2 below. In addition, the rise of China has also been accompanied by the rise of the trade shares of other major emerging economies, especially India and Brazil. Africa too has seen a small but very significant rise in its share of world trade (discussed further in the section below).

Table 2. World Merchandise Exports

World merchandise exports	1993 percentage share	2010 percentage share
China	2.5	10.4
US	13	8.4
Germany	10.3	8.3
Japan	9.9	5.1
France	6	3.4
UK	4.9	2.7
India	0.6	1.4
Brazil	1	1.3
Africa	2.5	3.3

Source: WTO, *International Trade Statistics, 2010 and 2011*.

⁴⁸ WTO, *International Trade Statistics, 2010*, p. 10

⁴⁹ *Financial Times*, "How China should rule the world", 23 March 2011

Let us examine the changing patterns of world trade between China and the world's largest economies. The data in Table 3 reflects that the share of US exports and imports to the EU remained more or less stable from 2000 to 2009. In sharp contrast, US exports to China grew rapidly from 2 percent of its total exports to 6.6 percent of its total exports. And even more dramatically, US imports from China as a share of its total imports rose from 8.5 percent in 2000 to 19.3 percent in 2009, making China its largest source of imports. Similarly, EU exports to China rose between 2000 and 2009, and its imports rose more dramatically, making China its largest source of imports by 2009.

Table 3 also reflects that China became both the largest export destination of Japan in 2009 and its largest source of imports. China's share of Japanese exports rose from 6.3 percent in 2000 to 18.9 percent in 2009 while China's share in Japanese imports rose from 14.5 percent in 2000 to 22.2 percent in 2009. The direction of Japanese exports and imports both shifted dramatically from the US to China between 2000 and 2009. In 2000, the US accounted for 30 percent of Japanese exports while this had fallen to 16.4 percent in 2009. Similarly, the US share of Japanese imports fell from 19 percent in 2000 to 10.7 percent in 2009.

Table 3. Trade Flows

	2000 % share	2009 % share
Export from US to EU	22	21
Imports from US to EU	19	18
Exports from US to China	2	6.6
Imports from US to China	8.5	19.3
Exports from EU to China	1	2.5
Imports from EU to China	2.7	6.3
Exports from Japan to China	6.3	18.9
Imports from Japan to China	14.5	22.2
Exports from Japan to US	30	16.4
Imports from Japan to US	19	10.7

Source: WTO, *International Trade Statistics*, 2010.

Table 4 reflects the huge trade surpluses that China has developed with both the US and the EU. In sharp contrast China ran significant

trade deficits with Asia, including Japan, Chinese Taipei and Korea.

Table 4. China's Balance of Trade

2009	Exports	Imports	Surplus/Deficit
China - US	US \$221 billion	US \$78 billion	US \$143 billion
China - EU	US \$ 236 billion	US \$127 billion	US \$109 billion
China - Asia	US \$516 billion	US \$581 billion	US \$- 65 billion

Source: WTO, *International Trade Statistics*, 2010

How should we understand this dramatic transformation in the world economy in the past decade? Part of the explanation resides in the structural changes in global production. Multinational corporations increasingly began to integrate their production "horizontally" (shift of location to capture markets) and "vertically" (corporate ownership and control of upstream suppliers and downstream buyers).

Vertical specialization was propelled by rapid changes in information technology and cheaper transportation. This created the basis for increasing fragmentation of production into distinct tasks that could be outsourced. MNCs took advantage of the differential production and labour costs in different countries and regions. Thus, "the integrated factory floor of the 19th century was increasingly replaced with

a network of individual suppliers specializing in specific services or phases of production". This sequence of value-added activities has been called a "global value chain".⁵⁰

This model of production started in the US with firms, such as Nike, focusing on branding and marketing and outsourcing the production to external suppliers in other countries. Many retail chains also began to drive international chains of suppliers in different countries (Walmart, Ikea, etc). As the bulk of this subcontracting was with Asia, the concept of "Factory Asia" emerged, with Japan dominating trade with the US from 1970 to the 1990s. However, by the late 1990s and early 2000s many supply chains that were producing for the US market increasingly relocated to China as a result of the more favourable economic environment created by China's increased openness, its accession to the WTO in 2001 and its lower labour costs. Wal-Mart alone has accounted for nearly one-tenth of all imports to the US from China in recent years.⁵¹

The emergence of China as the major trading partner of the US also led to the relative decline of the trade of Japan, Korea and other ASEAN countries with the US and the EU. Thus, the structural deficit the US held with Asia merely shifted to China. The US has been suffering from a structural deficit with Asia since the 1970s. China inherited a major trade surplus with the US as the supply chains at the final stage of production shifted to China, making China the processing hub or "processing factory of the world".⁵² Thus, the model of production that emerged is one where the final stage of production takes place in China, while the bulk of the value added takes place in other countries, especially in the US, the EU and Japan.

Thus, while the production system in Asia developed with Japan at its core in the 1990s, this system became more intense around China in the early 21st century. The shift of China to the centre of the production chain can be explained by the analysis of trade in intermediate goods. China became the core market for intermediate products, from which final consumption goods were produced for export to the US and to European countries. China was not only the largest importer of intermediate goods in Asia, but also the largest importer of intermediate goods in the world. Thus, in 2009, US exports to China were mainly intermediate goods while its imports were principally final goods. China's role is underlined as a manufacturer for the US, the EU, Japan and other parts of the world.

China's role as the factory of the world has brought down the prices of manufactured products, creating increasing demand for these low-priced products and improving the affordability of these products in both developed and developing countries. In addition, the increased demand for manufactures has increased the demand for inputs for manufactures, increasing the prices for primary products and raw materials, such as coal, oil, base metals and agricultural products. Therefore, a large number of commodity producing countries, such as Argentina and Brazil have gained from the increased prices of commodities.

African countries have gained increased revenues, bolstering their growth rates and creating wealth for infrastructure development and poverty reduction.⁵³ Thus, the increased prices of commodities and the declining prices of low-value manufactured products have led to a change in the "terms of trade".

50 WTO, "Trade patterns and global value chains in East Asia: From trade in good to trade in tasks", IDE-JETRO and WTO, 2011.

51 Surowiecki, J., "The Free-Trade paradox", *The New Yorker*, 26 May 2008. quoted in, Weil Liang, "Trade Diplomacy: China's Engagement with the Global South in the New Century", Graduate School of International Policy Management, Monterey Institute of International Studies, Monterey, California. Unpublished paper.

52 WTO, "Trade patterns and global value chains in East Asia: From trade in good to trade in tasks", IDE-JETRO and WTO, 2011.

53 Weil Liang, "Trade Diplomacy: China's Engagement with the Global South in the New Century", Graduate School of International Policy Management, Monterey Institute of International Studies, Monterey, California. Unpublished paper.

Developing countries producing commodities have benefited from this change while developing countries producing low-value manufactured products, including clothing and textiles (such as Lesotho, Mauritius, South Africa and several African countries), and that have had to compete with China have suffered considerable job losses and factory closures.⁵⁴

Another peculiar feature of the new global economy is that while the lion's share of value added goes back to the country at the top of the production chain, MNCs increasingly are creating jobs abroad. We illustrate this argument with the case of the Apple iPod. In 2006, Apple iPod employed nearly twice as many people outside the US as it did in the US where it was invented - 13,920 in the US and 27, 250 abroad.⁵⁵ Increasingly, US MNCs will base their growth strategies on the fast emerging markets, vertically integrating and horizontally integrating their production to compete and take advantage of the new fast-growing emerging markets led by China, India and Brazil.

Even more significant, not only were more iPod jobs created in the US, but also the lion's share of iPod salaries went to US workers. The 13,920 workers in the US earned nearly USD 750 million while the 27, 250 workers located outside of the US earned less than USD 320 million. In the US, more than half the jobs went to retail and other professional workers who earned USD 220 million while 6100 engineers and professional workers in the US earned USD 525 million.⁵⁶ Thus, most iPod jobs are poorly paid and low skilled and most of these are created outside the US, while a small proportion of highly paid professionals in the US and the owners of Apple make the lion's share of the value. This is why the recovery from the US after the Great Recession is going to be slow and painful for US workers. The growth in the US is created

by innovation-driven companies, like Apple. For these companies, the growth is likely to result in a hollowing out of production related jobs in the US, as production is progressively outsourced to other fast-growing emerging markets, like China. This trend will continue to foster increasing calls for protectionism and a backlash against the fast-growing emerging markets, such as China, India and Brazil.

9.3 Myths and Misconceptions about China's Rise

For Africa to take advantage of the opportunities for more beneficial trade and economic relations created by the rise of China, it will need to distinguish between fact and fiction in the narratives about China's rise in the mainstream press and literature. We have identified three significant myths and misconceptions of China's rise that need to be explained and demystified. First, despite China's rise, the majority of its people are still poor, and it shares many development challenges with Africa. Second, while China has become the largest exporting country, the value of its exports remains relatively low. Third, the spectre of Chinese dominance of Africa's resources needs to be measured against the fact that Chinese investment encompasses a very small share of Africa's resources.

China and other emerging developing countries are still poor and their development challenges remain large

China's rise to become the second largest economy and the world's largest exporter and largest manufacturer has prompted concerns and political pressures in the US and the EU to treat China as being equal to the level of development of developed countries. There have also been pressures on China and other emerging developing countries, such as India and Brazil, to take equal responsibility as developed countries in the WTO Doha Round

54 See Van der Westhuizen, C., "The clothing and textile industries in sub-Saharan Africa: an overview with policy recommendations", in Le Pere, G, *China in Africa. Mercantilist predator, or partner in development?*, Institute for Global Dialogue, Midrand South Africa and The South African Institute of International Affairs, Johannesburg, South Africa, 2007.

55 *International Herald Tribune*, 1 July 2011.

56 *International Herald Tribune*, 1 July 2011.

and in the Climate Change negotiations. However, these demands fail to recognize that China and other emerging developing

countries are still poor and their development challenges remain large. About 150 million people in China still live under USD 1 a day.

Table 5. Poverty Levels

2008	GDP	% below \$2	% below \$1.25	per cap inc
US	14.4	-	-	47,744
China	4.3	36	16	2,940
India	1.2	75	41	1,070
Brazil	1.6	13	5	7,350
South Africa	0.3	42	26	5,820
Sub-Saharan Africa	0.9	73	51	1,125

Source: The World Bank, *World Development Report*, 2010

The US remains the world's largest economy and the largest beneficiary of liberalization under the GATT.⁵⁷ It is still the world's richest economy, with a per capita income 15 times that of China and 47 times that of India (see Table 5).⁵⁸ While millions of people have been rescued from poverty due to the high growth in these economies, a large percentage of the people remain poor. In the case of China, 36 percent of its people still live under USD 2 a day. It will take at least 50 years before the US can demand to put these economies on the same playing field as its own. Some recent scenarios of global growth project that while China will become the world's largest economy by 2050 and India will be the world's third largest economy after the US, US per capita GDP will still be three times that of China and more than eight times that of India in 2050.⁵⁹

However, these projections point out that while some African countries (such as Ethiopia, Ghana, Kenya and Nigeria) could grow exponentially in the next 40 years, African per capita incomes will remain a fraction of those in China and less than half of China's by 2050.⁶⁰ This study raises the possibility of countries in sub-Saharan Africa becoming

competitive with China (and India) in labour-intensive manufactures as well as destinations for outsourcing. China and India can thus become major export destinations for Africa not only in raw materials, but also in basic manufactures.

China's high volume of exports should not be confused with high value.

The high volume of China's exports has created alarm in many quarters. However, the actual value-added of its exports is a fragment of the total value of its exports, as the bulk of its exports are intermediate products. A recent study argues that the trade deficits of the US and the EU with China (discussed above) are overstated as it does not take into account that most of the value of the exports from China does not originate in China.⁶¹ The study points out that if the valued added from the Asian region (Japan, the Republic of Korea, Malaysia, etc) that is embedded in China's exports to the US was taken into account, the trade deficit of the US with China in 2008 should be reduced by about 40 percent.

This analysis is supported by the case of Apple's iPhones. This study finds that "even

57 F. Bergsten, "Obama needs to be bold on trade", *Financial Times*, 24th June 2009.

58 World Bank, *World Development Report*, 2010

59 Dadush, U., and Stancil, B., "The World Order in 2050", *Carnegie Policy Outlook*, Carnegie Endowment For International Peace. Working Draft. February 2010. See also Dadush, U., and Shaw, W., *Juggernaut. How Emerging Markets are Reshaping Globalization*, Carnegie Endowment for International Peace, Washington, D.C, 2011

60 See also Dadush, U., and Shaw, W., *Juggernaut. How Emerging Markets are Reshaping Globalization*, Carnegie Endowment for International Peace, Washington, D.C, 2011

61 WTO, "Trade patterns and global value chains in East Asia: From trade in good to trade in tasks", IDE-JETRO and WTO, 2011.

though the devices are made in China, the financial value added there is very low".⁶² While China is the final assembler, it imports intermediate goods from a range of countries, including, Japan, Germany, and the Republic of Korea. China, however, accounts for less than 4 percent of the US deficit in iPhones, while Japan, which is not included in the usual statistics, accounts for 35 percent of the same deficit.⁶³

China is still a relatively small investor in Africa's resources.

The recent sharp increase in investment by China in Africa's resources, partly to secure its supply of raw materials and energy to fuel its high growth has created a spectre of Chinese attempts to "colonize" Africa. However, total Chinese FDI remains relatively small compared with FDI from developed countries and its share of total investments in Africa's resources is low compared with Western companies.

UNCTAD estimates that global FDI outflows in 2010 totalled USD 1.3 trillion with about USD 969 billion) of this from developed countries and about USD 300 billion from developing countries. However, about 70 percent of developing country outward FDI went to other developing countries. China has become a major outward investor.⁶⁴ In 2010, Chinese companies invested USD 68 billion abroad, rising from less than USD 1 billion in 1990 (about USD 900 million).⁶⁵ In comparison, the US was responsible for USD 325 billion of outward FDI in 2010, more than four times that of China. Currently, the developed countries account for the bulk of FDI flows and stock in Africa. In 2008, developed countries accounted for 91.6 percent of total FDI stock

in Africa, while developing countries' FDI stock grew to 7.4 percent.⁶⁶

Oil is a good example of the position that China occupies in Africa's resources. A Brookings study finds that while China is acting to secure resources, it has entered the race very late and is only getting the dregs.⁶⁷ Western MNCs still own the bulk of foreign ownership of Africa's oil resources. China is still a relatively modest investor in Africa's oil sector. In 2007, the value of China's national oil companies' (CNPC, Sinopec, and Sinochem) oil investments were still relatively modest at just 8 percent of the combined commercial value of international oil companies' (such as Exxon-Mobil, Total, Shell, Chevron and BP) investments in Africa.⁶⁸

9.4. a). China's Trade with Africa

The WTO's analyses of world trade records that trade within regions dominate world trade.⁶⁹ In 2009, trade within Europe accounted for 72 percent of European trade, intra- North American trade constituted 48 percent of its trade and trade within Asia accounted for 52 percent of its trade. In sharp contrast, trade within Africa was, about 12 percent of its total trade. In the section below we examine China's trade with Africa in more detail.

Africa's share of world trade increased from 2.2 percent in 1995 to 3.3 percent in 2008.⁷⁰ The value of trade between Africa and China increased nearly tenfold between 2000 and 2008 and amounted to USD 93 billion in 2008. By 2009 China overtook the US to become the top trading partner of Africa. By 2010, China

62 *International Herald Tribune*, "To have and to have not: the iPod test", 1 July 2011.

63 WTO, "Trade patterns and global value chains in East Asia: From trade in good to trade in tasks", IDE-JETRO and WTO, 2011.

64 UNCTAD Global Investment Trends Monitor, No 6. April 2011

65 See also Financial Times, "Global Pioneers of China Inc", 28th June 2011.

66 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

67 Downs, Erica.S., "The Fact and Fiction of Sino-African Energy Relations", *China Security* Vol. 3, No. 3 Summer 2007.

68 Downs, Erica.S., "The Fact and Fiction of Sino-African Energy Relations", *China Security* Vol. 3, No. 3 Summer 2007.

69 WTO doc, *International Trade Statistics*, 2010

70 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

also overtook the US to become South Africa's top trading partner. China accounts for 11 percent of Africa's external trade and it is the regions largest source of imports.⁷¹

Interestingly, Africa's trade with other non-African developing countries also increased from 19.6 percent in 1995 to 32.5 percent in 2008. This growing share of other developing countries in Africa's share of total trade has led to a decline of Africa's trade with its traditional partners in the EU and the US. The EU share of Africa's trade had declined from 55 percent in the mid-1980s to below 40 percent in 2008. The expansion of the trade between Africa and China has been the main driver of this change.

In 2009, China imported USD 38 billion of fuels and mining products from Africa and exported USD 48 billion of manufacturers. Of this, machinery and transport equipment made up USD 18 billion. In the case of South Africa the composition of its trade with China was similar to that of other African countries, exporting mainly minerals and other primary products to China and importing mainly manufactured products.⁷²

China's trade and economic relationship has evolved considerably since the founding of the Peoples Republic of China in 1949. In 1964, China provided 53 percent of the loans received by Africa, and in the 1970s it financed the Tazara Railway Line from Zambia's copper belt to the port of Dar es Salaam in Tanzania. However, since the formation of the Forum on China-Africa Cooperation (FOCAC) in 2000, this relationship has expanded rapidly.

FOCAC has met every three years at the ministerial and presidential levels and made a large number of commitments to enhance its support to Africa in a number of areas, including opening its market up to 95 percent for LDCs, to provide concessional loans and grants, to provide support for infrastructure, and to grant generous debt relief.⁷³

9.4 b). New Opportunities for Africa in China

China's rise provides Africa with at least five major new opportunities. It provides a new source of finance, new source of FDI and hence for industrial transformation, a new dynamic export market, a new form of development partnership and increased leverage to improve global governance. We discuss these issues in turn below.

Finance

China is the main source of southern aid to Africa, accounting for 83 percent of estimated southern flows in 2006 (about USD 2.3 billion).⁷⁴ The bulk of this support was for infrastructure and public works, estimated at USD 4.7 billion in 2007. The main sectors targeted were electricity, transport and ICT, and the main beneficiary countries included Angola, Ethiopia, Nigeria and Sudan.⁷⁵ At several FOCAC meetings China committed to provide debt relief and cancel overdue debt by African countries. At the 2006 FOCAC, it committed to cancel about USD 1.3 billion of African debt, and this commitment was made again at the 2009 FOCAC Summit for debt that was still due at the end of 2009.⁷⁶

71 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

72 WTO, International Trade Statistics, 2010

73 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

74 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

75 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

76 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

Foreign Direct Investment

Foreign direct investment to Africa increased from USD 2.4 billion in 1985 to USD 87.6 billion in 2008. Africa's share of global FDI inflows increased from 4.4 percent in 1985 to 5.2 percent in 2008. China has become a major outward investor. In 2010, Chinese companies invested USD 68 billion abroad, rising from just USD 900 million in 1990.⁷⁷ This surge in investment has been driven by a more favourable investment climate, high commodity prices and high economic growth. Currently, the developed countries account for the bulk of FDI flows and stock in Africa. In 2008, developed countries accounted for 91.6 percent of total FDI stock in Africa, while developing countries' stock grew to 7.4 percent. Southern countries share in FDI flows to the region have been growing, constituting 20 percent of such flows between 2000 and 2008.

Chinese investors have focused mainly on resources and infrastructure although they have also been increasingly "market seeking". South Africa has received the bulk of FDI from China, accounting for 40 percent of the stock of FDI in Africa.⁷⁸ In 2008, the Industrial and Commercial Bank of China purchased a 20 percent stake in South Africa's Standard Bank for USD 5.64 billion, making this South Africa's largest single foreign investment. Other significant investments have gone to Nigeria (USD 796 million); Zambia (USD 651 million); Sudan (USD 528 million); Algeria (USD 509 million); Mauritius (USD 230 million); Tanzania (USD 190 million) Madagascar (USD 147 million); and Ethiopia (USD 127 million). In 2008 China had total investment stock of USD 7.8 billion in Africa.

Export Market

China's trade with Africa has grown exponentially since 2001. In 2001, its exports to Africa totalled USD 5.9 billion and by 2010 this grew to USD 60 billion. Similarly, in 2001

China's imports from Africa totalled USD 4.8 billion, and by 2010 its imports had grown to USD 67 billion. China, thus, had a trade deficit with Africa in 2010 of USD 6 billion. South Africa's trade with China also grew dramatically. In 2001 China's exports to South Africa were valued at USD 1 billion and by 2009 this rose to USD 7.4 billion. Similarly, in 2001 China's imports totalled USD 1.2 billion and by 2009 they totalled USD 8.7 billion. Thus, China became the largest trading partner of Africa in 2010 and the largest trading partner of South Africa, Africa's largest economy.

China has been the cause of the increased value of African resource products, by increasing the demand for these products. It is also a major market for the export of these products. The value of African exports to China has grown exponentially. However, this pattern of trade could reinforce the general imbalanced pattern of trade that exists between Africa and developed countries. The challenge will be to begin to benefit and diversify its production and export basket through investments in infrastructure, beneficiation of minerals and processing of agriculture, industrial development and export capacity.

Development Partner

China's dramatic growth and innovative development path has created new space for developing countries to learn and implement alternative development strategies to the orthodox Washington consensus. China's experience has shown how a developing country can guide and lead the growth of its productive capacity as well as its development strategy and reduce poverty. Chinese technical assistance and the sharing of its development experience will be crucial for Africa in the years ahead.

In this context, there is some evidence that China has already begun to participate in this process. The FOCAC meeting of 2009 made

⁷⁷ Financial Times, "Global Pioneers of China Inc", 28th June 2011.

⁷⁸ UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

commitments to share China's experience with Africa on climate change, science and technology, poverty alleviation, small and medium enterprises, agricultural technology, health etc.⁷⁹

Global Governance

China's rise has increased the bargaining power of developing countries in the multilateral system. This has covered a range of areas, including the IMF, the World Bank and the Climate Change negotiations. China's accession to the WTO has coincided with an increased assertiveness of developing countries in the Doha Round of trade negotiations. China has played a positive and constructive role, joining in the struggles of developing countries to create fairer, more balanced and development-friendly trade rules in the WTO. China joined with India, Brazil, South Africa and Kenya to negotiate to create flexibility in the TRIPS Agreement for more affordable medicines. It also joined Brazil, India, South Africa and other developing countries to create the G20 - one of the most formidable developing country alliances in the WTO - for a fairer agricultural trade regime. It supported developing countries in their need for increased flexibilities in NAMA when China could very well have put more pressure on developing countries to reduce the flexibilities that could shield developing countries from Chinese exports.

In addition, China has supported the efforts of developing countries in general to reform the WTO to make it more transparent, accountable, representative (eg, the diversity proposal in the budget committee) and development friendly (eg, support for more equitable rules for LDC accessions). Thus, China has increased the bargaining power and capacity of the developing countries by playing an active role in several developing country alliances (such as the G20 and the G33).

9.4 c). Challenges for China in its Trade with Africa

There are at least three important challenges for China in building a new type of development partnership with Africa in the 21st century. First, there is a need for China's financial aid and FDI to reduce Africa's dependence on its natural resources and promote Africa's industrial development. Second, China should support the development of beneficiated exports from Africa. Third, China should manage its exports of low-value manufactured exports that compete with African manufactures. We discuss each of these three challenges below.

Reduce Africa's dependence on natural resources

China's support for infrastructure in Africa is often backed by access to natural resources—oil in Sudan, Nigeria, Angola, and the Democratic Republic of Congo; bauxite in Guinea; iron in Gabon; chromium in Zimbabwe; and cocoa in Ghana.⁸⁰ The jury is still out on whether these investments have helped to increase diversification and beneficiation of these natural resources as opposed to making these countries more dependent on these natural resources. The challenge is for aid for infrastructure to also finance regional projects, reducing transaction costs and linking regional economies and boosting intra-Africa trade and investment flows. A related challenge is for China's investment to establish joint ventures with or encourage development of local enterprises to participate in the building of infrastructure and to acquire skills, technology and competitiveness.

Although the bulk of Chinese FDI has been in natural resources and infrastructure, there is increasing evidence that new investments are going into finance (Standard Bank in South Africa); light manufacturing; agriculture, etc. China's FDI into Africa constituted a mere

79 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

80 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

China can build a new type of partnership with Africa - one that is not based on reinforcing dependence, but on building mutually beneficial economic relations that advance the development of Africa and contribute to successfully re-integrating Africa into the world economy.

4.2 percent of Chinese FDI stock abroad in 2008. Sovereign wealth funds in China have significant investment capital. Thus, there is vast potential for increased FDI from China to Africa that focuses on creating better linkages with the domestic economy, boosting domestic productive capacity, creating employment and spurring regional integration.

Increase imports of benefited products from Africa

China has been the cause of increased value of African resource products, increasing the demand for these products, and it offers a major market for the export of these products. The value of African exports to China has grown exponentially. However, this pattern of trade has reinforced the general pattern of trade between Africa and developed countries. The challenge will be to begin to benefit and diversify its production and export basket.

Increased domestic consumption is a critical component of China's new five-year plan (2011-2015). This shift will have implications for the global economy. For Africa, the increase in consumption in China provides abundant commercial opportunities. Already, African LDCs enjoy preferential access in 454 products into the Chinese market. This list will be increased to almost 5,000 products by 2013, providing strong opportunities for African exporters to capture market share in China. In the short to medium term China will need to actively encourage and support imports of more value-added manufactured products

from Africa to avoid repeating the pattern of trade that Africa has endured with the major developed countries for several decades.

China has sponsored seven special economic zones (SEZs) in Africa. These include: the Suez Economic and Trade Cooperation Zone in Egypt; the Dukem Industrial Park in Ethiopia; the Lekki Free Trade Zone in Nigeria; the Ogun Guandong Free Trade Zone in Nigeria; the Lake Victoria Free Trade Zone in Uganda; the Jinfei Economic Trade and Cooperation Zone in Mauritius and the Zambia-China Economic and Trade Cooperation Zone in Zambia. The challenge, however, is to ensure that these SEZs not only develop infrastructure and ICT in these areas, but also provide a platform for stimulating value-adding efforts, including technology and skills transfer, job creation and capacity building.

Manage exports of low-value manufactures to African countries

The change in relative prices between commodities and manufactures has changed the terms of trade against low-value manufacturers. While China has a competitive advantage based on its lower wages, high volumes of production and increasing productivity, other developing countries have found it more difficult to compete successfully against China in their domestic market and in third markets. Several African countries still producing low-value manufactured products, such as clothing and textiles, that have had to compete with China have suffered considerable job losses and factory closures.⁸¹

In the longer term China can begin to shift some supply chains and subcontract and outsource segments of its production as its wage levels rise. Some of China's clothing production has begun to relocate to Bangladesh, Indonesia and Vietnam.⁸² Some of this production can begin to move to parts of Africa, exporting its production capabilities, building human capabilities and

81 UNCTAD, "Economic Development in Africa. Report 2010. South-South Cooperation: Africa and the New Forms of Development Partnership", June 2010, UNCTAD, Geneva.

82 *Financial Times*, "An inflated outlook", 10 April 2011

creating employment and improving the welfare of African countries. In addition, investments in infrastructure, access to affordable finance and training for small- and medium-sized enterprises will help build local manufacturing capacity.

9.5 The Way Forward for China–Africa Relations

Africa has about 10 percent of global oil reserves, about one-third of cobalt reserves, and an abundance of base metals. South Africa alone has about 40 percent of the world's gold. China has begun to source about half its imports of alumina, copper, iron ore and oil from Africa.⁸³ The continent also has about 60 percent of the world's uncultivated, arable land.⁸⁴

The rise of commodity prices has been accompanied by the rapid expansion of telecommunications (over 80 million mobile users in Nigeria and 20 million mobile users in Kenya in 2010) and banking and other services. Thus, Africa provides an exciting opportunity for China to not only source its natural resources, but also to take advantage of the opportunity to benefit, build Africa's capacity to serve its new and rising middle class and raise living standards. Africa's GDP per capita stood at USD 1,630 in 2010, and it is expected to increase to USD 2,200 by 2015 at an annual growth rate of 5.7 percent. This increase is expected to result in a 30 percent rise in the continent's spending power.⁸⁵ Earlier this year the *Economist* reported that Africa is now one of the fastest-growing regions of the world.⁸⁶ During the past 10 years (2001-2010) 6 of the fastest-growing economies were in Africa, and the IMF projected that in the next 5 years Africa will take 7 of the top 10 places.⁸⁷ China is well positioned to take advantage

of these developments. China's rise provides Africa with a range of new opportunities. China has tended to be more holistic in its approach to promoting its own exports and securing raw materials by providing alternative financing modalities, supporting direct investment in infrastructure, manufacturing production and offering development aid to reduce poverty in Africa.⁸⁸ For its part, as Africa's abundant resources have become more valued and the size of its middle class grows, it can become attractive for exporters and investors, and it can leverage these strengths to negotiate a more mutually beneficial relationship with China.

However, both African leaders and development partners, such as China, should heed the words of Kofi Anan's Africa Progress Report published in 2011. The report argues that "in order to make the most of the continent's enormous potential and counter the risks in the years ahead, African leaders with the help of international leaders need to accelerate economic diversification and structural transformation".⁸⁹ It went on to state that, "without such transformation, growth will remain inequitable, jobless, volatile and largely inadequate for achieving the MDGs by 2015". The report also stressed that "the key ingredient for progress remains good governance by the global community and most importantly by African leaders and people, to ensure that the continent's vast resources are geared to positive ends". A qualitative approach in trade and aid that emphasizes economic growth and development and that leads to the reduction of poverty, creation of jobs and widening of social services is needed.

China can build a new type of partnership with Africa - one that is not based on reinforcing

83 *Financial Times*, "Ripe for reappraisal", 19 May 2011

84 McKinsey Global Institute, "Lions on the move: The progress and potential of African economies", June, 2010.

85 Standard Bank, Economic Strategy. BRIC and Africa: China and the US in Africa: Measuring Washington's response to Beijing's commercial advance. March 2011.

86 *The Economist*, Daily Chart, Africa's Impressive Growth, 6 January 2011.

87 *The Economist*, "Daily Chart, Africa's impressive growth", 6 January, 2011. The 10 for 2001-2010 were Angola (11.1 percent); China (10.5); Myanmar (10.3); Nigeria (8.9); Ethiopia (8.4); Kazakhstan (8.2); Chad (7.9); Mozambique (7.9); Cambodia (7.7) and Rwanda (7.6). For the period 2011-2015 the 10 will be China (9.5); India (8.2); Ethiopia (8.1); Tanzania (7.2); Vietnam (7.2); Congo (7.0); Ghana (7.0); Zambia (6.9) and Nigeria (6.8).

88 See African Economic Outlook, Africa and its Emerging Partners, 2011

89 Africa Progress Report 2011

dependence but on building mutually beneficial economic relations that advances the development of Africa and contributes to successfully re-integrating Africa into the world economy. This is the real test of the new leadership role that has been thrust upon China.

If China succeeds in this historic challenge it will have contributed to reducing global poverty, advancing sustainable development and creating greater stability, security and peace, not only for Africa, but also for the world at large.

10. CHINA'S TRADE RELATIONS WITH LDCS IN THE POST-WTO ACCESSION PERIOD⁹⁰

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China's accession to WTO in 2001 was considered one of the major steps for integrating the world economy, and it was expected to have an enormous impact on both China and the global trading regime. One of the five basic policy reforms associated with accession to the WTO is preferential treatment for developing countries, especially the LDCs. However, many people were concerned that China's accession to the WTO could impinge on other countries through the expansion of export markets in China, an increase in the Chinese exports to other markets, competition with others in third markets and an expansion of outward foreign investment from China to third markets.

10.1 Implications of China's Accession to the WTO for the LDCs

China's accession to WTO will present both opportunities and challenges for LDCs. The effects of China's accession on other developing countries are likely to be felt in two areas. In the goods and service markets, there will be increased competition from Chinese exporters in the world market as well as increased export opportunities in China. In the international capital market, competition for FDI is likely to intensify as the Chinese market becomes more open to foreign investment.

10.1.1 Trends of Chinese Exports to the LDCs

With respect to the effects on LDCs of China's accession to WTO, China's exports to LDCs increased more than its exports to the world.

Despite the short-term benefits of the trade surplus with China, each LDC should promptly build up an integral trade policy system and reform their trade structure.

Over the decade to 2010, China's export to the world increased by 5 percent while total exports to LDCs increased by 8.9 percent. China's exports to LDCs increased with an annual average growth rate of 0.91 percent, and the export growth rate was more inclined toward the African LDCs (annual average growth rate of 1.22 percent) compared with the Asian LDCs (annual average growth rate of 0.65 percent).

Among the Asian LDCs, Bangladesh is the highest ranked importer, representing roughly 47 percent of the total exports of China to the Asian LDCs. It imports mostly raw cotton, boilers, and machinery and mechanical appliances. In terms of imports, Bangladesh is followed by Myanmar (24 percent), Republic of Yemen (10 percent) and Cambodia (10 percent). Chinese exports to LDCs in Africa increased by 11 percent over the decade. Among the African LDCs, Liberia ranks as the top importer (22 percent of total imports to LDCs from China), followed by Benin (11.4 percent) and Angola (10 percent).

In the Post-accession period Chinese exports increased significantly with countries like Chad, Equatorial Guinea, Somalia and Angola. Almost 10 percent of China's total exports to LDCs are cruise and cargo ships. Other products experiencing high growth are petroleum (27 percent) and motor vehicles (18 percent).

⁹⁰ This article is a transcript from the author's presentation made on the ICTSD Dialogue on 29 June 2011.

Table 6. China's Export Products to LDCs

Products	2001		2010		Growth Rate (%)
	Value (Billion USD)	% of total export to LDC Asia	Value (Billion USD)	% of total export to LDC Asia	2001-2010
Cruise ship, cargo ship, barges	0.1	2.65	3.81	11.00	37.10
Electric app for telephone line	0.1	2.65	1.56	4.50	14.60
Electric transformer	0.02	0.53	0.35	1.01	16.50
Fabrics, knitted or crocheted	0	0.00	0.46	1.33	.
Footwear	0.09	2.38	0.52	1.50	4.78
Petroleum oils, not crude	0.02	0.53	0.56	1.62	27.00
Primary cell and primary batteries	0.15	3.97	0.37	1.07	1.47
Structures of iron & steel (rods, angle, plates)	0.04	1.06	0.64	1.85	15.00
Trucks, motor vehicles for the transport of goods	0.02	0.53	0.38	1.10	18.00
Total of Top 15	2.02	53.44	17.57	50.72	7.70
Others	1.77	46.83	17.1	49.36	8.66
Total (All Products)	3.78	100.00	34.67	100.09	8.17

Source: CPD Estimates based on ITC-Trade Map Database

10.1.2 Trends in Chinese imports from LDCs

Chinese imports from LDCs increased faster compared with China's total imports from the world. China's imports from the world increased by USD 1,150 billion during the post-accession period (2001-2010), which is a large growth rate of 0.52 percent on average annually. However, imports from LDCs increased annually by 1.52 percent.

Currently, the benefit to African LDCs is obvious and prospects for further improvements are foreseeable. For instance, similar to exports, China is more inclined to import from LDC African countries. Chinese imports from African LDCs amount to about 88 percent of

total imports from LDCs. This compares with imports from Asian LDCs of about 11 percent. By 2010, imports from Asian LDCs increased by only 6.58 percent compared with 16.8 percent from African LDCs. Imports from Asian LDCs increased with an annual average growth rate of 4.44 percent while for African LDCs its 13.25 percent. China's imports from Asian LDCs increased by 6.53 percent over the decade. Yemen ranks at the top as an exporter, covering 56 percent of total imports by China from LDCs. Other large LDC exporters to China are Myanmar (19.32 percent) and Lao People's Democratic Republic (11 percent). The mentionable export products of Yemen to China are crude petroleum oil, petroleum gas, waste, parings and scrap.

Table 7. China's Imports from LDCs

Indicators	Total Import (Billion US\$)		Share (%) in China's Import from World		Annual Growth Rate (%)
	2001	2010	2001	2010	2001-2010
China's Import from LDCs	2.94	43.2	1.21	3.1	1.52
LDCs: Asia (14)	0.66	4.97	0.27	0.36	0.73
LDCs: Africa (33)	2.15	38.19	0.88	2.74	1.86
China's Import from World	243.57	1393.92			
World's total Import	7337	12647			
China's share in World Import	3.32	11.02			

Source: CPD Estimates based on ITC-Trade Map Database

In 2001, almost 45 percent of total imports from African LDCs to China came from Sudan, followed by Angola (33.5 percent), which flipped by 2010 when 55 percent of total imports from African LDCs came from Angola with Sudan providing 17.4 percent. By 2010, China started

importing from countries like Benin, Burkina-Faso and Burundi. The import of precious metal ores and concentrates, unrefined copper and copper anodes for electrolytic refining, refined copper and copper alloys increased significantly over the decade.

Table 8. China's Imports from LDCs by Products

Products	2001		2010		Growth Rate (%)
	Value (Billion USD)	% of total export to LDC Asia	Value (Billion USD)	% of total export to LDC Asia	2001- 2010
Precious metal ores and concentrates	0.00	0.00	0.25	0.58	62971.00
Unrefined copper; copper anodes for electrolytic refining	0.00	0.04	1.75	4.06	1688.01
Refined copper and copper alloys, unwrought	0.01	0.34	1.97	4.56	197.99
Cobalt ores and concentrates	0.01	0.17	0.73	1.68	142.07
Cotton, not carded or combed	0.00	0.07	0.28	0.65	128.05
Precious & semi-precious stone, not strug	0.00	0.13	0.14	0.33	36.60
Natural rubber, balata, gutta-percha etc	0.01	0.23	0.13	0.31	18.85
Wood in the rough	0.19	6.61	0.91	2.10	3.67
Wood sawn/chipped lengthwise, sliced/peeled	0.03	1.17	0.14	0.34	3.23
Total (Top 15)	2.82	95.99	41.55	96.18	
Others	0.12	3.99	1.65	3.81	
Total (All)	2.94	99.98	43.20	99.99	

Source: CPD Estimates based on ITC-Trade Map Database

10.1.3 *Tariff regime in China*

In connection with WTO accession, and as a part of its overall reform strategy, China's tariff reduction plan is the continuation of a long-standing trend. Following a gradual trend of reduced tariff rates China became more open toward other economies. By 2010, a decade after China's accession, the non-weighted average tariff rate became almost of that in effect in 2000. A similar trend is also observed with respect to the weighted average tariff rate for China. For a number of years, trade plans co-existed with exchange controls and border measures, but they eventually gave way to border measures in the late 1980s and early 1990s. Along with tariffs, China's NTBs have also been reduced. Over half of China's imports come into the country duty free, and actual duty-free collection is about 3 percent of import value.

10.1.4 *Trade regime of China with LDCs*

Starting 1 July 2010, China began to provide duty-free treatment to LDCs for 60 percent of the total import lines (4762 tariff lines). The Hong Kong Declaration sets different obligations to the developed and developing members in the provision of DFQF to LDCs. As a developing country, China has made its efforts to fulfil the Hong Kong mandate.

China's net exports grow at a faster rate than world net exports. China's trade balance has experienced a 7 percent growth rate over the decade, while world net exports increased by 5.93 percent. Despite having a world trade surplus, China has a trade deficit with the total LDC group regarding trade balance. China has a trade surplus with Asian LDCs while it has a trade deficit with African LDCs.

10.2 **Impact of China's accession to WTO on the LDCs**

China's trade liberalization and growth will have a huge impact on both Asian and African LDCs. We can find that developing countries are significant in China's total trade and still have a great potential. However, it is

unavoidable for China to become a competitor with other developing countries in the world market since it becomes the key exporter in the world. Therefore, keeping strengthening the multilateral trade negotiation, south-south cooperation, further deepening trade and investment through China and LDCs is important for the healthy and sustainable development of our international trade system.

10.2.1 *Impacts on the goods and service markets*

Greater specialization of production has emerged among Asian economies, with China being the central link between its Asian trading partners and industrial countries markets. However, continuous liberalization of MFA quotas, culminating in the final elimination of all remaining quotas at the beginning of 2005, led to further expansion of Chinese exports, probably at the expense of some other developing countries. Even though the LDCs enjoys relatively trade surplus from China, the products imported mostly by China are primary goods such as petroleum, mining materials, and some other raw materials which China has a huge demand due to its rapid growth of economy. Despite the short-term benefits of the trade surplus with China, each LDC should promptly build up an integral trade policy system and reform their trade structure.

10.2.2 *Impacts on the international capital market*

China's entry has made it more attractive to FDI and as result may further divert investment away from other developing countries (mostly from ASEAN countries like Singapore and Thailand being net investors from ASEAN) as trade liberalization will lower production costs and the price of capital goods. At the same time, industrial countries and the more advanced developing countries in Asia will gain from China's accession to WTO, while less advanced countries tend to lose, although marginally. Most notably of the estimated losses for developing countries result from

the removal of quotas on China's textile and garment exports to United States, Canada and EU. China's accession is also likely to set off changes in regional trade and production patterns. Investment liberalization in China will make it possible for multinational firms to further rationalize their production processes within East Asia. In some sectors, China's neighbours may receive FDI flows that complement those going to China.

10.3 Opportunities for both China and LDCs of China's entry

China's trading partners will benefit from the increased transparency and predictable trade policy as China follows general WTO rules and a number of specific commitments. The general WTO policy rules include among those things the need to publish trade rules and regulations. The specific commitments involve uniform application of the trade regime, independent judicial review and a mechanism to bring problems of local protectionism to the attention of the central government. This means that access to China's market will be much more secured and disputes will be

solved following the international standards. This will be an important benefit to China's trading partners.

With the accession to WTO, China gains a wider export market while simultaneously it becomes more open to the world market. While LDCs could benefit from China's high demand on the resources, China also enjoys the stable supplement of the raw material which is essentially supporting its high growth economy. China could share its experience in the design of institutions that work effectively in low-income developing countries. This will help those LDCs to integrate into the world trade system as well as reduce their poverty.

10.4 Concluding Remarks

In the future, China is expected to toward fuller implementation of DFQF access to LDCs. It is also expected to change the structure of exports from the LDCs to China in favour of more manufactured products. We also should be more aware of China's non-tariff measures, and how new Chinese investment contributes to structural change in LDCs' product baskets.

11. CHINA IN THE WTO: A BRAZILIAN PERSPECTIVED⁹¹

Roberto Carvalho de Azevedo

Permanent Mission of Brazil to the WTO

11.1 The Overall Picture: China as a Trading Partner

To begin, let me put Brazil's bilateral trade with China into perspective.

China's rise over the past few years is nothing short of spectacular. Virtually no day goes by without new articles and reports being published on how China impacts global affairs, especially in the economy. Let me illustrate China's growing importance with a few facts:

Since the beginning of the economic reform process in 1978, China's growth has averaged almost 10 percent a year, more than enough to make it the fastest GDP growth in the world over that period. For this reason, in 2010, China overtook the US as the world's leading manufacturer, a position the US had held from more than a century. Furthermore, according to the IMF, China will become the largest economy in the world by 2016 on a purchasing-power-parity basis. The *Economist Intelligence Unit* predicts that, on the basis of market exchange rates, China will be the top economy in the world in 2020. China has also accumulated foreign reserves of more than USD 3 trillion as a result of the sustained growth of a mostly exports-oriented economy.

Accession to the WTO has been instrumental in consolidating all this dramatic tide of change in China, which involved both internal reform and integration of China into the world economy and into the international trading system rules and disciplines. Its economy has benefited from a well-functioning multilateral trading system, and China has been playing a leading role in the ongoing Doha Round. It has also become one of the major users of the WTO dispute settlement mechanism.

In brief, China has become a successful competitor in international markets, which goes hand in hand with the gradual liberalization of China's international trade and investment regime. After China, now Russia is the only major economy outside the WTO. We hope that the accession of Russia will be completed as soon as possible.

11.2 Bilateral Trade: Recent Performance and Patterns

Bilateral trade flows have expanded considerably over the past 10 years. Bilateral trade has climbed from USD 3.2 billion in 2001 to USD 56.4 billion in 2010. China is Brazil's top trading partner today, accounting for 15.2 percent of Brazil's exports and 14.1 percent of our imports. Brazil had a surplus of about USD 5.2 billion in 2010.

The expansion of bilateral trade flows has continued unabated this year. From January to May 2011, bilateral trade reached USD 27.8 billion. This represents a 44 percent increase relative to the same period last year. Brazil's accumulated trade surplus with China over the first five months of this year totalled USD 3.6 billion, an increase of 93 percent in relation to the trade surplus for the same period last year.

This overall good performance in 2011 resulted to a large extent from price rises in the top three products exported to China, all of them commodities, namely iron ore, soya beans and products and oil-products. Combined, those three products alone accounted for 86 percent of Brazil's total exports to China in the first five months of this year.

This is a trend that reflects a systematic pattern in Brazil's bilateral trade with China, marked by Brazilian exports of commodities and imports of industrial goods, especially

⁹¹ This article is a transcript of the author's presentation on the Dialogue on 29 June 2011.

The internal debate in Brazil has been reflecting some degree of concern with the present pattern of bilateral trade, particularly among those sectors that are more directly affected by the competitiveness of China's industry.

machines, equipment, electrical material and nuclear energy machines and reactors. Those products represented 53 percent of Brazil's imports from China last year.

This pattern in bilateral trade reflects many factors, such as Brazil's high degree of competitiveness in commodities' trade, especially food products, and China's increasing need for commodities as its economy grows and the purchasing power of the Chinese consumer improves. China's share of global demand for selected commodities in 2010 was as follows: i) soybeans (65 percent); ii) iron ore (54 percent); iii) coal (47 percent); iv) copper 38 percent) and v) oil products (10 percent).

Conversely, Brazil's imports of industrial goods from China can be explained by: i) the inherent competitiveness of China's industry worldwide as a result of a relatively low-cost structure coupled with heavy investments in a very efficient infrastructure for exports; ii) the appreciation of the Brazilian currency and its negative impact on the competitiveness of the industrial sector; iii) shortcomings in infrastructure that add to the costs of producing in Brazil; iv) an economy that is expanding fast, with a demand for industrial goods that is on the rise after the incorporation of millions of new consumers in the markets in the course of the past few years; and v) an abundance of raw material and food products, which tend to be absent from Brazil's list of imports.

11.3 Current Internal Debate in Brazil

Although this enormous growth of trade flows over the past few years has been to the mutual benefit of China and Brazil, the internal debate in Brazil has been reflecting

some degree of concern with the present pattern of bilateral trade, particularly among those sectors that are more directly affected by the competitiveness of China's industry.

Such concerns are often voiced as a reflection on underlining elements like:

- The extremely fast rate of growth in China's exports;
- The penetration of China's exports into traditional segments occupied by the local industry;
- Concentration of exports on just a few commodities;
- The concentration of Chinese exports in high value-added products;
- Investments in farming and mining in Brazil with business models mostly oriented toward exports to the Chinese market;
- The legal nature of Chinese companies that compete in Brazil's market, some of which are SOEs, and lower costs on inputs, both are perceived as promoting unfair competition.

Of course, as expected, the Chinese side has its grievances also. It points, for example, to the fact that Brazil has been increasing the number of AD investigations against Chinese products.

All in all, this higher level of friction is only natural against the backdrop of rapidly increasing trade flows. Where shifting trends meet traditional patterns the process of accommodation is normally bumpy and non-linear. This should not be a source of discouragement, just an incentive to work harder and closer.

11.4 Conclusion

Brazil and China will continue to stimulate bilateral trade and investment and adopt measures aimed at its diversification and long-term sustainability.

President Hu Jintao's visit to Brazil in April 2010 signaled an important step toward strengthened cooperation in the most relevant areas, resulting in the signature of several agreements, such as the Joint Plan between the two governments for the years 2010-2014.

More recently, during the visit of President Dilma Rousseff to China last April, one year exactly after President Jintao's visit to Brazil, this dialogue

intensified and the trade concerns of the two sides were extensively addressed at the summit.

In the WTO, Brazil and China work together seeking a balanced and fair outcome for the Doha Round. Both are extremely disappointed by the current state of affairs. Nonetheless, opportunities will be seized by both countries to foster bilateral trade flows and South-South trade and cooperation.

PART IV:
WHAT COMES NEXT?

12. WTO ACCESSION: A HISTORICAL OPPORTUNITY FOR CHINA'S REFORM AND OPENING

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Time travels in the blink of an eye. It has been 10 years since China joined the WTO. Over the past decade, tremendous changes have taken place both in the Chinese economy and the world economy. In retrospect, 10 years ago when China was negotiating its WTO membership, economists performed a large amount of theoretical and empirical research into the impact that China's WTO accession would have on the economy and trade of China and the world as a whole. There was a large volume of research results. But honestly speaking, none of these research results were able to predict the profound and far-reaching changes China's WTO membership has made to the landscape of the global economy and trade.

The Chinese government submitted its application for resuming its status as a contracting party to the GATT in 1986. Its transitional period after accession to the WTO ended in 2005. The 20 years between these two events represent a period when economic globalization led by developed countries was in full swing. China's bidding for WTO membership and its later WTO alignment was a process of getting integrated into the global economy. Especially after China initiated a series of market-oriented reforms in 1994, China accelerated its pace of integration into the world economy, and enjoyed a booming period of economic development, as evidenced by the tremendous inflow of FDI into China, particularly in the export-oriented manufacturing sector, a significant increase of imports and exports and a rapid growth of GDP.

12.1 Three stages of China's accession

China's WTO accession process can be divided into the following stages: first, from 1985, which was one year before China formally submitted its application for resuming GATT contracting party status, to 1994, which was

also one year before China implemented the reform of its foreign exchange administration regime; second, from 1995 when China adopted the reform of the foreign exchange regime to 2000, which was one year before China joined the WTO; and, third, from 2001 when China joined the WTO to 2007, which was one year before the outbreak of the global financial crisis.

A study of statistics during the above stages will lead to the following conclusions:

First, China's WTO accession and implementation process has strongly boosted the large inflow of foreign direct investment into China in the export-oriented manufacturing sector. From 1985 to 1994, the annual average inflows of FDI reached USD 9.324 billion. From 1995 to 2000, it increased to USD 41.86 billion, an increase of 4.5 times. It rose to USD 60.267 billion in the period from 2001 to 2007, 6.5 times as much as that of 1985-1994.

Second, FDI into China represents a distinctive feature of economic globalization. Foreign-invested enterprises in China, as a part of global production relocation by transnational companies, are mostly export-oriented enterprises engaged in processing trade. Foreign-invested companies have always made a large contribution to China's exports and imports. In 2000, one year before China acceded to the WTO, exports and imports by foreign-invested enterprises accounted for 49.9 percent. However, in 2007, the share increased to 57.7 percent. Meanwhile, foreign-invested enterprises have always taken a share as large as 85 percent in processing trade in China. In terms of industrial structure, textiles and clothing industry was the main category of processing trade in the 1980s, then the focus shifted to machinery manufacturing in the 1990s and IT industry in the early 21st century, demonstrating a clear trend of the relocation of labour-intensive production from developed countries to China.

With the outbreak of the global financial crisis in 2008, the economic globalization that has been underway for 20 years will inevitably go into low ebb.

Last, but not least, China's WTO accession has strongly promoted its own trade growth. From 1985 to 1994, the annual average growth rate of China's imports and exports was 14.5 percent. In the period from 1995 to 2000, the rate dropped to 11.0 percent because of the impact of the Asian financial crisis. However, after China joined the WTO, growth picked up miraculously and soared to 27.3 percent in the years from 2001 to 2007. China's GDP enjoyed a similar pattern of growth as driven by the growth of imports and exports. In the period from 1985 to 1994, the GDP growth rate was 9.9 percent. In the years from 1995 to 2000, it dropped to 8.6 percent, but rose to 10.5 percent from 2001 to 2007.

These analyses show that the process of rapid economic and trade growth for China is also the process of the accelerated development of economic globalization and China's accession to the WTO. The significant factor behind China's high growth is the strategic decision made by the Chinese government to join the WTO. In doing so, China has seized the opportunity to get integrated into the global economy and has achieved rapid economic growth.

12.2 New Energy for the WTO

China is a major developing country with a rich supply of cheap but skilled labour and huge market potential. Since its accession to the WTO, its integration into the global economy itself means a huge supply of new production factors and a strong boost to market demand for the world economy and trade, thus injecting new vitality into its growth. In the period 2001 to 2007, China's share in global trade increased from 4.06 percent to 7.73 percent, contributing 10.7 percent to the growth of global trade. In the same period, the share of

China's GDP in the world total increased from 4.01 percent to 5.99 percent, contributing 15.4 percent to GDP growth worldwide.

Above all, China has set an example for other developing countries. Through WTO accession and participation in economic globalization, China has realized rapid growth of trade and economy. The Chinese concept of development and its mode of growth have greatly impressed other developing countries. Even when the Doha Round is in a deadlock, many developing countries are actively involved in bilateral or regional FTAs, hoping to achieve economic growth and trade development through participation in economic globalization. Currently, a number of emerging countries are on the rise. Traditionally backward regions, such as the African continent are also demonstrating robust economic vitality. All these changes are reshaping the world economic and political landscape. The impact of China's WTO accession on these historical changes is discernable. In this sense, China's accession to the WTO has also injected new energy into the multilateral trading system and the process of trade liberalization.

12.3 Confrontation and Interdependence

The historical process of China's WTO accession has demonstrated that for a large-scale economy like that of China—a developing country in economic transformation—the unswerving determination and commitment to take part in economic globalization is not only a prerequisite for the achievement of economic modernization, but also an important driving force for reform and opening. However, with the outbreak of the global financial crisis in 2008, the economic globalization that has been underway for 20 years will inevitably go into low ebb. There will be a long period of adjustment to address problems accumulated over these years in the process of globalization.

The current world is facing more severe challenges than those 10 years ago when

China joined the WTO. With an interwoven network based on global flows of capital, goods, information and personnel, economic fluctuations will be even wider. Economic activities will be increasingly dependent on resources, which are in short supply. In such a globalized world, governments not only need to promote economic growth, but also ensure social stability. These usually conflicting objectives are putting more stress on governments' ability to control and adjust economic growth.

Therefore, for a long time into the foreseeable future after the global financial crisis, the world economy and trade will have to embrace competition and cooperation at the same time, a situation of both confrontation and interdependence. First, international competition will be more evident among major economies and trading powers with respect to the adjustment of economic growth modes and economic structures, their ability to pursue reforms and how quickly they can achieve adjustment. At the same time, however, no country will be able to make successful

adjustment in its mode of growth and economic structure without full international cooperation. Against the current picture of the world economy and trade, the multilateral trading system of the WTO is confronted with severe challenges. If this system is not able to keep up with developments, and can only play a role of facilitator for free trade like that in the older times of economic globalization, the multilateral trading system represented by the WTO will be marginalized. Therefore, it must adapt to the new landscape of global production and the new picture of global trade and development. It must be able to push forward trade liberalization and provide new trading rules against the backdrop of an environment in which the overriding objective for trade policymakers worldwide is to transform their modes of economic growth and adjust their economic structures. These new issues not only call for broader perspectives and vision, but also provide the WTO itself with many new topics and more extensive space for discussion. Every advocate of the WTO will be happy to envisage a bright future for the WTO.

13. THE NEXT DECADE: THE IMPERATIVE OF A HARMONIOUS WORLD

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In November 2001 two events occurred in Doha, Qatar. China acceded to membership of the WTO after 16 years of protracted negotiations. The Doha Round was launched. In 2001 China's share of world trade was 4 percent; by 2010, it surpassed 10 percent. In December 2011, a WTO ministerial meeting will be held in Geneva, marking the tenth anniversary of the launch of the Doha Round, with the quasi-certainty - short of some black swan suddenly appearing over the horizon - that it will not be concluded.

13.1 Possible Scenarios

So what can one expect in 2021? Based on current trends, China's share of global trade would have reached 20 percent, while officials and pundits would be declaring how the twentieth anniversary of the Round was a wonderful window of opportunity for completion, especially since the negotiators are clearly within a few centimetres of the finishing line!

Of course, as we know - or should know - the planet does not function according to extrapolations. Just as 2011 is radically different from 2001, 2021 will be radically different from 2011. Still, while leaving extrapolations aside, in terms of scenarios emerging from current trends, it would seem that:

- there is about a 20 percent chance that by 2021 the world will have a reasonably functioning multilateral trade environment, with reduction in barriers and distortions, with global growth purring along at a decent clip that manages on the one hand to absorb the massive new entries in the labour market and on the other to avoid excessive exploitation of resources. We might call it the *harmony scenario*.
- there is about a 50 percent chance that the world will have a dysfunctional multilateral system and the WTO will be an empty shell, having lost legitimacy, credibility and support, and the world trade system will operate based on regional or bilateral agreements with fairly frequent phases of protectionism between blocs, high transaction costs and the exclusion of poor countries, resulting in very uneven growth and an increase of poverty in high population growth/low economic growth countries, especially in the continent of Africa. We might call it the *disharmony scenario*.
- there is a 30 percent chance that there will be acute trade and investment conflict and the WTO will be about as impotent as the League of Nations was in the 1930s, there will be low/negative global growth, poverty increases and social ferment pervading the planet. We might call it the *de-globalization scenario*.

13.2 Global Market

We live in an exceptional era. The transformations that have occurred over the course of the last two decades have been deeply profound and breathtakingly rapid. ZHENG Bijian, the reputed Chinese economist and reformer wrote in *Foreign Affairs* ("China's peaceful rise to great power status", September/October 2005), "The most important strategic choice the Chinese made [in the late 1970s] was to embrace globalization". This turned out to be perhaps one of the hottest embraces in the history of man.

It has had a huge impact on China and on the world, generating a sustained high growth rate and lifting millions out of poverty. The country has opened up to trade, investment and people. Quantitative data needs to be complemented by qualitative data to illustrate the changes in lifestyle of the urban middle- and upper-income classes: 40 million Chinese

There is an imperative for a value system guiding trade policy in the 21st century. The concept of harmonious world fits well.

travel abroad; China is the world's biggest market for French Bordeaux wines, and the fastest-growing market for grand pianos. Urban China is undergoing a "bourgeois revolution", something that had eluded the country in the past.

The impact on the world is enormous. Chinese purchases of US Treasury bills help finance the US debt; the China Development Bank and Exim Bank lent more in 2009-2010 to developing countries than the World Bank; while Brazilian trade with China was negligible in 2001, at present China is Brazil's biggest trading partner.

Over the past two centuries, trade has been dominated by the West. There developed in the post-World War II decades a hub-and-spoke global economy, in which the OECD countries constituted the hub and the rest of the world were the spokes. As recently as 1985 the Japanese business strategy guru, OHMAE Ken'ichi in his book *Triad Power: the Coming Shape of Global Competition* argued that the international strategy of a company should consist of ensuring a robust presence in three (the triad) markets: Germany, Japan and the US, and that everything else should be seen as these countries' respective backyards.

Whatever trade there was between the first world and the third world was a hub-spoke affair, almost exclusively consisting of the latter providing raw materials to the former, and the former providing manufactured goods and services to the latter. It was this kind of relationship that the famous Argentine economist Raúl Prebisch warned about in his "dependency theory" in respect to trade relations between metropolitan and satellite states. However, China's neighbours, Korea, Taiwan, Hong Kong and Singapore, the four

economies that constituted what were called the newly industrialized economies (NIEs) broke this pattern and became active exporters of labour-intensive goods in the course of the 1970s, generating high growth rates, significant poverty reduction and urbanization.

Following the NIEs, China launched its own globalization revolution. China's embrace of globalization has been emulated to greater or lesser degrees by other countries that had hitherto followed inward-looking import-substitution industrialization policies. By the beginning of the 21st century, the global market revolution had occurred. Before 1990, the number of countries engaged in the global market represented a small minority, with most second- and third-world countries opting out; by 2000, the categories of second and third world no longer existed and the vast majority of countries became members of the WTO.

The world has a global market. Why then does it not have a robust multilateral system of global trade governance? Why is Doha a dodo?

13.3 The Values Chasm

The basic reason there is such a disconnect between the global market and global trade governance - the reason 10 years of painful negotiation has led nowhere - is that while there may be a global market, there is no global village, no global sense of community, no global perspective of shared interests and hence no spirit for global collaboration.

There are deep and fundamental chasms impeding the development of a sound global village governance system. When the West unequivocally ruled the trade roost in the period 1950-2000, in the form of the so-called "quad" (Canada, the EU, Japan and the US), though tensions did exist - especially between Japan and the US in the 1970s and 1980s - fundamentally there was a common wavelength. The major trading powers were also at similar levels of economic development

and income. They were the “rich” countries that had common interests in, among other things, preventing the poor countries from gaining access to their markets in politically “sensitive” sectors: hence, the barriers in agriculture or the separate regime for textiles and garments (the Multi-Fibre Agreement).

I have likened the current environment to a play by Luigi Pirandello, the late 19th/early 20th century Italian Nobel Prize (1934) Laureate sur-realist writer, entitled *Six Characters in Search of an Author*. The six actors come on to the stage; they know they are supposed to be there, but there is no author and no script; they walk around dazed, confused, lost. For contemporary purposes, the analogy might be applied to the G20. Twenty characters (along with the fellow travellers and camp followers) arrive in, say, Seoul, or in Cannes; they wander about; they make cacophonous declarations; there is no substantial narrative and no logic. However, at the end, as the curtain falls, they all show up for the final, celebratory photograph and they all smile and wave.

The smiling and the waving, however, are little more than cosmetics seeking to hide deep discords and confusion.

Among the many chasms, the most fundamental is a values chasm. The members of the G20 (let alone the 154 members of the WTO) are not on the same wavelength. The levels of economic development and income vary enormously; hence, the priorities. They have different cultural legacies drawn from different historical experiences and perspectives. The value system that says that trade is per se a good thing finds no echo in the experiences of the emerging economies over the previous 200 years. The British fought the Opium War in the name of trade, the consequences of which for China were devastating. India was colonized and exploited by the East India Trading Company. The Dutch ransacked Indonesia.

Though India has undertaken reforms, the tradition and concept of *swadeshi* स्वदेशी, the movement for self-sufficiency, remains ingrained

in the Indian consciousness, associated, as it is, with India’s struggle for independence and with its “saints”, Mahatma Gandhi and Rabindranath Tagore and, hence, with the very essence of the Indian identity. On an occasion when I was in Delhi at the time of Rajiv Gandhi’s premiership, when early attempts at some degree of economic liberalization were being introduced, I had a conversation with a senior Indian official about multinational foreign investment in India. “Don’t forget”, he told me, “we were colonized by a multinational (East India Trading) company”.

Although Islamic countries, especially, but not exclusively, from the Gulf are increasingly crucial players in global finance, there is very little understanding in the international community of Islamic finance governed by the principles of the *shariah* شريعة.

In the context of the Confucianist Renaissance that Beijing promoted in the last decade it has sought to articulate a world view on the principles of harmonious world: *hexie shijie* 和谐世界. The term “harmony” is the core principle of Confucianism; as much as Confucianism may have been derided in the Maoist past, the term harmony features frequently in Chinese current official discourse. On the basis of my enquiries whenever I have questioned non-Chinese officials and business leaders on the meaning of harmony, its origins, its philosophical heritage, its implications for global governance, I get a blank stare.

The current trade situation may be a quasi-perfect illustration of the “same-bed-different-dreams” syndrome. The bed is the global market, but the dreams are formed by different past experiences, current challenges and future aspirations and motivations. Unless we can harmonize the dreams, or, at the very least, recognize and respect the different dreams, the prospects are bleak.

India, China, and the world’s Muslims each represent roughly 22 percent of humanity. India, China and Indonesia (the world’s biggest Muslim country) are key members of the G20.

By no means is it being suggested that these value systems, along with the Western value system based on Judeo-Christian religion, Greek philosophy and Roman law, are civilizations that, in the words of the title of Samuel Huntington's famous (or infamous?) publication, are bound to clash. In fact, for centuries, the four civilizations cohabited quite peacefully and dynamically through trade - as was the case with the Silk Road. Indians, Chinese, Arabs and European Christians greatly valued trade, and it forms a fundamental pillar in the evolution of their societies and civilizations. Perhaps one of the greatest paeans to trade was expressed by the 14th century Tunisian scholar Ibn Khaldun when he wrote that "through trade, people's satisfaction, merchants' profits and countries' wealth are all increased".

The problem today, in good part arising from the legacy of the 19th and 20th centuries under Western imperialism, in which trade was followed by the flag, as in the case of the British conquest of India and the Opium Wars, is that suspicion has arisen in respect to trade which in turn has been deeply imprinted by the mercantilist system and spirit that defines the current culture of the global trading system. So long as negotiations are carried out on the basis of "concessions" and "sacrifices", rather than for the greater global public good, and so long as the mercantilist system and spirit continue to prevail, it will be impossible to bridge the values chasm. The reason the Doha Round is going nowhere, when all is said and done, comes down to one basic flaw: the absence of trust.

13.4 2021 – Harmony from Rhetoric to Reality

Continued negotiations on the basis of the current mercantilist spirit will clearly not lead to a 2021 *harmony scenario*. As Benjamin Franklin remarked, "the definition of insanity is doing the same thing over and over again and expecting different results". This has been the Pirandello-like underlying *leitmotiv* of the decade of the Doha Round. If this insanity

continues, the *disharmony scenario* will be likely in the short to medium term, ultimately probably descending to the *de-globalization scenario*.

To break the circle, there is above all an imperative to change mindsets. The current mercantilism must be replaced by liberalism. Mercantilism will prevent a mindset change and prevent tolerating, let alone opening up to, different values. Liberalism will.

As China emerges as the world's leading trading power it should also assume a position of global trade thought and values leader. There is an imperative for a value system guiding trade policy in the 21st century. The concept of harmonious world fits well. One great advantage of Confucianism is that it is non-exclusionary. It is universal. In the 16th and 17th centuries Jesuit missionaries in China "discovered" Confucianism; they wrote extensive works on Confucianism, notably the major opus by Philippe Couplet and Prospero Intorcetta, *Confucius Sinarum Philosophus* ("Confucius, the Philosopher of the Chinese"), published in 1687. The Jesuits argued that Confucianism was an ethical system fully compatible with Christianity. The works by the Jesuits on Confucianism strongly influenced the 18th century European philosophers of the Enlightenment. Confucianism was a source of the Enlightenment, which in turn engendered Liberalism.

The impact of Confucianism on European thought and its contribution to the rise and development of the Enlightenment illustrates how civilizations not only need not clash, but also can be mutually enriching. To achieve this enrichment, however, open minds and respect are essential ingredients.

If Chinese leaders can go beyond the rhetoric of *hexie shijie* 和谐世界 to making it a reality - and of course other societies are prepared to adhere to these principles, the 2021 *harmony scenario* will materialize. The challenge to China's leadership is to lead us to a harmonious world.

14A DECADE IN THE WTO: ENVIRONMENTAL IMPLICATIONS FOR CHINA

Tao Hu, Jun Pang and Lili Wang

14.1 Background

Since China's reform and opening up to the world, especially after its accession to the WTO, its international trade has soared rapidly. From 2002 to 2008, China's total trade grew by 20 percent a year. In 2001, the total trade valued USD 500 billion, which doubled only in three years. In 2007, it totalled USD 2 trillion (see figure 1). Furthermore, China's total exports also increased very quickly, growing from USD 266 billion in 2001 to USD 1,431 billion in 2008; the average annual growth rate is more than 20 percent. China's ranking in exports went up steadily from being number six in 2001 to number one in 2009. Now, China is the largest exporter and the second largest importer in the world, with the trade value totalling nearly USD 3 trillion annually.

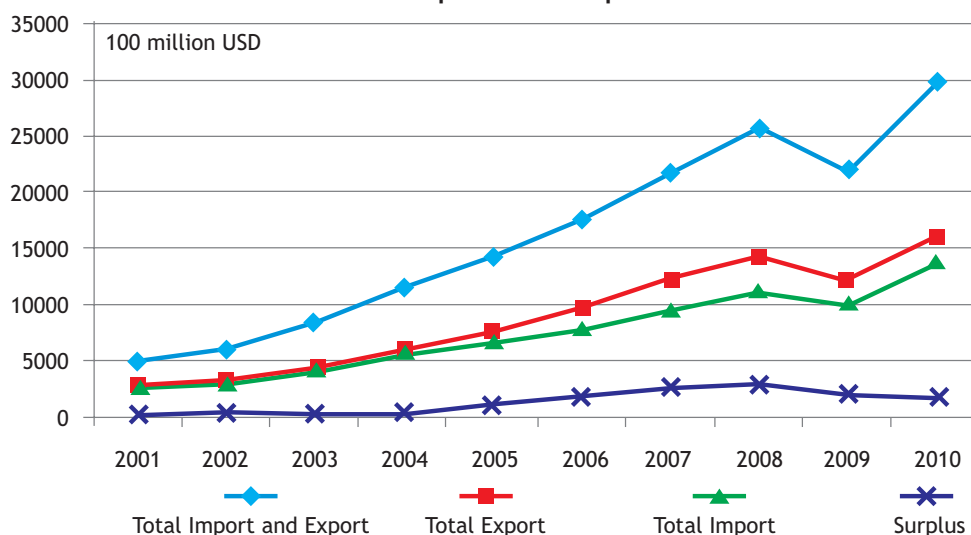
The rapid growth of China's exports boosted China's trade surplus and foreign exchange reserves. In 2001, the trade surplus was only USD 22.5 billion, but in 2008 it had increased to USD 300 billion, even in the year 2009, when the global financial crisis severely influenced international trade, the surplus was more than USD 190 billion. By the end of 2010, China's foreign exchange reserves had gone beyond USD 2.85 trillion. According to the People's

Bank of China, China's reserves grew USD 3 trillion by the end of March 2011. China's high level of foreign exchange reserves is essential to maintain not only the stable renminbi exchange rate, but also the financial stability of the whole economy.

Although China's trade achieved rapid growth after its accession to the WTO, its emissions increased dramatically at the same time. Now, China's greenhouse gas emissions rank number one, with over 6 billion tons of carbon dioxide (CO₂). Sulfur dioxide (SO₂) emissions have now reached a peak at 25 million tons, and other emissions, such as nitric oxide and nitrogen dioxide (together, NO_x), particulates (PM), and organic pollutants in water (measured by the COD test) also increased rapidly.

Taking into account environmental protection and sustainable development, China's policies have evolved from GDP-oriented development to a scientific approach for development, from a grey/black economic mode toward a green economy transformation, and from export-oriented trade to balanced trade. Under the guidelines for energy saving and emission reduction of the 11th five-year development plan, China's tendency toward worsening environmental pollution has, to a certain degree, been arrested.

Figure 1. General Condition of China's Imports and Exports 2001-2010



Source: Ministry of Commerce of the People's Republic of China.

14.2 Ex-Post Environmental Impact Assessment (EIA) on China's WTO Accession

There are many international standards and impact assessments, including the Sustainability Impact Assessment (SIA) and the EIA. As for EIA of trade, the Ex-post EIA on the North American Free Trade Agreement (NAFTA) can be used as a reference for our research on an Ex-Post EIA on China's WTO Accession. Environmental measurement of balance of trade is a good approach to make an assessment of trade's environmental impact, and the former case of the Ex-ante EIA on the China-Japan-Korea trilateral Free Trade Agreement (C-J-K FTA) proved this method highly effective.

In the past decade, China has had a trade surplus in terms of monetary value, but a trade deficit in terms of environmental indicators, which reflects the fact that when goods are exported to other countries, pollution remains in China.

14.3 Methodology

At present, most measurements of trade balance concern only trade value, paying no attention to the cost of resources and the environment. The Trade Expert Group of the Ministry of Environmental Protection explores the measurement of balance of trade from the perspective of resources and environment (Hu Tao, 2008). During the process of production and consumption, both goods and services will consume resources and emit pollution, so there are embedded resources and emissions in the product, which are called embedded pollutants, such as embedded water, embedded SO₂ and embedded CO₂. We can measure trade's impact on the environment through the embedded pollutants of the traded goods.

From the point of flow side, we define the export of embedded pollutants as negative and

the import of them as positive. When the sum of them is greater than zero, the environment trade is surplus, and the trade is deficit if the opposite is true. We can also assess this with respect to stock, if the trade makes the resource and environment better, we say that it is the environment surplus, and vice visa.

Using CE3-GEM (China Energy-Economy-Environmental General Equilibrium Model) and China's Input-Output tables of 2002, 2005 and 2007, we assessed the trade impacts on SO₂, CO₂, COD and energy consumption after China's accession to WTO.

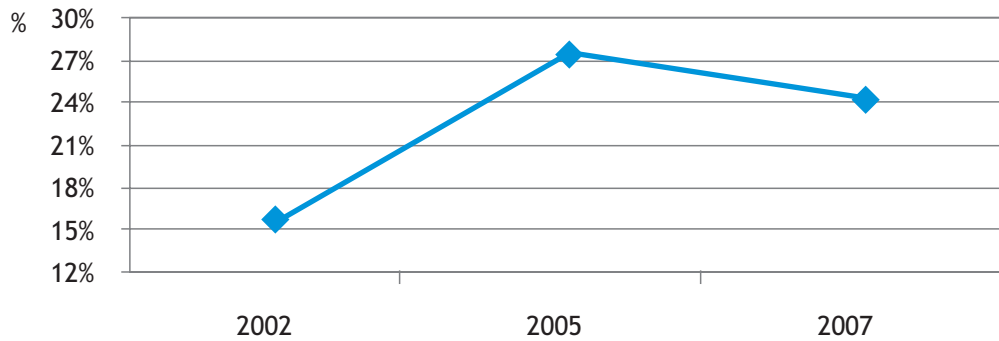
14.4 Results

In the past decade, China has had a trade surplus in terms of monetary value, but a trade deficit in terms of environmental indicators, which reflects the fact that when goods are exported to other countries, pollution remains in China.

14.4.1 Net export contributions to SO₂ emissions by embedded pollutants

With respect to the impacts of trade on SO₂ emissions during the period of 2002 to 2007, although the average annual growth rates of embedded SO₂ emissions due to exports and net exports are lower when compared with the growth rates of total exports and total net export value, they are still 10 percent higher than those of total SO₂ emissions, indicating the important impact of exports on China's SO₂ emissions. Although SO₂ emissions grew annually before 2005, because of the emission control policies during the 11th five-year plan period, both the exports and domestic SO₂ emissions began to decrease after that time.

As seen from figure 2, the ratios of exports and net exports embedded pollutant to the total SO₂ emission grew rapidly from 2002 to 2005, and then declined by small margins, accounting for nearly 50 percent and 20 percent, respectively, by the end of 2007. Exports have become one of the most important influencing factors of SO₂ emissions.

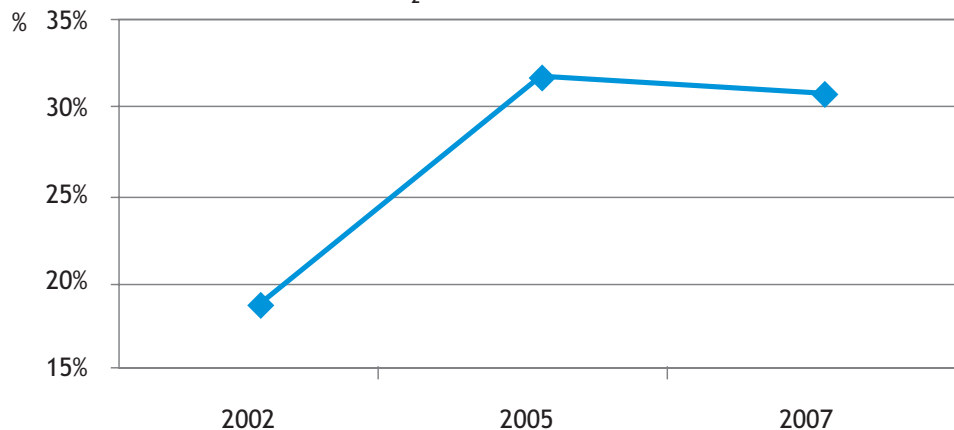
Figure 2. Proportions of Embedded SO₂ Emissions Driven by Net Exporting 2002-2007

14.4.2 Net export contributions to CO₂ emissions by embedded pollutants

Exports also contribute a lot to China's CO₂ emissions. Recent years have witnessed a high growth rate of CO₂ emissions in China, and the average annual growth rate was 12.48 percent from 2002 to 2007. Many of the CO₂ emissions were from exports. The growth rates of the embedded CO₂ emissions contributed by exports and net exports were higher than that of total CO₂ emissions by 9-12 percent, which reflected export goods are more carbon intensive than the other goods.

Similar to SO₂ emissions, exports' embedded CO₂ emissions grew before 2005, and declined

after 2005. Furthermore, the proportion of the exports and net exports' CO₂ emissions of the total CO₂ emissions increased greatly during 2002 to 2005, and edged down in 2007. However, even by the end of 2007, CO₂ emissions contributed by exports accounted for more than 65 percent of the total emissions, while the net exports' embedded CO₂ emissions accounted for nearly one third (see figure 3). Exports have become the main source of China's CO₂ emissions. In 2007, the CO₂ emissions contributed by net exports were equivalent to EUR 17.1 billion of economic losses, assuming that the carbon price was EUR 10/t. This means we do not attain the deserved gains, just producing for other countries.

Figure 3. Proportions of Embedded CO₂ Emissions Driven by Net Exporting 2002-2007

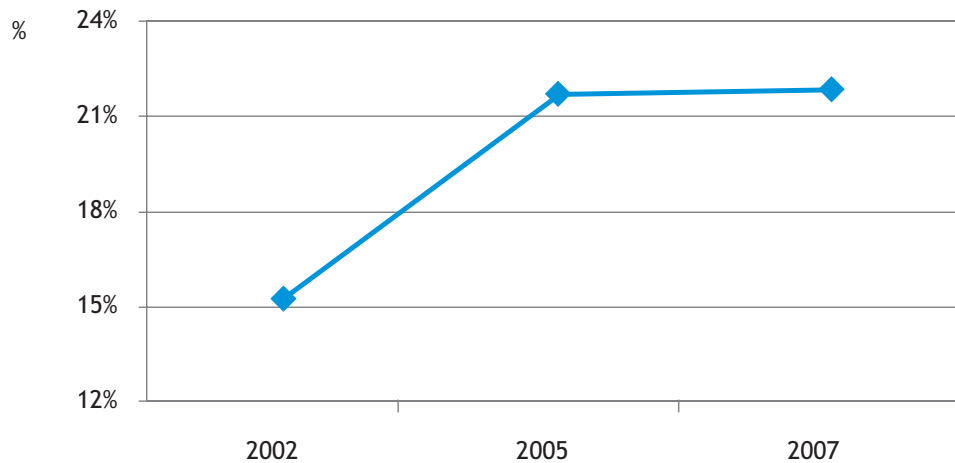
14.4.3 Net export contributions to COD emissions by embedded pollutants

With respect to COD emissions, the impact of trade on China's embedded COD emissions during 2002 to 2007 was to the situation concerning SO₂ emissions. The average annual growth rates of exports and net exports were lower than the total exports and net exports value, but considerably higher than that of China's domestic COD emissions, showing that when exports' COD density was decreasing the export sector still played a vital role in China's COD emissions. Before 2005, exports' and net exports' embedded COD emissions

gradually increased, while—owing to the policies of energy efficiency and emission reduction during the 11th five-year plan—the net exports' embedded COD emissions began to decline after 2005.

In the domestic total COD emissions, the proportion of the export sector increased significantly during 2002 to 2005, and then began to drop. By the end of 2007, COD emissions coming from exports still accounted for 40 percent of the total. By contrast, the ratio of the net exports' embedded COD emissions grew more slowly, and remained stable at about 20 percent after 2005 (see figure 4).

Figure 4. Proportions of Embedded COD Emissions Driven by Net Exporting 2002-2007



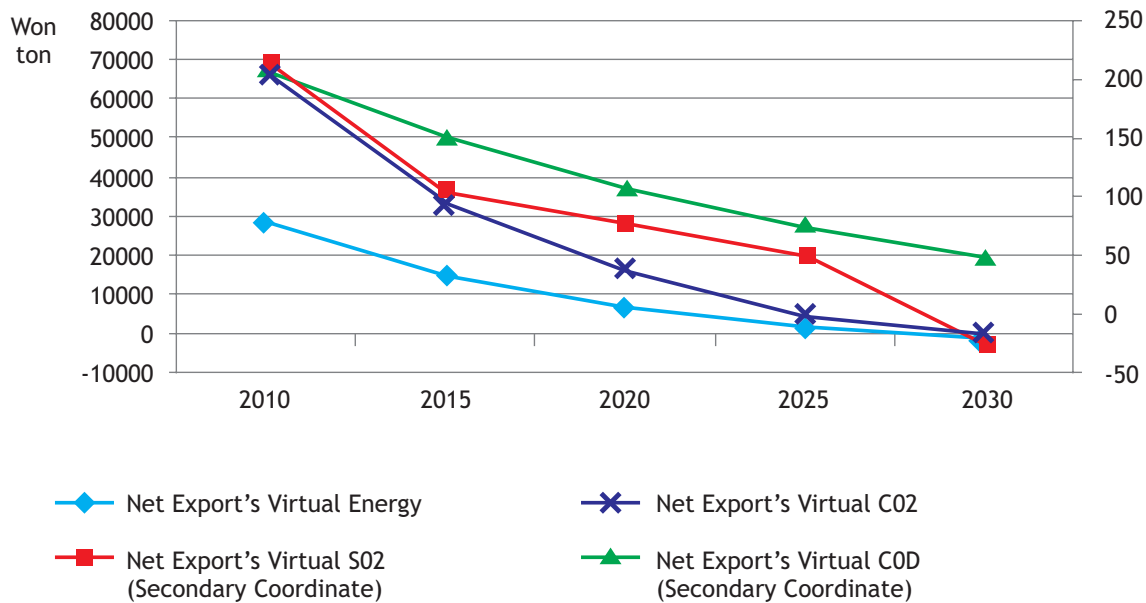
All in all, the embedded pollutant emissions driven by exports, including embedded SO₂, CO₂ and COD, grew substantially from 2002 to 2005, and went back down a bit when reaching the peak in 2005. All this illustrates that the emission control policies of the 11th five-year plan have already achieved remarkable effects.

14.4.4. Prediction for 2010-2030

If the current trends of economic development and technological progress as well as the emission control policies continue, China's embedded energy consumption and the amount of pollutants generated by trade

will gradually decrease, but will not achieve balance until 2030 (the COD emissions driven by trade still have some deficits then, see figure 5).

By the end of the 12th five-year plan, the contribution of trade to pollutant emissions and energy consumption will remain at a very high level. Energy consumption, SO₂, COD and CO₂ emissions contributed by net exports will be 140.77, 1.03, 1.51 and 328.31 million tce, respectively. Under the conditions of no further powerful emission-control policies, the 12th five-year plan period will still witness great environment deficits.

Figure 5. Embedded Pollutants Emissions Driven by Net Exporting 2010-2030

14.5 Possible Reasons

Irrational structure of trade

The irrational structure of trade puts great pressure on China's environment trade balance. The irrationality of China's trade structure consists of the following three aspects. First, there are too many resources and pollution-intensive products for export; for example, textiles, leather products, chemical products, cement, iron and steel are all high-pollution and resource-intensive industries that form a large part of China's exports. Second, most of the exports are low value-added products. In the scheme of the international division of industry, China is at the low level of the industry chain, under which more than 55 percent of China's total exports and 90 percent of the high-technology export products come from processing trade. Third, compared with services, goods dominate exports. The growth rate of China's goods exports is far more than service exports. During the period of 1997 to 2003, goods exports grew by 30.2 percent on average while the service exports' growth rate was only 11.3 percent.

Low efficiency of exports

China's exports, including goods and service products, have high levels of average energy consumption and pollution intensity. For most of the exports, pollution intensity per product in China is higher than that in developed countries. Take textiles, for example, in China, textiles usually consume 3.5 ton water and 55 kilogram coal to produce one hundred meters cotton, while emitting 3.3 ton waster water, 2 kilogram COD and 0.6 kilogram BOD.

Large scale and rapid growth of trade

China's total value of exports is not only large in scale, but also high in growth rate. The high-growth speed of 20-30 percent per year considerably promotes the related industries' development, especially the industries with high pollution emissions and energy consumptions. According to an estimation of Development Research Centre of the State Council of China, during the 10th five-year plan period, exports structure and scale contributed 20 percent and 5 percent of China's SO₂ emissions respectively, and only production efficiency abated SO₂ emissions, which represented -5 percent of the total emissions.

14.6 Mitigation Measures

In order to mitigate the impacts of trade on environmental pollution, the strategy of green trade transformation is in needed. Under the

principle of internalizing environmental costs into China, green trade policy instruments will mainly concern on export, and can be differentiated by the levels of product, firm, and sector and macro economy.

15 DESIGNING COMPREHENSIVE EXPORT CARBON PRICING POLICIES IN CHINA

Xin Wang

IDDR, Sciences Po Paris and EQUIPPE, University of Lille

15.1 Challenges of Consolidating Global Climate Actions

Climate change has become one of the major threats to the development of mankind in the 21st century. Efforts must be made increasingly to prevent human beings from suffering irreversible disasters due to global warming. However, the current national pledges of greenhouse gases (GHG) emission-reduction targets, which have been submitted to the United Nations Framework Convention on Climate Change (UNFCCC) could hardly ensure the Two Degree target.⁹² In addition, the Kyoto Protocol will expire in 2012, and the agreement of an effective international treaty for the future seems to be unclear. In the logic of taking immediate actions to minimize the cost due to climate change damage,⁹³ more global efforts are needed to prevent lock-in effects and to attain the long-term targets. Among key elements that ensure a successful consolidation of international efforts on climate change, mutual trust⁹⁴ (State Council Information Office of China, 2008), transparency⁹⁵ and incitation effects⁹⁶ can be considered indispensable for each country. First, the reciprocal trust requires understanding the unique objectives, interests and difficulties of each country. Second, the policy transparency

(and the measuring of policy effects in a non-invasive way) consolidates such reciprocal confidence and provides a credible basis for making next-step actions. Finally, the incitation effect of a climate policy could generate further implementations of actions of other countries and, thus, contribute to strengthening global mitigation efforts.

The need of immediate actions for addressing climate change is not an exception in China, which is now encountering both potential energy shortages and challenges related to climate change impacts. China would suffer slightly higher negative impacts of climate change than the global level.⁹⁷ It is currently the biggest CO₂ emitter in the world, and its CO₂ emissions could continue to increase at an annual growth rate of 2.8 percent during 2006-2030, compared with 0.1 percent for OECD European countries over the same period.⁹⁸ Its energy deficiency in terms of coal and natural gas could reach 25 percent of total domestic production, while its oil import dependency could attain 60 percent by 2020.⁹⁹ It is not possible for China to replicate the development pathways of industrialized countries and wait for the peak of its Kuznets curve to reduce its CO₂ emissions.¹⁰⁰ Instead, its modernization trajectory must coordinate economic growth with GHG emissions control.¹⁰¹ Obviously, combating climate change is in China's own interest, a realization that has helped

92 Rogelj, J., Nabel, J., Chen, C., Hare, W., Markmann, K., Meinshausen, M., Schaeffer, M., Macey, K., Höhne, N., 2010, Copenhagen Accord pledges are paltry, *Nature* 464, pp.1126-1128 (22 April, 2010)

93 Stern, N., 2007, *The Economics of Climate Change: The Stern Review*, Cambridge University Press, Cambridge.

94 See Hu Jintao's speech "Mutual trust is key for collaborating with China", available at <http://blog.appliedmaterials.com/mutual-trust-key-collaborating-china>, 2011; Also see China Daily, "Beijing urges more political mutual trust", 18 April, 2011, available at http://www1.chinadaily.com.cn/china/2011-04/18/content_12345023.htm

95 McKibbin, W.J., Wilcoxon, P.J., 2002, The role of economics in climate change policy, *Journal of Economic Perspectives* 16 (2), pp. 107-129. Transparency International, 2011, Ensuring corporate transparency to mitigate climate change, Policy Position 2011/02, http://www.transparency.ch/de/PDF_files/Newsletter/2011_TI-S_Policy_Position_Climate_change.pdf

96 De Boer, Y., 2007, Changements climatiques 2007: une année décisive, *Liaison Energie Francophonie* 75, pp. 86-90.

97 National Development and Reform Commission of China (NDRC), 2007, *China's National Climate Change Programme*, <http://www.ccchina.gov.cn/WebSite/CCChina/UpFile/File188.pdf>

98 EIA, 2009 International Energy Outlook, US Energy Information Administration (EIA), 2009.

99 Mao, R.B., Chen, Q.T., A Study of Approaches and Methods to Meet China's 20% Energy Efficiency Target for 2010, Science Press, Beijing, 2008. (in Chinese)

100 Tubiana, L., Wang, X., 2011, La croissance verte, une option pour la Chine?, *La Chine au milieu du monde, AGIR* 46, pp.149-162.

101 He, J.K., Deng, J., Su, M.S., 2010, CO₂ emission from China's energy sector and strategy for its control, *Energy* 2010, pp. 4494-4498.

the development of a political willingness to tackle the problem.

Such willingness has been concretely given by setting a long-term strategy of developing the low-carbon economy (LCE) in its 12th five-year plan (2011-2015), which aims to re-orient China's market toward larger components of products with higher value added and technology contents and lower pollution and energy and carbon intensities. However, most of China's current policies are command-and-control, which are not cost-effective in terms of GHG emissions reduction and energy savings and have also gained China very limited recognition in the international community.¹⁰² In particular, the lack of an explicit and comprehensive domestic carbon price in China has made China a principal target in the carbon leakage and competitiveness literature, given its large capacity of energy-intensive products. Despite the fact that the existence of carbon leakage and competitiveness problems have received mixed results so far,¹⁰³ such issues constitute not only a barrier for developed countries to implement more stringent climate policies, but also a contentious subject between developed and developing countries, which could lower the mutual trust and slow down the consolidation of making global climate efforts.¹⁰⁴

15.2 Market-Based Instruments for Addressing Climate Change

In the light of either or both contexts, China has decided to implement more economic and market-based instruments in order to

strengthen its efforts to develop a low-carbon economy (LCE) in a cost-effective manner and/or contribute to consolidating international efforts for addressing climate change. Among such policies, export value-added tax (VAT) rebates and export taxes (which are implemented when export VAT refund is zero) (EVRET) have been implemented massively since 2007 on energy- and carbon-intensive products with a major objective of building a greener export structure. Domestic emission trading system (ETS) is on the official agenda and could be implemented by 2013.¹⁰⁵ However, the absence of an explicit and predictable carbon price on the export on the one side, and the level and coverage of a domestic carbon price in the forthcoming years on the other side, still constitutes a challenge for China in becoming a "climate champion".

Contrary to conventional cases of developing countries that use export taxes primarily for trade and economic ends,¹⁰⁶ there is a key political willingness to use EVRET to abate the energy and carbon intensity (and conserve natural resources) in China in order to restructure its exports to attain a higher share of products with high value added and technology contents. More interestingly, such measures have been frequently promoted by Chinese senior officials.¹⁰⁷ In addition, several official documents, such as *China's National Climate Change Programme*, have announced a climate policy. However, despite such official willingness, EVRET entails no explicit and unique carbon price and has received little recognition by China's major trade partners as genuine climate policy. According to Wang

102 Zhang, Z.X., 2010, The US proposed carbon tariffs and China's responses, *Energy Policy* 38, pp.2168-2170.

103 Elliott, J., Foster, I., Kortum, S., Munson, T., Pérez Cervantes F., Weisbach, D., 2010, Trade and carbon taxes, *American Economic Review* 100(2), pp.465-469. Babiker, M.H., Rutherford, T.F., 2005, The economic effects of border measures in sub-global climate agreements, *Energy Journal* 26(4), pp.99-126.

104 Wang, X., Chen, Y., 2010, Disentangling border carbon tax - an analysis of the EU policy, *Chinese Journal of European Studies*, 166, pp.44-48. (in Chinese)

105 See "China Plans national emissions trading by 2015", April 11, 2011, Reuters, <http://uk.reuters.com/article/2011/04/11/china-carbon-trading-idUKL3E7FB1Q320110411>

106 Piermartini, R., 2004, The Role of Export Taxes in the Field of Primary Commodities, World Trade Organization, http://www.wto.org/english/res_e/booksp_e/discussion_papers4_e.pdf

107 For example, see "XIE Zhenhua: five key achievements of China's actions against climate change", June 26, 2009, http://www.gov.cn/jrzq/2009-06/26/content_1351477.htm (in Chinese).

and Voituriez¹⁰⁸ and Wang et al.,¹⁰⁹ both the tax rates and taxed products vary periodically and the implicit carbon price that EVRET entails differs dramatically among products or sectors.

So far, there has been no domestic official announcement on the implementation of a nationwide carbon price. In addition, even if such a carbon price could be introduced in the short term, its level would probably be low and incomparable with, for example, the EU ETS carbon price. Indeed, the EVRET and a low starting domestic carbon price might be sufficient for China to ensure good implementation and develop a LCE, yet they cannot effectively lessen the carbon leakage and competitiveness problems, thus, making no contribution to consolidating global climate actions.

15.3 Introducing Comparable and Comprehensive Carbon Prices in China's Exports

Is there a case for China to provide a pro-active strategy by introducing a comprehensive and comparable carbon price in its export in the short term? Before unpacking this question, it might be worth recalling Chinese President, Hu Jintao's speech to the United Nations General Assembly, 23 September, 2009.¹¹⁰ "*We should make our endeavor on climate change a win-win for both developed and developing*

countries and a win-win for both the interests of individual countries and the common interests of humanity". As Müller and Sharma¹¹¹ point out, this trade tactic could contribute to consolidating international climate efforts. An explicit carbon price on China's export could send a clear and comprehensive climate signal to both domestic exporters and industries in other countries. First, this could improve the policy transparency and effectiveness for China's domestic LCE development. Second, if such a price is implemented at a comparable level, it could lessen the carbon leakage and competitiveness problems, thus, providing an alternative and pro-active solution that consolidates global climate efforts.

In fact, such a comparable and comprehensive export carbon price can be introduced by two means. First, according to Wang et al.,¹¹² USD 20/tCO₂ can be converted into fixed export non-refundable VAT rates for major energy-intensive sectors, which generate little additive competitive problems on exports. Second, according to Li et al.,¹¹³ China could afford to implement an export carbon tax on all exports or major energy-intensive sectors.

Using export non-refundable VAT for climate change

Based on 2007 data, Wang et al.¹¹⁴ first estimate the sectoral export CO₂ emissions. Based on such emissions, they calculate the cost of an

108 Wang, X., Voituriez, T., 2010, China's export tax and export VAT refund rebate on energy-intensive goods and their consequence for climate change. In Soares, C.D., Milne, J.E., Ashiabor, H., Kreiser, L., and Deketelaere, K. (ed), *Critical issues in environmental taxation, International and comparative perspectives*, Vol. VIII, Oxford University Press, New York.

109 Wang, X., Li, J., and Zhang, Y., 2010, Can Export Tax be Genuine Climate Policy? An Analysis on China's Export Tax and Export VAT Refund Rebate Policies, *Working Paper of IDDRI Ideas No. 08* (2010), <http://www.iddri.org/Publications/Collections/Idees-pour-le-debat/Can-export-tax-be-genuine-climate-policy-An-analysis-on-China-s-export-tax-and-export-VAT-refund-rebate-policies>

110 See <http://www.nytimes.com/2009/09/23/world/asia/23hu.text.html> for the whole speech.

111 Müller, B., Sharma, A., 2005, Trade Tactic Could Unlock Climate Negotiations, SciDev.Net, <http://www.scidev.net/en/opinions/trade-tactic-could-unlock-climate-negotiations.html>

112 Wang, X., Li, J., and Zhang, Y., 2010, Can Export Tax be Genuine Climate Policy? An Analysis on China's Export Tax and Export VAT Refund Rebate Policies, *Working Paper of IDDRI Ideas No. 08* (2010), <http://www.iddri.org/Publications/Collections/Idees-pour-le-debat/Can-export-tax-be-genuine-climate-policy-An-analysis-on-China-s-export-tax-and-export-VAT-refund-rebate-policies>

113 Li, J., Wang, X., Zhang, Y., 2011, Is it in China's interest to implement an export carbon tax?, IDDRI Working Paper (Ideas), 2011-06, http://www.iddri.org/Publications/Collections/Idees-pour-le-debat/ID_1106_wang-li-zhang_export-carbon-tax.pdf

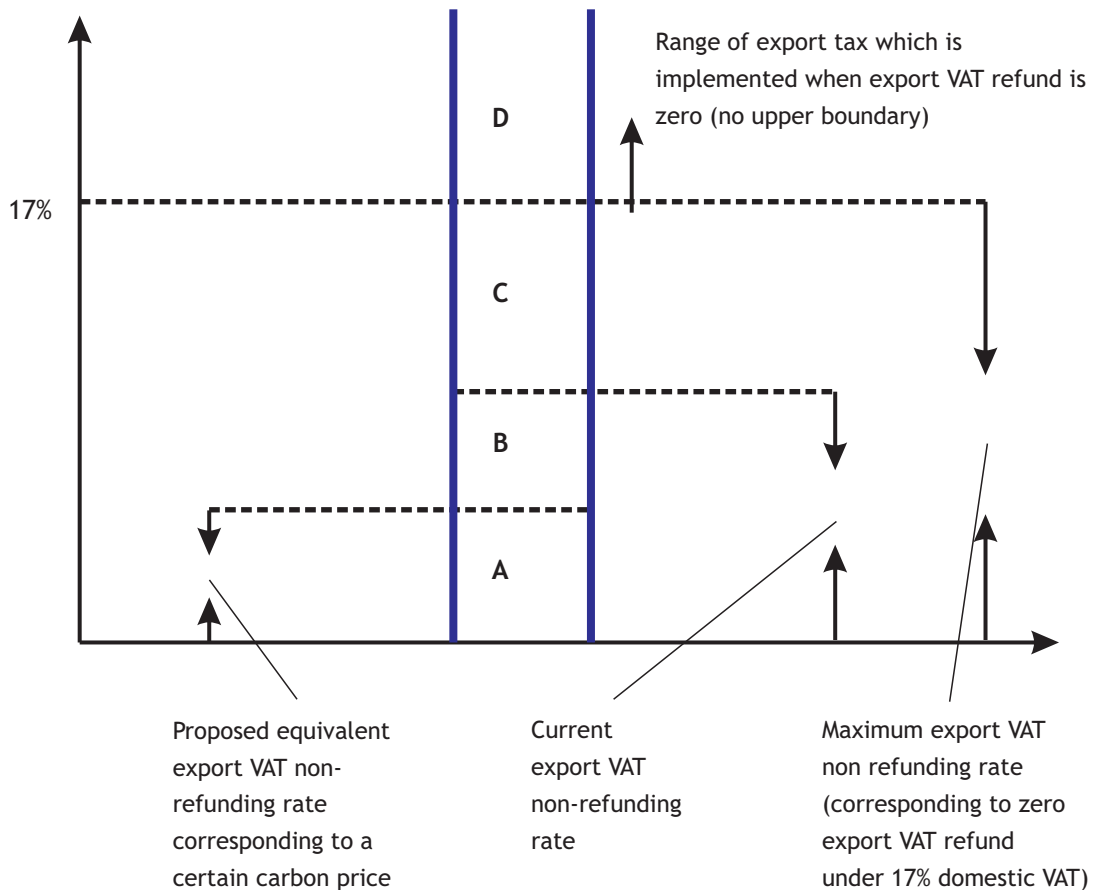
114 Wang, X., Li, J., and Zhang, Y., 2010, Can Export Tax be Genuine Climate Policy? An Analysis on China's Export Tax and Export VAT Refund Rebate Policies, *Working Paper of IDDRI Ideas No. 08* (2010), <http://www.iddri.org/Publications/Collections/Idees-pour-le-debat/Can-export-tax-be-genuine-climate-policy-An-analysis-on-China-s-export-tax-and-export-VAT-refund-rebate-policies>

export carbon price of USD 20/tCO₂ and convert this cost into export non-refundable VAT rates (which is equal to domestic VAT 17 percent minus export VAT refund rates) for each sector. By comparing with the export non-refundable VAT rates of 2007, they find that the equivalent export non-refundable VAT rates that the introduction of USD 20/tCO₂ entails are lower than the 2007 export non-refundable VAT rates of the eight most energy-intensive sectors. They propose to fix the equivalent export non-refundable VAT rates and announce them officially as climate policy.

The advantage of such a solution can be illustrated by Figure 1. Part A represents the equivalent export non-refundable VAT rate

for a certain energy-intensive sector, which is inferior to the current level of export non-refundable VAT rate (part A+B). Therefore, part A should be clearly announced as the fixed export non-refundable VAT rate of this sector corresponding to USD 20/tCO₂, which can be considered a comprehensive climate policy. One additional advantage of such a proposal is that it leaves flexibility of using EVRET policies for concerns other than climate change. In figure one, part B could be modified, thus leading to a final total export non-refundable VAT equal to A+B (where the part B can be a sum of B and C). Finally, such a proposal will not generate WTO disputes as long as the export VAT refund rate is non-discriminatory.

Figure 6. Illustration of Export Non-refundable VAT for Climate Change End



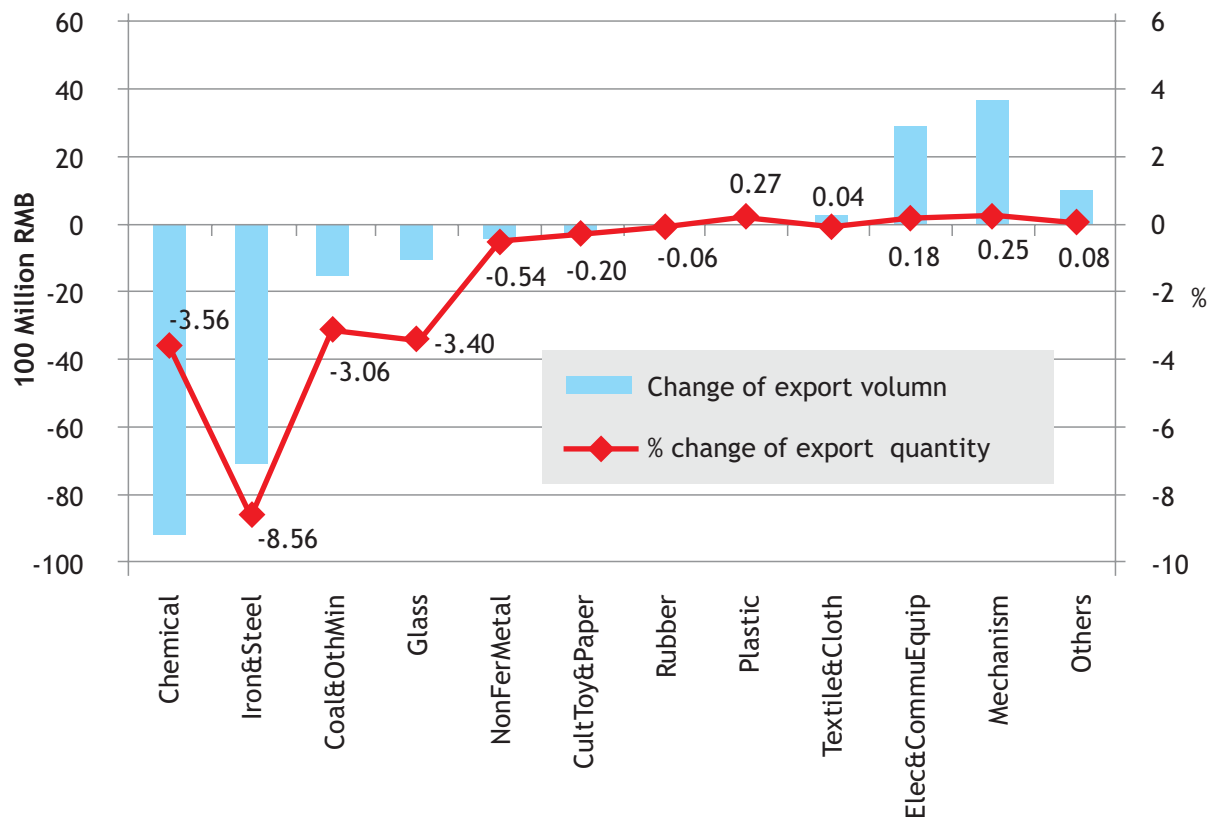
Source: author

Export carbon tax

In the above-mentioned proposal, the final rates of non-refundable VAT and/or export tax of a product could still vary as a result of rates modification for uses other than climate change. This does not deny the explicit carbon price signal that the proposal ensures, but it could lead to different CO₂ emissions reductions due to net export charge change of EVRET. Li et al., therefore provided another

solution of implementing an export carbon tax on China's exports and define the current EVRET as non-climate policies. By using a dynamic computable general equilibrium model of the State Information Center of China, namely the SIC-GE model, they found that the implementation of an export carbon tax of CNY200/tCO₂ (roughly EUR 20 /tCO₂) would generate little negative macroeconomic impact but engender a significant export structural effect (see Figure 6).

Figure 7. Structural Effect of Export Carbon Tax on China's Exports

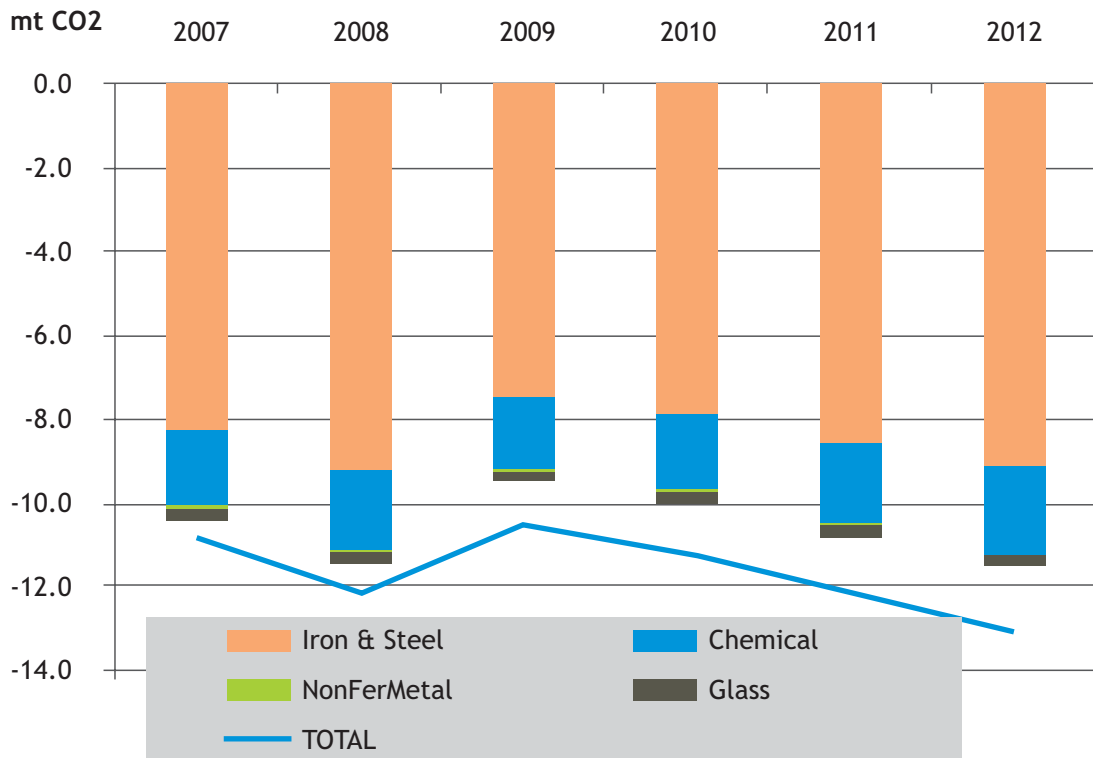


Source: Li, J., Wang, X., Zhang, Y., 2011, *Is it in China's interest to implement an export carbon tax?*, IDDRI Working Paper (Ideas), 2011-06, http://www.iddri.org/Publications/Collections/Idees-pour-le-debat/ID_1106_wang-li-zhang_export-carbon-tax.pdf

In terms of CO₂ emission reduction, the export carbon price of CNY 200/tCO₂ could reduce 3.6 percent of direct CO₂ emissions due to the exports with regard to the reference scenario.

As Figure 3 shows, more than 90 percent of CO₂ emission reduction comes from iron and steel, chemicals, non-ferrous metals and the glass sector.

Figure 8. Long-term Export CO₂ Emission Reduction Under CNY 200/tCO₂ (SIC-GE model)



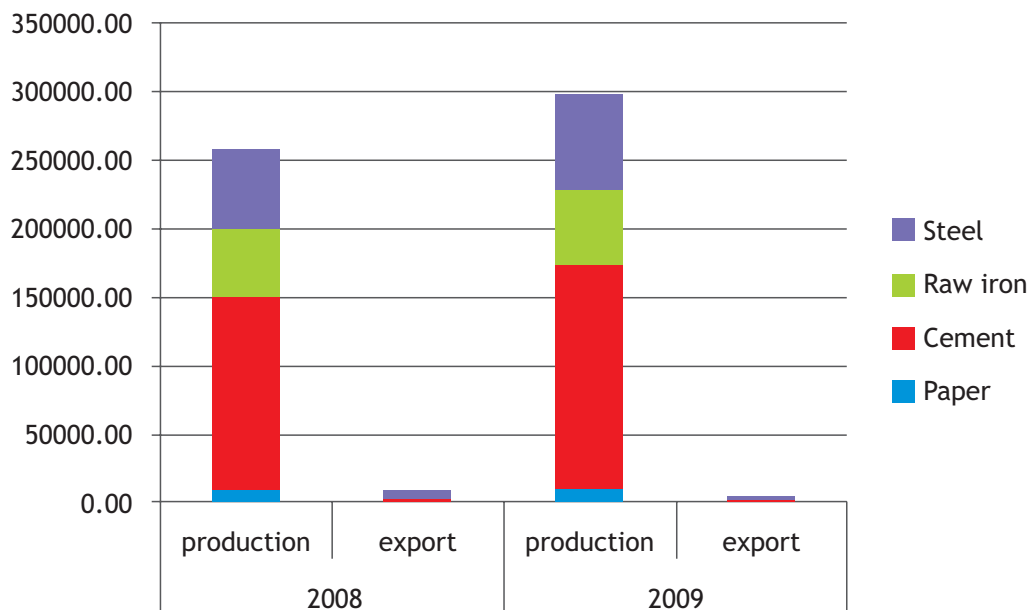
Source: Li, J., Wang, X., Zhang, Y., 2011, *Is it in China's interest to implement an export carbon tax?*, IDDRI Working Paper (Ideas), 2011-06, http://www.iddri.org/Publications/Collections/Idees-pour-le-debat/ID_1106_wang-li-zhang_export-carbon-tax.pdf

In terms of policy management cost, the export carbon tax can also be implemented on major energy- and carbon-intensive sectors instead of being introduced on all exports. It can be noticed that the export CO₂ emissions

reduction account for only a very small share of China's national CO₂ emissions. This is because the export of major energy-intensive products only account for a very small share of domestic production (see figure 8).

Figure 9. Domestic Production and Export of Selected Energy Intensive Products 2008-2009

(unit: 10,000 ton)



Source: 2010 Statistical Yearbook of China.

In terms of WTO-compatibility, the export carbon tax can be considered generally applicable. Compared with other trade instruments, the export tax is less frequently discussed at the WTO and the necessary legislation is incomplete.¹¹⁵ The use of an export tax can generally be considered feasible according to GATT Art XI para. 1, as long as the tax is non-discriminatory. Art XIII para.1 of GATT clearly states that “[n]o prohibition or restriction shall be applied by any contracting party...on the exportation of any product destined for the territory of any other contracting party, unless...the exportation of the like product to all third countries is similarly prohibited or restricted”.

It is, however, the elimination of export taxes that is commonly combined into the “WTO-plus” obligations for new entrant country members on their accession to the WTO (for example, China, Mongolia, Saudi Arabia, Ukraine and Vietnam). Art. 11, para. 3 of the Protocol of Accession of China (WT/L/432) states that “China shall eliminate all taxes and charges applied to exports unless specifically provided for in Annex 6 of this Protocol or applied in conformity with the provisions of Article VIII of the GATT 1994”. This “Annex 6” includes 84 products (HS 8-digit), mainly steel and other non-ferrous metal products. However, the note at the end of Annex 6 leaves flexibility for further export tax implementation: “China confirmed that the tariff levels included in this Annex are maximum levels, which will not be exceeded. China confirmed, furthermore, that it would not increase the presently applied rates, except under exceptional circumstances. If such circumstances occurred, China would consult with affected members prior to increasing applied tariffs with a view to finding a mutually acceptable solution”. Therefore, the introduction of an export carbon tax with the intention of addressing climate change, if properly designed and based on consultations with China’s major trading partners, should qualify as WTO compatible.

15.4 Conclusion

In a world of unequal carbon prices, the use of an explicit export carbon price in China serves as a transitional measure until the domestic carbon price reaches an internationally comparable level. The merits are at least fourfold: First, it ensures a comprehensive and predictable climate policy for export restructuring and, therefore, for domestic low-carbon development of China; second, it contributes to lessening carbon leakage and competitiveness problems in a comprehensive manner; third, it could contribute to tightening climate policy in Annex I countries (for example, to accelerate the stringency of quota auctions at EU ETS); finally, and most important, it could give a positive political example of North-South cooperation for tackling carbon leakage and competitiveness questions and could involve more participation both of developed and developing countries in using border carbon measures in a cooperative way. Carbon leakage, therefore, would be no longer a negative blockage in the context of consolidating international efforts for addressing climate change.

Table 9 gives the suggested implementation timeline of introducing an explicit and comparable carbon price on China’s exports. The year 2012 could serve as a preparation buffer for determining methodologies, selecting sectors, carbon price(s) and making inter-ministerial coordination. The Climate Change Department of NDRC should thus lead the coordination work. The export carbon pricing policy could be proper to be introduced in the beginning of 2013 together with the 2013 Custom Tariffs of Imports and Exports. The publication of a joint circular of related ministries could ascertain the functioning of the export carbon pricing policy. Followed by the implementation, a benchmark revision would be necessary in 2015 or 2016 in order to re-examine sector or product export CO₂ emissions. Finally, general modification of the export carbon price level could be made once the domestic carbon pricing policy is implemented.

¹¹⁵ Karapinar, B., 2010, Export Restrictions and the WTO Law: “Regulatory Deficiency” or “Unintended Policy Space”, http://www.wto.org/english/res_e/publications_e/wtr10_forum_e/wtr10_21may10_e.htm

Table 9. Timeline of Export Carbon Pricing Policy Implementation and Revision

	2012-13	2013-14	2015-16	20XX
Export carbon pricing policy	Determine approach; Sector/product and carbon price selection and calculation; Prepare related administrative procedures	Implementation	First period of benchmark revision; Possible additive industrial process CO ₂ emission data	Modification/ revision based on national wide domestic carbon pricing policies implementation
Domestic carbon pricing policies	ETS and/or carbon tax pilot programs		Possible national wide implementation.	

Source: author.

16. A DECADE AHEAD: IS CHINA INC. SUSTAINABLE?

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December 2011 marks China's 10th year in the WTO. When China joined the WTO, few might have expected China would gain its economic status as impressively as the reality is today. Within one decade, China almost tripled its GDP, increased exports 4.9 times and imports 4.7 times. China's outward direct investment (ODI) soared 68 times, from less than USD 1 billion in 2001 to USD 68 billion in 2010. It accumulated the world's largest foreign reserves worth over USD 3 trillion.

Meanwhile, China's fast economic growth is unbalanced and, perhaps, unsustainable, as the nation's Premier has said on a number of occasions.¹¹⁶ It is reported that many Chinese companies have very small profit margins, or are even not profitable. The economy is over dependent on exports and investment in fixed-assets, and there has been less contribution by domestic consumption. Over 150 million people are living below USD 1.25 per day. The alarming income disparity is illustrated by the ratio of urban to rural per capita income, which is above 3, and the ratio of incomes of coastal provinces to inland provinces is close to 2.5. In addition, the environment is challenging and social pressures both from within and outside are mounting.

16.1 Institutional advancement and backwardness

China's institutional advancement started in the trade policy area. To comply with its WTO obligations, China eliminated over 190,000 laws, regulations and directives that were

not consistent with WTO rules. China also immediately dismantled the SOEs' monopoly on international trade. China cut down the level of average tariff to 9.8 percent, about one-fourth of the level before its accession to the WTO and far below the average level of the developing countries in general.

WTO-driven trade policy reforms have generated positive ripple effects on political and social changes. For instance, before the WTO accession, the tariff for imported cars ranged from 100 percent to 150 percent, which tempted many involved in the high-profit, high-risk business of smuggling. Since China lowered the tariff and eliminated import quotas after its WTO accession, smuggling and corruption on the border have dropped significantly.

Nevertheless, some deep-rooted systemic illnesses remain unchanged and, to some extent, have even gotten worse in the past years. Most of these issues are behind the border and entrenched in the domestic political and economic system. They are different from those cross-border or on-border issues, such as tariff reduction and customs procedures that were tackled in the first-generation reforms.

One such challenge at the institutional level is that private firms do not enjoy non-discriminatory "national treatment" in comparison with SOEs. National treatment is a WTO term that means treating foreigners and locals equally. Why shall we care about whether locals are treated equally? Because it is a question related to the ultimate goal of the nation's WTO accession, namely to establish a market-oriented economy in which all market actors can operate and compete on equal footing. The economy shall be rule based, instead of ownership based.

¹¹⁶ For instance, Premier Wen spoke about the problem of "unbalanced and unsustainable" situation of Chinese economy recently in Chinese National People's Congress (NPC) in March 2011. National People's Congress: "Wen Jiabao: unbalanced, uncoordinated and unsustainable problems in development are outstanding", March 5th, 2011, http://www.npc.gov.cn/npc/dbdhhy/11_4/2011-03/05/content_1632510.htm

So far, SOEs' own dominant positions in what are called "fundamental and pillar industries", such as defence, power generation and grid, oil and chemistry, telecommunication, coal, aviation, shipping, machinery manufacturing, automobile, information technology, construction, iron and steel, metal, etc. As one entrepreneur quoted in an article colourfully puts it, the current policy environment "leaves the private sector event hardly drinking the soup while the state enterprises are eating the meat".¹¹⁷

Some of the discrimination is de jure, while some is de facto. According to a survey by All-China Federation of Industry and Commerce in 2010, the exclusiveness of SOEs' entry in selected sectors and restrictive rules of land usage are the top two policy obstacles that prevent private enterprises from having an equal opportunity to operate. In those sectors that are open to private firms, some complain there are still many "glass doors" in the approval procedure and access to loans.

Researchers warned that policies must be in place to correct this uneven development between SOEs and private firms.¹¹⁸ The WTO spirit of non-discrimination shall be implemented at the domestic level. Even from an economic point of view, private firms are at least equally important because they pay taxes, invest in innovation and provide millions of jobs.

16.2 Trade Surplus, and Environmental Deficit?

No country in history has emerged as a major industrial power without creating a legacy of

environmental damage that took decades and big dollops of wealth to undo.

Unless it is well managed, there is a risk that China will repeat the old path of environmental deficit. According to a World Bank Report, China is home to 20 of the world's 30 most polluted cities.¹¹⁹ Two-thirds of China's cities do not meet the country's own air emissions standards.¹²⁰ 43.2 percent of state-monitored rivers were classified as grade 4 or worse in 2010, meaning their water was unsuitable for human contact, according to data from China's Ministry of Environmental Protection.¹²¹ The estimated cost of the air pollution ranges from 3 to 7 percent of GDP, not mentioning the damage to human health.

Whether and to what extent China's trade growth has contributed to the stunning environmental degradation is a hard question.

On the one hand, the statistics show that in the past decade, the emission of industrial waste has increased in a similar trajectory to the growth of trade growth. For example, the emission of industrial waste almost tripled. In 2000, the total emission of industrial waste gases, waste water and solid waste were 13.8 trillion standard cubic meters, 19,424 million tons and 816 million tons, respectively. By 2009, the emission of waste gases rose to 43.6 trillion standard cubic meters, waste water to 23,438 million tons and solid waste to 2,039 million tons.¹²²

The large proportion of China's trade is processing trade, from which, economists argue, China generally derives too little rent at the expenses of burning coals and discharged pollutants. According to Chinese Customs, the share of processing trade in total trade was consistently high, ranging from 47 percent to 55 percent in

117 "State enterprises eat meat, private firms can hardly drink soup", Finance Channel of Net Ease <http://money.163.com/11/0711/03/78LEBQ3K00253B0H.html>

118 One of those outspoken experts on the national treatment to all enterprises is Mr Long Yongtu, China's Chief Negotiator for the WTO Accession. "Long Yongtu: The National Treatment Problems are not solved yet", March 1st, 2011, <http://finance.sina.com.cn/hy/20110301/09589449509.shtml>

119 Time Magazine "The World's Most Polluted Places", 12 September 2007.

120 "China: The Balance Sheet", Bergsten, 2006.

121 The Economist "Raising a stink" August 5, 2010.

122 Sun Shuhong, Zhou Tiantian, "Impacts of China's exports on environmental pollution and policy responses", Paper Prepared for the Contemporary Asian Economic Research Institute, available at <http://www.caeri.or.jp/cn/research/cat19/724.html>

the period from 2000 to 2010.¹²³ It argues that, instead of exported products, the industrial production process and failure to curb the emission of pollutants are to blame for the rising pollution in China.

On the other hand, there are studies that may break this causal link between China's trade growth and its environment degradation. For example, a recent study published by the National Bureau of Economic Research in Washington DC argues that China's exports have shifted toward relatively cleaner, highly fragmented sectors, and the pollution intensity of Chinese exports has fallen dramatically from 1995 to 2004.¹²⁴

Both sides, however, agree on one thing: China needs to develop cleaner trade. The question is how. Here are two examples indicating the complexities of these trade and environment linkages that have been and will continue to be headlined for many years to come.

Example one: Can we consider taking restrictive measures that provide disincentives for production and exports of high-polluting products?

In 2007, China issued a number of policies to restrict exports of high energy-consuming and polluting resources products and to encourage imports of raw materials. The policies include the large-scale scrapping or cutting of export tax rebates for 2,831 commodities, aimed at curbing the growth of energy-consuming industries and reducing the nation's rising trade surplus. China also raised the resources taxes on lead, zinc, copper and tungsten ore by 3 to 16 times from August 2007.

However, China's above-mentioned export restrictions, together with a latest restriction on rare earth exports, which were claimed for environmental objectives, have been called by

several trading partners "making trouble" and brought to the WTO. Export restrictions cannot be justified on environmental grounds, the WTO panel finds.¹²⁵

Example two: How about policies to encourage investing in manufacturing and trading in clean energies, such as solar panels?

China is now the world's largest producer of polycrystalline silicon, a key component of solar cells. But the dark side of this green energy solution is that the manufacturing process itself is energy consuming and polluting. According to industry tests, a 1m × 1.5m production of solar panel must burn more than 40 kilograms of coal. Even China's most inefficient coal power plants can use these 130 kwh of electricity production to 2.2 watts, which is sufficient light-emitting diodes (LED) light bulb 12 hours a day, calculated in accordance with 30 light years. And, a solar panel's design life is only 20 years.¹²⁶ The polycrystalline silicon production process will produce up to a dozen various hazardous and harmful substances in the environment that harm the human body, including chlorine, hydrogen chloride, silicon tetrachloride, hydrofluoric acid, nitric acid, nitrogen, hydrogen fluoride, sodium hydroxide and other substances, according to the report of a Beijing-based energy technology company.¹²⁷

China's booming manufacturing business of solar panels not only raised environmental concerns, but also was very recently accused of dumping in the U.S. market and of being substantially subsidized by the Chinese government. The seven-party Coalition for American Solar Manufacturing, led by U.S. module maker SolarWorld, is accusing the Chinese government of cushioning its solar sector with land grants, export assistance, preferential loans and other state-sponsored subsidies. The complaint says

123 The data are based on information available at China Customs (<http://www.chinacustomsstat.com/>).

124 Judith M. Dean, Mary E. Lovely, "Trade Growth, Production Fragmentation, and China's Environment", NBER Working Paper No. 13860, March 2008.

125 "WTO Panel Rules against China's Export Restrictions on Raw Materials", ICTSD Bridges Weekly, 6th July 2011 <http://ictsd.org/i/news/bridgesweekly/110043/>

126 Jian Shuisheng, "Two Problems of China's Solar Panel Industry", <http://opinion.hexun.com/2011-11-04/134875611.html> ; Marla Dickerson, "Solar energy's darker side stirs concern: Cells contain toxic items that could end up in landfills. Some firms", January 14, 2009, Los Angeles Times, <http://articles.latimes.com/2009/jan/14/business/fi-notsogreen14>

127 <http://www.bjsola.com/Technology/gudianl/2087.html>

that these measures have artificially deflated the price of Chinese products and caused “material injury to the domestic industry”.¹²⁸

As these two examples show, in order to ensure the trade growth does not bring environmental damage, there are three major unanswered questions for China and the international community to address:

- (1) Can trade policy tools be used to leverage cleaner production in China? And, if so, how?
- (2) Are current international trade rules backed by the WTO agreements sufficient to address the trade and environment tensions?
- (3) How can international trade rules and domestic industrial policies be devised in a coordinated way to tackle environmental challenges, such as climate change, while keeping the principles of leveling the playing field in the international market?

16.3 Fear of China and the way forward

It is arguable that China, through its increased imports and outward investment, has contributed a large share to global economic growth in the past decade. Since 2008, China has become the largest export destination for LDCs, absorbing roughly 23 percent of their total exports. Between 2000 and 2009, China’s imports from the LDCs increased 24 percent annually. In 2010, China was the largest export destination for Japan, Australia, Brazil and South Africa, the second largest for the EU and the third largest for the US.

At the same time, China’s competitive production and exporting power has given rise to popular narratives, arguing that its strength squeezes the potential of poor developing countries to industrialize and takes away jobs from developed countries. As early as 2006, some respected

researchers found that China’s export might not so much result in the displacement of existing producers (in sub-Sahara Africa), but might have “adverse long-term implications for SSA industrialization”.¹²⁹ There are similar discussions about the pressures Chinese products put on Latin American firms by out-competing them in both world and home markets and about the heavy environmental and social toll that Chinese investment in natural resources can exact. In Brazil, for example, China has triggered a debate over de-industrialization and the future of economic growth.¹³⁰

The subject of anxiety is exacerbated by the perception that the policymaking process in China transpires in a black-box. It is argued that Chinese policymakers promote unfair trade practices by subsidizing cheap exports and manipulating the exchange rate of China’s currency.

Fear of China may be over-simplistic, inaccurate and resentful. But, China has a vital interest in maintaining long-term stability and a peaceful international environment in addition to sustaining the growth of its own domestic economy. Therefore, China must pay sufficient attention to these perceptions and the development challenges its trade has brought about. Apart from supporting international policy research and dialogues, China can continue its efforts to gradually expand domestic demand, especially for goods and services from lower-income countries. In the manufacturing sector, China shall intentionally give some development space for other developing countries. It could be very positive to ramp up China’s support for trade capacity building in its southern partners through bilateral schemes and multilateral AFT. Further support for outbound investment of Chinese enterprises in a sustainable fashion could make a big difference to the well-being of local communities in host countries.

128 “US, China Solar Tensions Threaten to Eclipse Environmental Trade Talks”, ICTSD Bridges Weekly, 9th November 2011, <http://ictsd.org/i/news/bridgesweekly/117948/>

129 Kaplinsky, R. and Morris, M. “The Asian Drivers and SSA; MFA Quota Removal and the Portents for African Industrialisation?”, mimeo, paper prepared for Asian and Other Drivers of Change Workshop, St Petersburg, Brighton: IDS, 2006.

130 For instance, Enestor Dos Santos, “Will the emergence of China deindustrialize Brazil?” Brazil Economic Watch, 20 October 2010.

16.4 Conclusion

Apart from a huge step forward in terms of trade and economic growth, China has made significant progress on policy reforms at the institutional level that go in the right direction toward establishing a rule-based market economy. Nevertheless, the economy is neither balanced nor sustainable in many ways. That is mainly because the institutional foundation for a market economy is still rather distorted and the spirit of the WTO, such as with respect to the rule of law, transparency and non-discriminatory treatment have not been fully implemented. To sustain its economic development, China shall continue its market-oriented reforms in the same direction agreed 10 years ago and shall not reverse the reforms back to a state-oriented economy that is based on political power, ownership and non-transparent decision-making.

Environmentalists may see China's gains of trade growth and financial well-being in the past decade are overshadowed by its environmental losses and the astonishing pollution in China. Although there are other contributing factors, such as failure of implementation in environmental laws and regulations and poor management of industrial and urban waste, international trade together with extensive manufacturing is indeed part of the problem. Therefore, the sustainable development goal will not be achieved in China unless its trade and industrial policies are consistent with environmental instruments. However, as illustrated by the two examples discussed in the previous section, the linkages between trade and the environment are extremely complex. While it at first glance it seems like a positive step towards environmental protection to carry out export restrictive measures in high polluting and high energy consuming sectors, but such measures might be violations of China's obligations in the WTO. A set of policies of encouraging investment in solar-energy technology sectors appears fine for the environment, but such policies not only

A decade in the WTO has proved China's incredible capability to grow. The question for the next decade is whether and how China can grow with less pain at home and abroad.

overlook the huge pollution created during the process of manufacturing, but also might break the rules of fair trade in the international market. Looking to the future, China will play a key role of discussing and testing existing rules on trade and the environment in the WTO and other international policy forums.

International scholars and new channels have had many discussions about the negative impacts of China's competitive manufacturing on its trading partners. Meanwhile, the majority of the Chinese research and policy community is focused on how to increase the competitiveness of its industry. It is true that China is still a developing country with one-tenth of its population living in absolute poverty, and it has a long way to go to grow its economy and lift up the living standards of its people. But, China is different today compared with ten years ago. To sustain a peaceful development environment, China shall take into account the concerns raised about its impacts on, for instance, industrialization in sub-Saharan Africa or risks of de-industrialization in some Latin America countries. It is in China's own interest to intentionally craft international-development-friendly policy tools, because allowing more development space for other developing countries will enhance political solidarity and sustain mutually beneficial commercial interlinkages.

A decade in the WTO has proved China's incredible capability to grow. The question for the next decade is whether and how China can grow with less pain at home and abroad.

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