

# Whose Trade Policy? Leadership and Industry Voice in China's Evolving Global Trade Position

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In most WTO member countries, trade policy is driven not only by government priorities, but also by industry interests. Since trade policy's primary impact is on the operations of businesses, it is intuitive that most countries would want to make policies that are in the interests of their domestic enterprises. Business interests often have a particularly large impact on a country's pursuit of trade remedies and dispute cases. Trade remedies include, most notably, a country's antidumping regime, which is the system whereby the government determines whether imports from another country are being sold below a fair price and, if so, assesses extra duties on the product to raise the price. Each WTO member country has the right to set its own antidumping procedures (subject to certain basic rules) and carry them out domestically. Dispute cases, on the other hand, are filed through the WTO and decided by a panel of international judges.

In the U.S., almost all antidumping investigations, as well as most WTO dispute settlement cases, are initiated at the behest of individual businesses or industry groups. However, while the involvement of business interests in these matters is found in almost all countries, and certainly in all large economies, the internal distribution of power and the structure of decision-making necessarily differ between countries. This paper will examine these distributional and structural issues in the Chinese context. China became a member of the WTO in 2001, in the midst of a major economic transformation. Since the 1980s, but especially since the mid-1990s, China has become a much more open, market-driven economy. Additionally, in the 2000s, the Hu administration has emphasized legal reforms that give more freedom to the domestic private sector, in hopes of further encouraging its growth. However, while the growth of the domestic private sector is a policy priority

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in China and its power has increased considerably, its voice in trade policy has not caught up to its economic and strategic importance.

Since the earliest stages of the WTO accession process, China's state-owned enterprises (SOEs) have held a privileged position as industry's voice on trade policy, thanks to their longstanding connections to the industry bureaucracy. While the SOEs' importance in the economy has generally diminished over time, they have retained much of the access to monetary and political resources that they enjoyed for decades. Most recently, their continuing influence is reflected in their prominent role in China's emerging use of the WTO dispute settlement system and other trade remedies. As China becomes more active in pursuing its national interests in the WTO (and in the global trade regime more generally), it needs to develop a formal mechanism for the private sector to help drive trade policy, as witnessed in advanced economies. Doing so will help ensure that China's trade policymaking apparatus is better positioned for the future by including input from those most likely to drive China's economic growth.

The structure of this paper is as follows: the first section considers the current distribution of power between the state-owned enterprises and the domestic private sector, concluding that the state-owned sector retains far more resources for influencing trade policy. In the second section, the paper turns to a current analysis of how these power dynamics are at play in China's first filings as a plaintiff in the WTO dispute settlement system, and it reviews how these dynamics are similar to those seen in China's antidumping and safeguard regime. Through this analysis, this paper will contribute to the emerging dialogue on how China's increasingly assertive trade policy reflects the longstanding distribution of power among domestic industry groups and the potential ramifications of maintaining that distribution. The paper concludes with a few brief recommendations on how China's trade policy regime could better reflect its changing economy.

#### *The State-Owned and Private Sector's Access to the Policy Apparatus*

Before looking at recent trade policy developments, it is important to understand the political and historical context by briefly examining the power structure in government-industry relations. While the domestic private sector's power has increased quite significantly, especially under Hu, its ability to influence trade policy is still very limited. Meanwhile, the interests of the large SOEs remain entrenched in the Chinese bureaucracy, giving them an important voice on trade policy issues. Before proceeding with an examination of each sector, however, it is necessary to clarify what is meant by "state-owned" and "private" for the purposes of this paper. Given the ongoing reforms of the SOEs, the line between the two sectors is somewhat blurry. There are now partially privatized SOEs (in which the government still maintains a majority stake), foreign-SOE joint ventures, enterprises owned

by local governments, and state-owned holding companies whose assets include both public and private businesses, to name just a few of the many ownership structures in the Chinese economy. Fortunately, in this case, it is not necessary to classify all of these hybrid forms into either private or state-owned categories. Because our main consideration is the power of the SOEs in the government bureaucracy, it is most appropriate to focus on the large SOEs. These firms are the ones that have traditionally enjoyed access to the policymaking process, and, due to Hu's strategy of retaining government control over key sectors (discussed in greater detail below), are also the ones that largely remain state-owned today under the management of the State-Owned Assets Supervision and Administration Commission (SASAC).

The large SOEs represent a stable group of industries that have consistently enjoyed the most power among business interests in the policymaking process over time. This makes the process of examining their influence on trade policy much simpler, since the core group of 150 large SOEs (those that are now under SASAC) has largely remained consistent over time. For the purposes of this analysis, then, "state-owned" will refer strictly to the large state-owned enterprises in which the government maintains full or large-majority ownership, and their wholly state-owned subsidiaries. The "private sector" will be defined as domestically originated businesses that were private from their founding (in other words, this definition excludes foreign enterprises and newly privatized former SOEs). This strict definition is appropriate given that these indigenous entrepreneurs are the ones the Hu administration focuses on supporting through its economic policy.

### *The State-Owned Enterprises*

The Jiang- and Hu-era reforms to the state-owned sector created the policy environment in which the large SOEs now operate. SOE reform began in the 1980s, when Deng Xiaoping initiated the process of separating the enterprises' day-to-day business operations from government control. However, by the 1990s (under Jiang), it was clear that further action was needed to prevent the SOEs from becoming a serious drain on the economy, as well as to prepare for WTO membership. According to the OECD, "By the early 1990s SOE profit rates had already fallen to levels that were low by international standards. SOE employment growth slowed to an annual rate of 1.7% between 1990 and 1995, from 2.8% over the prior five years."<sup>1</sup>

Even more troublesome was the burden the SOEs placed on the financial system through the number of loans they required to maintain their business. As SOE profits shrank and the companies were unable to repay their lenders, many of these ended up as bad loans on Chinese banks' balance sheets. To alleviate these difficulties, Jiang's idea was to "hold on to the

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<sup>1</sup> OECD Reviews of Regulatory Reform, *China: Defining the Boundary Between the Market and the State*, OECD, 2009, p. 39, <http://www.oecd.org/dataoecd/35/45/42390089.pdf>.

large, while letting go of the small,” meaning to close or sell off small and mid-sized SOEs while retaining government control of the large ones.<sup>2</sup> Once the central government decided on this strategy, the process happened quite rapidly – “the number of SOEs fell by 60% between 1995 and 2001 ... by 2001, when China became a WTO member, the private sector, including foreign invested enterprises, had surpassed the public sector in contributing to real GDP.”<sup>3</sup>

In addition to selling off the smaller SOEs, the key components of Jiang’s strategy for lessening the burden of the state-owned sector on the Chinese economy were to prepare the large SOEs for listing on the stock exchange by further professionalizing their management and to reform the laws regarding the legal status of private businesses.<sup>4</sup> While this legal reform was intended to facilitate the privatization of the smaller SOEs, it also laid the groundwork for a stronger legal status for the domestic private sector, a process that the Hu administration would later accelerate.<sup>5</sup> Throughout the SOE reform process, WTO accession was at the front of Jiang’s mind, motivating him to prepare the state-owned sector for the competition they would face once China joined. Margaret Pearson explains his thinking: “The lead-up to China’s WTO accession convinced policymakers that increased competition in the domestic market would strengthen Chinese firms prior to the onslaught of foreign competition. Yet they continued to regard unfettered competition as harmful and decided accordingly that competition in strategic, state-owned industries should be ‘orderly’.”<sup>6</sup> Several sources suggest that Jiang probably envisioned a very gradual privatization process for the larger SOEs (aside from those in sectors of national security concern, which the government has always intended to keep under its control).

In a break with Jiang’s policy trajectory, Hu elected instead to keep the large SOEs in the hands of the government permanently and to focus on improving their competitiveness from within through the use of SASAC. The following list represents the mission of SASAC according to its director, Li Rongrong:

- SASAC guides and pushes the reform and restructuring of state-owned enterprises, as well as supervises the maintenance and appreciation of state assets’ value for those state-invested enterprises

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<sup>2</sup> Guoqiang Tian and Hong Liang, “What Kind of Privatization?” in *Dilemmas of Reform in Jiang Zemin’s China*, ed. Andrew Nathan et al. (Boulder, CO: Lynne Rienner Publishers, 1999), 77.

<sup>3</sup> *Ibid.*, 42.

<sup>4</sup> *Ibid.*

<sup>5</sup> OECD Reviews of Regulatory Reform, *China: Defining the Boundary Between the Market and the State*, OECD, 2009, pp. 41–42, <http://www.oecd.org/dataoecd/35/45/42390089.pdf>.

<sup>6</sup> Margaret M. Pearson, “The Business of Governing Business in China,” *World Politics* 57 (January 2005), 314.

- SASAC dispatches the supervisory board to some large enterprises on behalf of the state and takes charge of daily management of the supervisory board
- SASAC appoints, removes, and evaluates the executives of enterprises through legal procedures and grants rewards and punishments according to their performances
- SASAC drafts laws, administrative regulations, and related rules on the management of the state-owned assets, and directs and supervises the work of local state-owned assets management according to law
- SASAC undertakes other tasks assigned by the State Council<sup>7</sup>

While SASAC has largely been effective in these tasks, outside observers such as the OECD have criticized the fact that SASAC is both an owner and a regulator of the SOEs. As a result of this dual role, many of the conflicts of interest inherent in state ownership of businesses have not been eliminated under the SASAC system, despite the more market-driven management style.

Besides the formation of SASAC, Hu's other early priority was to get rid of the non-performing loans (NPLs) that still remained on bank balance sheets as a result of past requirements that they lend to SOEs. Through Hu's use of capital injections to banks, by 2006 "NPLs for the banking system as a whole had fallen to 6.2% of loans from just below 18% in 2003."<sup>8</sup> Later, in 2005 and 2007 respectively, Hu increased the potential for private competition with SOEs by mandating that the domestic private sector would be allowed to participate in all parts of the economy that already allowed foreign investors and equalizing property rights for businesses regardless of their form of ownership.

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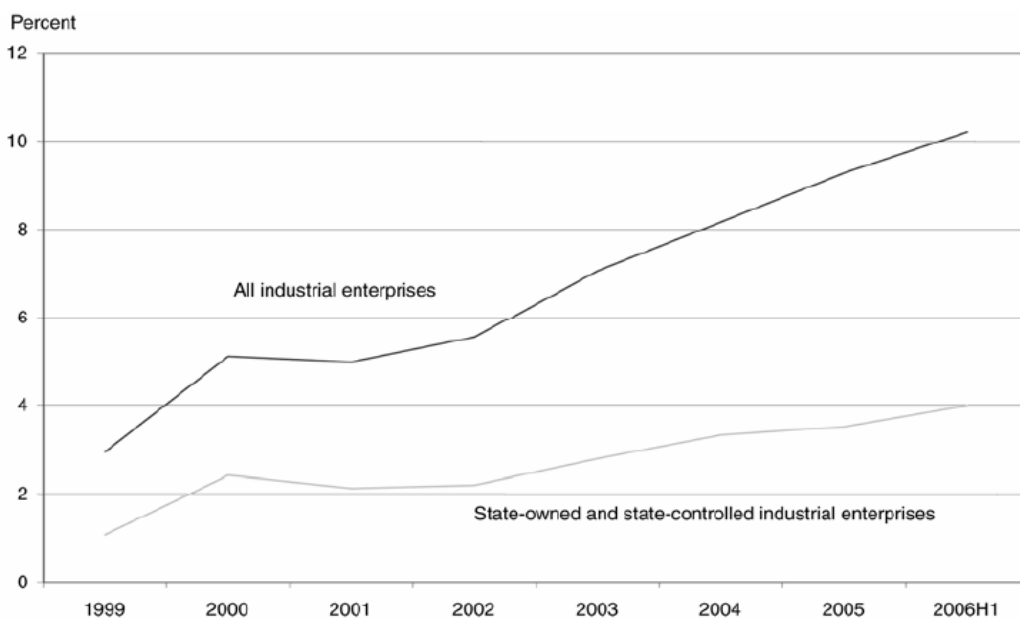
<sup>7</sup> *People's Daily*, "SASAC's Responsibilities and Targets," *People's Daily* online, May 22, 2003, [http://english.peopledaily.com.cn/200305/22/eng20030522\\_117060.shtml](http://english.peopledaily.com.cn/200305/22/eng20030522_117060.shtml).

<sup>8</sup> OECD Reviews of Regulatory Reform, *China: Defining the Boundary Between the Market and the State*, OECD, 2009, p. 47, <http://www.oecd.org/dataoecd/35/45/42390089.pdf>.

*State-Owned Enterprises and the Political Bureaucracy*

Having established the basic background on the reforms that have shaped the current state-owned sector, it is possible to now consider the present SOE role in policymaking. As a result of the success of Hu's strategic consolidation of the sector, the top SOEs now enjoy a source of legitimacy that they lacked in the 1980s and 90s — they are contributing to the Chinese economy. As an illustration of this, the graph below tracks industry profits as a percentage of GDP:

**Industry Profits as a Percent of GDP, 1999–2006**



Source: Nicholas Lardy, "China: Rebalancing Economic Growth," Peterson Institute, May 2007

As the graph shows, the profitability of state-owned enterprises has been on a consistent upswing since the beginning of Hu's reform program in 2003, which is an extension of the Jiang-era philosophy of "holding on to the large while letting go of the small" mentioned above. Since Jiang carried out the politically difficult task of privatizing these smaller SOEs, Hu now seems to believe that the largest ones should remain state-owned since they are generally profitable and thus a good source of revenue for the state. As an overall trend since the mid-1990s,

While unprofitable SOEs, mostly small and medium-sized ones, have been privatized or otherwise off-loaded, the state ... has devoted enormous energy and resources to the reorganization and governance

of the largest and most profitable state firms. While monitoring and supervision have been enhanced, the biggest SOEs have also received special government backing, including priority listing on stock markets and access to bank credit.<sup>9</sup>

The creation of SASAC is the latest extension of this philosophy of preferential management of the large SOEs. Through this lens, it is not difficult to see how SOEs have become much more profitable in recent years — only the state-owned firms that were profitable to begin with remain under government control, and they are given every opportunity to succeed, including consolidation. The monopolies and oligopolies that this approach has created in strategic industries presumably also contribute to profit margins. In sum, a shrinking number of SOEs are making profits that are growing even when measured as a share of a GDP figure that is also growing. These profits make a substantial contribution not only to the overall economy, but more importantly for policy, to the resources of the government, since “the most powerful generator of wealth to the direct benefit of the Party and the state is not the tax system, but the network of top SOEs.”<sup>10</sup> There is little doubt that this successful turnaround in the performance of the state-owned sector and its contribution to both the economy and the government budget gives the SOEs greater credibility to push for the policies they prefer. Thanks to the offloading of unprofitable firms, most SOEs are no longer a drain on the economy, and Hu and other top leaders may see this success as a validation of their own strategies, taking pride in the newly competitive state-owned sector.

Despite the more market-oriented current management structures of the SOEs, the companies still retain powerful links to the bureaucracy. This is partially due to the historic business culture of SOEs, which have traditionally been vertically oriented with a “focus on developing privileged relations with CCP officials, ‘[spurning] horizontal association and broad networking with each other’.”<sup>11</sup> However, it is also due to the fact that as the government has continually restructured the organization of the industry bureaucracies, state-owned companies have taken advantage of power vacuums and capitalized on the opportunity to shape policy to suit their own agendas. For example, in an interesting case study of the energy sector, Erica Downs finds that “the projects pursued by the energy SOEs tend to shape the country’s energy policies rather than vice versa.”<sup>12</sup> Throughout the 1990s and 2000s, the government’s authority over the energy sector has declined. During this

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<sup>9</sup> Ibid., 33.

<sup>10</sup> Kenneth DeWoskin, “China: Key Issues for Business,” in *China into the Future*, ed. W. John Hoffmann and Michael Enright (Singapore: John Wiley & Sons, 2008), 105.

<sup>11</sup> Gordon Redding and Michael Witt, *The Future of Chinese Capitalism* (Oxford: Oxford University Press, 2007), 95.

<sup>12</sup> Erica S. Downs, “Business Interest Groups in Chinese Politics: The Case of the Oil Companies,” in *China’s Changing Political Landscape*, ed. Cheng Li (Washington: Brookings Institution Press, 2008), 137.

time period, government oversight of the sector has changed structure four times, including two periods in which central leadership was claimed by multiple agencies. This uncertainty meant that state-owned energy companies were “poised to take advantage of the energy leadership vacuum. By lending employees to the government’s understaffed energy bodies, they were able to influence decision making to advance their own interests. Sinopec employees, for example, became involved in drafting the country’s strategic oil reserve law.”<sup>13</sup> The purpose in highlighting this example is not to blame the energy companies for taking advantage of the opportunity to influence policy — any industry given a similar opening would likely do the same. Rather, it demonstrates the vulnerability of the policymaking process to influence by large firms.

Companies in strategic industries have been able to seize on opportunities to influence policy because the industry bureaucracy has remained in place but become weaker through the reform process. The companies that tend to have these opportunities are primarily the large SOEs, both because these SOEs are concentrated in the strategic industries that retain bureaucratic representation, and also because the relationships between these companies and their representative bureaucracies grew over several decades. When there is an opening to exert influence with the bureaucracy, such as in a power vacuum, they are the companies poised to take advantage of it. This opportunity exists on trade policy as well, where the “constituencies with reasons to resist or worry about WTO-related changes and other reforms continue to retain and develop institutional patrons and allies.”<sup>14</sup> The industry bureaucracy, while smaller and somewhat less powerful than in the past, retains influence within the government on trade policy, and the interests of the major SOEs tend to figure prominently in its recommendations. This is further demonstrated in the section below, which covers industry interests’ influence over the use of antidumping and safeguard measures in China.

### *The Private Sector*

Where does all of this leave the domestic private sector? After all, the private sector has flourished under Hu’s reforms and is now the engine of growth in the Chinese economy. In recent years, “total factor productivity for this sector has been running at double that for the state sector ... it is then, not surprising that two-thirds of China’s value-added is now coming from this ... entrepreneurial sector.”<sup>15</sup> However, until the Hu administration, the domestic private sector was largely ignored in favor of courting foreign private firms (although Jiang did allow private business owners to join the CCP be-

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<sup>13</sup> *Ibid.*, 129.

<sup>14</sup> Hui Feng, *The Politics of China’s Accession to the World Trade Organization* (London: Routledge, 2006), 170.

<sup>15</sup> Redding and Witt 2007, 139.

ginning in 2001). With Hu's more inclusive development focus, there is much greater recognition that China's private businesses, while individually small, have an enormous collective impact on the economy and should be supported.

Hu has strengthened property rights and allowed domestic private enterprises to pursue the same investment opportunities that are open to foreign firms. This has led to the entry of domestic entrepreneurs into industries historically dominated by the large SOEs, such as the automotive sector.<sup>16</sup> At present, though, the domestic private sector remains largely "a system of small to medium enterprise, usually focused on one field, such as component manufacture, low-tech production, or specific service."<sup>17</sup> The opportunity for these firms to have an impact in shaping economic policy, let alone international trade policy, has not caught up to their contribution to the economy. Often, for smaller, localized firms, "there are no formal institutions to make the locals' voice heard, except for the informal and personal contacts between provincial governors and central leaders ... [their views are] largely irrelevant in the policy-making process."<sup>18</sup>

There is one new measure that facilitates communication between the private sector and the central government. To meet the requirements of joining the WTO, the Ministry of Commerce (MOFCOM) initiated a public comment process whereby citizens and the business community can voice their opinions on proposed changes to trade-related laws in China. While instituting this system is a step in the right direction, as one MOFCOM official admits, "We need to consult better with the public and industry while the laws are still being drafted. We need to learn how to better communicate with business circles and citizens; to include their views into our decision- and law-making" — he acknowledges that while public comments are collected and reviewed, they are often not considered in the process of actually making policy.<sup>19</sup>

Even for the larger private firms, they do not enjoy the same access to the bureaucracy that the SOEs retain. Their overall level of connectedness to policymakers on many issues remains quite low, as evidenced by the fact that they still face a disproportionate share of the "difficulties in accessing loans from principal Chinese banks, gaining miscellaneous administrative approvals, and becoming eligible for tax and other official business

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<sup>16</sup> *China Daily*, "Doors Open Wider for Private Sector," March 8, 2004, <http://www.china.org.cn/english/BAT/89648.htm>.

<sup>17</sup> Redding and Witt 2007, 139.

<sup>18</sup> Feng 2006, 134.

<sup>19</sup> Gregory Chin, "Implementing China's WTO Transparency Obligations: An Inside View," Working Paper, Hong Kong University of Science and Technology, July 2006, <http://www.cctr.ust.hk/articles/pdf/WorkingPaper13.pdf>.

incentives.”<sup>20</sup> Private business owners may now join the CCP, which is a step toward giving them greater voice in government, but the historical connections between the large SOEs and the industry bureaucracy remain the primary way by which interest groups participate in the creation of Chinese trade policy. As Naughton writes, “Interest group contention remains very much behind the scenes, and the legitimacy of the process is not established. Instead, policymaking is still concentrated in the hands of a group of long-serving elite technocrats in Beijing.”<sup>21</sup>

The lack of access to the policymaking process is compounded by the fact that the private sector is usually not well-informed on trade issues and their effects on domestic business – “whereas U.S. industries are old hands at pressing for trade complaints, Chinese industries are just starting to be advised of their global legal options.”<sup>22</sup> For all but the largest domestic private firms, their focus in interacting with the government may still be the more immediate problems of obtaining approvals and resolving tax issues, as mentioned above. As the next section will show, the concentration of industry’s voice in trade policy among the SOEs has a significant effect on the issues China chooses to pursue, especially in settling trade disputes (the area of trade policy where industry has the greatest influence in most countries). If China does not develop a more institutionalized mechanism for incorporating the opinions of its most productive sector in its trade policy, it risks allowing a small group of less globally competitive industries to dominate its use of the WTO system and other trade policy tools.

#### *Newly Assertive: China’s Growing Use of Trade Remedies*

As the WTO has become more legalized, a member’s strategy and capability for participation in the dispute settlement system have become increasingly important components of its trade policy. Despite the fact that China set up a Bureau of Fair Trade for Imports and Exports with the mission of handling trade enforcement issues<sup>23</sup> in conjunction with WTO accession in 2001, China did not initiate a complaint to the WTO for the first six years of its membership. However, it did pursue its own antidumping and safeguard procedures, in ways described later in this section. In an initial use of the WTO system, China signed on to a 2002 complaint by the EU against U.S. steel subsidies, but it was apparently reluctant to bring any cases of its own, de-

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<sup>20</sup> United States International Trade Commission, “China: Description of Selected Government Practices and Policies Affecting Decision-Making in the Economy,” Investigation No. 332-492, USITC Publication 3978, December 2007, p. 36.

<sup>21</sup> Barry Naughton, “China’s Left Tilt: Pendulum Swing or Midcourse Correction?” in *China’s Changing Political Landscape*, ed. Cheng Li (Washington: Brookings Institution Press, 2008), 143.

<sup>22</sup> Tina Wang, “Where Are China’s WTO Lawyers?” *Forbes*, April 27, 2009, <http://www.forbes.com/2009/04/27/china-wto-law-business-economy-trade.html?partner=relatedstoriesbox>.

<sup>23</sup> In rough terms, China’s equivalent of the U.S. International Trade Commission.

spite being a frequent target of complaints by other members. However, since 2007, China has initiated three cases of its own, all against the U.S. The first of these cases was ultimately settled before a panel was established. In response to the second of these complaints, however, "in January [2009], the WTO, for the first time ever, created an expert panel to decide a suit initiated by China, which accused the U.S. of illegally levying duties against Chinese steel pipes, off-road tires and laminated woven sacks."<sup>24</sup> Subsequently, China has filed another case against the U.S. (in April 2009).

There is every reason to believe that China's use of the dispute settlement system will continue to grow as China builds its capacity to handle complex trade cases. China's newly litigious stance in the WTO, explains Tina Wang of *Forbes*, is nothing short of "a massive attitude shift for Beijing, from seeing WTO disputes as a failure of bilateral diplomacy to wielding the WTO dispute settlement mechanism as an extremely useful, and necessary, instrument of foreign trade policy. For Beijing, a more mature role as WTO plaintiff is also part and parcel of its growing assertiveness in the global economic order this year."<sup>25</sup> In fact, this shift is so noteworthy that Wang is currently writing an ongoing series for *Forbes* about China's new role as WTO complainant. The series is the first to focus exclusively on China in this role, but past research has examined how countries, including developing countries, decide whether to use the dispute settlement system and select cases to bring to the WTO. Wang's research offers some clues as to how China's role as plaintiff may evolve over the next several years. The next section will develop a picture of China's newly litigious stance in the WTO. It will examine how China has selected its trade dispute cases so far and how it is likely to do so in the future. This analysis is based both on contextual factors unique to China and on existing research that reveals how developing countries generally tend to use the dispute settlement system.

### *A New Role: China as WTO Plaintiff*

In a convincing study of the use of the WTO dispute settlement system by all developing countries (including China, but the study was done before China's most recent two filings), Christina Davis and Sarah Bermeo find conclusively that one of the strongest predictors of future filings is past filings. The authors explain that use of the system, especially for developing countries, requires a large initial investment in legal expertise and capacity. Once this capacity is built, however, the marginal cost of bringing future cases goes down, encouraging developing countries to continue to use the system. In other words, "Governments and industry must invest considerable resources in learning how to use the dispute process the first time, but this experience

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<sup>24</sup> Tina Wang, "China's Coming of Age in the WTO War," *Forbes*, April 20, 2009, <http://www.forbes.com/2009/04/20/china-wto-trade-markets-economy-law.html>.

<sup>25</sup> *Ibid.*

itself can be applied more generally to future cases ... those who gain knowledge through experience become repeat players that will use the system more often because they face lower startup costs for subsequent participation.”<sup>26</sup>

Interestingly, their analysis shows that initial experience can be obtained in a variety of ways. Their findings hold true for countries that gain exposure to the system through experience as a defendant (certainly a relevant factor in China’s case, since China has been a respondent in 7 distinct cases – 14 if separate filings by different countries on the same matter are included<sup>27</sup>), and for countries that sign on as a third party to a complaint initiated by another country (which China did in the EU’s 2002 case against U.S. steel subsidies). Since China was forced to gain expertise in the workings of the dispute settlement system as a defendant, Davis and Bermeo’s analysis predicts that it would only be a matter of time before China would have the capacity to feel comfortable bringing cases of its own, and that once it did so, it would use the system with increasing frequency. The chart below summarizes the authors’ findings on the increasing likelihood of a country to file a dispute in a given year based on previous filings:

| Variable          | Shift of value | Baseline probability | Change in probability | Percent change |
|-------------------|----------------|----------------------|-----------------------|----------------|
| Prior Initiations | From 0 to 1    | 0.050                | 0.006                 | 13             |
| Prior Initiations | From 0 to 3    | 0.050                | 0.022                 | 44             |
| Prior Defendant   | From 0 to 1    | 0.053                | 0.008                 | 15             |
| Prior Defendant   | From 0 to 3    | 0.053                | 0.027                 | 52             |

Source: Davis and Bermeo, p. 39

To apply the findings in the chart to China’s case, as China moved from no prior experience as a defendant to three experiences as a defendant, the likelihood that China would file a complaint of its own rose 52 percent. If multiple complaints from different countries on the same matter are excluded, China reached this three-case threshold of experience as a defendant in early 2007. Sure enough, 2007 also saw China file its first complaint, lending credibility to the authors’ findings. After filing this first complaint in 2007, the probability that China would file again rose by 13 percent. Now that China has initiated three cases, the likelihood of it filing another rises by 44 percent. However, this trend toward increased filings may eventually level off – “while the first few initiations have a significant positive effect, after

<sup>26</sup> Christina L. Davis and Sarah Blodgett Bermeo, “Who Files? Developing Country Participation in GATT/WTO Adjudication,” forthcoming in *Journal of Politics*, working paper dated December 5, 2008, p. 4, [http://www.princeton.edu/~cldavis/files/who\\_files.pdf](http://www.princeton.edu/~cldavis/files/who_files.pdf).

<sup>27</sup> [www.wto.org](http://www.wto.org).

a country has initiated five or six cases within the past decade, the marginal effect becomes quite small for any additional case.”<sup>28</sup> This does not mean, however, that a country will use the dispute settlement system less frequently after the first six cases, only that once a country becomes a frequent user of the system, it is likely to continue using it at a consistent pace. Given its growing body of experience with the WTO system, chances are that China will continue to be a more active plaintiff in trade disputes – in other words, Davis and Bermeo’s analysis lends statistical support to the trend that *Forbes* observes. However, as Wang points out in the *Forbes* series, China still has a great deal of capacity-building to do in order to maximize its effectiveness as a plaintiff.

As Wang points out in the series’ second piece, titled “Where Are China’s WTO Lawyers?” much of China’s WTO legal work is still done by foreign lawyers, primarily from the U.S. China has only barely begun to develop indigenous expertise in the complexities of WTO law. Wang describes the process by which Chinese trade law firms are scrambling “to ameliorate [their] competitive disadvantage, in a process that could take many years” – ten to twenty years, in fact, according to one Chinese law professor cited in the article.<sup>29</sup> Why would it take so long for a country like China, with substantial financial resources, to develop the legal capacity to represent itself before the WTO? According to the experts cited in Wang’s article, the reason is that effective WTO lawyers are knowledgeable about “common law, civil law, and WTO law, [with] a solid background in economics, accounting, and other fields, and English language ability that is sophisticated enough for lengthy briefings and argumentation before the WTO court.”<sup>30</sup> This skill set is difficult to obtain in China, since it requires thorough understanding of the foundations of Western law. However, as U.S.-trained Chinese lawyers return home to practice law, the number of lawyers with these skills is growing. In the meantime, according to Wang, Chinese lawyers often serve on teams headed by U.S. firms, providing valuable insider perspective on the Chinese laws being challenged by other countries.<sup>31</sup>

Serving on these teams, Chinese lawyers also begin to overcome the challenge of experience: the best way to build the legal capacity necessary to handle WTO cases is through direct experience, but this is hard to come by given the limited number of WTO cases in any given year.<sup>32</sup> What is apparent in the article, above all, is that China is paying a great deal of attention to developing this capacity. With a new WTO law center in Shanghai and an increasing number of Chinese firms with WTO practices, the evidence presented in the article lends further support to the idea that China intends to

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<sup>28</sup> Davis and Bermeo 2008, 27.

<sup>29</sup> Wang, April 27, 2009.

<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.*

<sup>32</sup> *Ibid.*

become a more active user of the WTO dispute settlement system in the future. In fact, many of these Chinese trade law specialists are now using their knowledge of the system to drum up new business — “trade lawyers and scholars are traveling around the country, advising state-owned and private enterprises and local government officials about the impact of WTO decisions and cases. Many are encouraging Chinese enterprises to assert their rights more aggressively through trade disputes, as well as helping companies and governments adhere to global trade rules.”<sup>33</sup> Thus, while China may still have work to do in building its ability to handle its WTO cases independently, their active efforts to do so, coupled with their use of domestic lawyers to educate industry on its rights and responsibilities under the international trade regime, suggest that China is preparing to take a more active stance in trade enforcement.

The final factor compounding the likelihood of increased use of the dispute settlement system is the size of China’s market. As Davis and Bermeo point out, “A larger market generates more economic interest in potential trade disputes, provides greater resources to cover the cost of initiating a case, and increases the capacity to enforce compliance with rulings through retaliation.”<sup>34</sup> China has a vast pool of potential domestic economic interests that may at some point wish to report market access barriers and other trade violations. These industry concerns are likely to lead to increased numbers of formal cases, especially once they learn more about the WTO system through such mechanisms as the recent campaigns by trade scholars mentioned above. China’s industries will continue to advocate for greater use of the dispute settlement process for the foreseeable future, as the economy continues to grow and businesses become more internationally sophisticated. In addition, the size of China’s market gives it an ability to retaliate against its trading partners that is quite significant. Due to the size of its market, if China is authorized to retaliate by winning in the WTO, this is likely to carry considerable economic losses for the losing party.

The importance of the market-size factor is why small economies often rightly protest that they are at a serious disadvantage in the WTO settlement system — the size of their markets precludes them from having the power to impose any meaningful retaliation against countries that violate the rules, particularly when the violator is a major producer. Hence, those with larger markets, like China (and most of the other frequent users of the system, such as the U.S., EU, and increasingly, Brazil), tend to see more value in obtaining favorable WTO decisions. For these reasons, China’s large market size is another key factor that increases its likelihood of becoming an active and effective WTO plaintiff.

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<sup>33</sup> Ibid.

<sup>34</sup> Davis and Bermeo 2008, 19.

### *Dispute Settlement Case Selection: Whose Interests Matter?*

For any country using the WTO dispute settlement system, a key question is how to determine which cases to pursue. A country's approach to this issue is a major component of its trade policymaking. In a large, open economy such as the U.S., the selection and resolution of trade cases consume the careers of hundreds of bureaucrats and private-sector lawyers. These trade experts field numerous complaints annually from domestic industries who are facing access barriers in foreign markets or who are urging action against foreign producers who seem to be engaging in unfair trade practices.<sup>35</sup> Given the private sector's limited voice in and experience with trade policymaking in China, however, one can only expect that there is a somewhat different process for choosing cases under the Chinese system. From the recent filings, China's case selection seems to be primarily driven by consultations between the government and the state-owned sector. The state-owned sector is likely to retain a major role in bringing cases forward, not only due to their privileged position in directing policy, but also due to the nature of the industries in which state-owned firms tend to be concentrated. As discussed below, research on other WTO member countries shows that low-velocity industries are much more likely to initiate cases than are high-velocity industries. However, as the private sector's role in the economy grows, it may play an increasingly important role in case selection, perhaps eventually persuading the government to take up cases important to private firms.

Even a cursory glance at the three cases China has initiated in the past two years reveals the key priority in its selection of cases: challenging U.S. antidumping and countervailing duty measures against China. In its first two filings, China challenged the U.S.'s application of these duties against Chinese paper, steel pipes, tires, and woven sacks. As Christina Davis and Yuki Shirato find, many governments tend to steer case selection toward challenging antidumping measures and other trade remedies pursued by other members, both because these measures can be particularly damaging and because these cases stand a strong chance of success. In their view,

Governments may view some trade barriers as more problematic than others and give them priority. In particular, WTO rules for im-

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<sup>35</sup> While the exact number of complaints annually in the U.S. is impossible to determine, it should be noted that U.S. industries have the option not only of bringing a formal legal complaint, but also of contacting the U.S. Department of Commerce at any time to "report a trade barrier." See the online form at [http://tcc.export.gov/Report\\_a\\_Barrier/index.asp](http://tcc.export.gov/Report_a_Barrier/index.asp). In the author's own experience at both the Department of Commerce and the U.S. International Trade Commission, many U.S. companies (including smaller companies) follow trade policy quite closely and are likely to contact the government to seek action on their behalf when trade policy affects their business. A glance at the public comments filed by a wide range of U.S. companies during the annual review of the Generalized System of Preferences (<http://www.ustr.gov/trade-topics/trade-development/preference-programs/generalized-system-preferences-gsp/prior-reviews-2>) is but one example that confirms this overall impression.

port relief measures (antidumping, countervailing, and safeguard duties applied for temporary protection) have been highly contested. Governments have shown a strong tendency to initiate WTO disputes related to these measures and panels have consistently found in favor of their challenges.<sup>36</sup>

As China is the number one target of U.S. antidumping measures, it is no surprise that the Chinese government saw an opportunity to challenge these measures and possibly succeed, especially given that U.S. procedures in these cases have been struck down by the WTO in the past (for example, in the ongoing battle over “zeroing” and in the Byrd Amendment case<sup>37</sup>).

Once China had sufficient experience with the dispute settlement system to bring a case, there was little to lose by going after U.S. antidumping and countervailing duty procedures – “studies find that countries that use the WTO to challenge antidumping duties are less likely to be targeted with antidumping duties by other members.”<sup>38</sup> That is, even if China does not win this particular case, initiating it may still have a positive impact if other members curtail antidumping duties against China because they realize that China is now willing and able to challenge them.

Adding to this priority for the Chinese government is the fact that the U.S. maintains China’s “non-market economy” (NME) status for the purposes of these investigations. This designation has two consequences for Chinese producers: first, because home-market pricing information is deemed unreliable in non-market countries, antidumping cases against an NME country always use prices in a third country market to calculate the dumping margin. In the view of many observers, this biases the investigation because investigators may strategically choose the third market with the purpose of making it easier to find dumping. Second, U.S. practice “requires NME companies to demonstrate that their export activities are not subject to government control in order to be considered eligible for individually determined duty rates, rather than considering all companies eligible for such rates, as it does in market economy cases. NME companies that do not meet these criteria, or do not participate in ... investigations receive ‘country-wide’ rates.”<sup>39</sup> In its second filing, the case for which a panel was recently established, China challenges these procedures. The complaint alleges that the U.S.’s use of NME rules and certain other procedures results in unfair methods for determining the level of subsidization of Chinese firms, including

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<sup>36</sup> Christina L. Davis and Yuki Shirato, “Firms, Governments, and WTO Adjudication: Japan’s Selection of WTO Disputes,” *World Politics* 59 (January 2007), 283.

<sup>37</sup> World Trade Organization, Dispute Settlement, Byrd Amendment case DS217 and “zeroing” case DS350, [http://www.wto.org/english/tratop\\_e/dispu\\_e/find\\_dispu\\_documents\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/find_dispu_documents_e.htm).

<sup>38</sup> Davis and Shirato 2007, 280.

<sup>39</sup> U.S. Government Accountability Office, “Eliminating Non-Market Economy Methodology Would Lower Antidumping Duties for Some Chinese Companies,” Report to Congressional Committees, January 2006, p. 3, <http://www.gao.gov/new.items/d06231.pdf>.

selective use of the data to support findings of dumping, and that the procedure misclassifies SOEs and Chinese banks as "public bodies."<sup>40</sup>

While it is beyond the scope of this paper to examine the legal substance of these claims, the selection of this case by the Chinese government reveals several things about its strategy in pursuing WTO cases. First, the length and scope of the complaint reveals China's frustration with numerous aspects of U.S. antidumping and countervailing duty procedures. This suggests that China is likely to continue to challenge these procedures until it obtains some favorable resolution in this area — in other words, this is not an issue that China seems likely to drop if things drag on too long, or if the panel rules against them at first, or if the U.S. fails to comply with a ruling in China's favor. Second, the complaint repeatedly takes issue with the U.S.'s handling of Chinese SOEs, suggesting that the SOEs were influential in shaping the government's understanding of how the technical aspects of U.S. procedures in these cases damage their business.

As China becomes more active in bringing cases before the WTO dispute settlement body, SOEs are likely to retain their role as the primary industry voice behind China's case selection. This is not only because of the role they already have in shaping policy, but also because of the nature of the kinds of businesses that tend to be state-owned. For one thing, state-owned industries tend to be large, and "larger industries have more capacity to bear the costs of WTO disputes and to persuade the government to support their interests."<sup>41</sup> Of course, this is even less of a factor for the SOEs because they already know that the government will bear many of the costs of keeping them happy and that the government will largely support their interests. Still, SOEs have pushed even harder for trade policy that supports their interests since the onset of the global recession. As Wang underscores, "Facing plunging exports, powerful state-owned companies are putting strong pressure on Beijing to advance their interests or voice their trade complaints. It is no coincidence that the first WTO suit launched by China this year to reach a WTO expert panel protects the country's giant steelmakers, which have been squeezed by the global economic crisis."<sup>42</sup>

There is more to the SOEs' involvement in trade cases than just their size and political clout, however. Davis and Shirato conduct an interesting analysis of WTO case selection, using Japan as a model. They find that low-velocity industries are much more likely than high-velocity industries to pursue dispute resolution through a WTO filing. Low-velocity industries are those characterized by a single product (or a small number of products) which changes little, if at all, in response to consumer demands, and a rela-

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<sup>40</sup> World Trade Organization, "United States — Definitive Antidumping and Countervailing Duties on Certain Products from China: Request for Consultations by China," Case number WT/DS379/1, September 22, 2008.

<sup>41</sup> Davis and Shirato 2007, 281.

<sup>42</sup> Wang, April 20, 2009.

tively slow pace of sales. A prime example of a low-velocity industry, in fact, is the steel industry. High-velocity industries, by contrast, have diversified product lines that rapidly shift in order to meet changing customer demands (usually, this means that they are consumer-driven). The classic example of a high-velocity industry is consumer electronics. As Davis and Shirato point out, high-velocity industries do not have two to three years to wait for a WTO ruling to resolve a problem. After all, by then, they probably will not be selling the product in question anymore, having moved on to a newer, more advanced item. If that is the case, a favorable ruling will be of little impact. By contrast, "firms in a slower business environment are more willing to invest in a longer process. Given their narrow product lines and low rates of product turnover, these firms have a large stake in actions to defend the profit stream for one product line."<sup>43</sup>

Davis and Shirato's analysis demonstrates convincingly that it is not just the size or the political clout of an industry that makes it more likely to pursue WTO adjudication — the nature of their business matters as well. In China's case, this finding makes it more likely that SOEs will continue to drive the government's selection of cases to pursue. This is because SOEs tend to be concentrated in low-velocity sectors such as commodities and utilities, while private businesses are more likely to be engaged in high-velocity industries. Of course, there are exceptions to this rule, but on the whole, this general pattern holds. This factor makes it even more likely that SOEs will dominate industry's engagement with the government on trade policy issues, particularly on selecting cases to bring before the WTO. To the extent that Chinese private sector firms, especially those in high-velocity industries prefer to use other, faster means of resolving disputes, perhaps this dynamic is appropriate. However, the Chinese government will be better served in the long run if mechanisms are put in place now to ensure that the SOEs' voice on trade policy does not become so institutionalized that the private sector's perspective gets drowned out.

Adding more evidence to the suggestion that SOEs are likely to dominate China's use of WTO dispute resolution is the fact that SOEs are already the active players in the use of China's antidumping and safeguard measures. Antidumping (AD) and safeguard measures allow a country to respond domestically to imports deemed "unfair," typically because they harm domestic producers. WTO member countries are permitted, subject to certain limitations, to establish their own procedures for: 1) investigating specific imports sold below "fair" value and applying additional duty to raise the price (through antidumping cases) and 2) responding to sudden, unexpected import surges by applying quotas, even if those imports are priced normally (through the use of safeguard measures).<sup>44</sup> As Ka Zeng ex-

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<sup>43</sup> Davis and Shirato 2007, 283.

<sup>44</sup> World Trade Organization, "A Summary of the Final Act of the Uruguay Round," [http://www.wto.org/english/docs\\_e/legal\\_e/ursum\\_e.htm#1Agreement](http://www.wto.org/english/docs_e/legal_e/ursum_e.htm#1Agreement).

plains in his study of antidumping and safeguard policymaking in China, the use of these tools has been dominated by two largely state-owned industries: chemicals and steel. Through interviews with Chinese bureaucrats, Zeng presents evidence that these industries are taking full advantage of their longstanding connections to the top levels of the bureaucracy. Citing the chemical industry's success in convincing the government to take up antidumping cases on its behalf, he writes, "The chemical industry and its representative bureaus and agencies have effectively tapped on the privileged position the industry enjoyed during the era of centralized planning and [availed themselves] of existing institutional channels to influence China's AD process."<sup>45</sup>

The steel industry is another key interest group advocating the use of antidumping and safeguard measures. In conjunction with China's participation in the EU's steel case against the U.S., its steel producers also pushed for a corresponding safeguard measure to be implemented. Zeng describes how "the Chinese steel industry, spearheaded by the China Iron and Steel Association and leading Chinese steel companies such as Baoshan Iron and Steel and Anshan Iron and Steel made strong demands" for safeguard protection, citing the surge in imports into China due to the use of safeguards in other import markets around the world.<sup>46</sup> Baoshan and Anshan are both large SOEs managed by SASAC. Through these examples, Zeng illustrates the fact that China's antidumping and safeguard policies are dominated by uncompetitive industries that stand to lose from freer trade. Overall, "the sectoral pattern of China's AD activities reveals the growing ability of heavily-concentrated state-owned enterprises in import-competing sectors to influence the pattern of China's AD initiation in a way that would help to ward off foreign competitive pressure."<sup>47</sup> The fact that the state-owned industries already dominate the use of China's domestic antidumping and safeguard procedures lends further evidence to the hypothesis that they are likely to also become the major players pursuing remedies through the WTO dispute settlement system as China becomes a more active plaintiff.

Currently, industry's voice on trade policy reflects only the views of a few narrow sectors that, while increasingly profitable through consolidation, do not reflect the most innovative parts of the economy or the sectors most likely to drive China's growth in the future. However, there are a few signs that this may be changing. First, MOFCOM's acknowledgment of the need to solicit private industry views through the public comment process suggests that the regime recognizes the need to bring the private sector into its trade policy. Second, China's most recent case filing before the WTO was not driven by SOEs, but was instead on behalf of its poultry producers, perhaps re-

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<sup>45</sup> Ka Zeng, "State, Business Interests, and China's Use of Legal Trade Remedies," in *China's Foreign Trade Policy: The New Constituencies*, ed. Ka Zeng (London: Routledge, 2008), 134.

<sup>46</sup> *Ibid.*, 126.

<sup>47</sup> *Ibid.*, 128.

flecting Hu's priority of responding to the concerns of the agricultural sector. The third sign that things may be changing is the fact that the new trade law professionals in China are actively advising private businesses of their rights and options under the trade regime. However, these three small steps are not sufficient to overcome the SOEs' continuing dominance of the industry perspective on economic policy issues given the longstanding formal ties they've enjoyed to the bureaucracy. The government has put a great deal of effort into developing the private sector, and it has become the main driver of growth in the Chinese economy. In accordance with this position, it deserves to have its views reflected in trade policy in at least equal measure with those of the SOEs. Thus, the Chinese government would do well to institutionalize mechanisms for domestic private firms to participate in trade policy. It could do this through the use of standing advisory boards, as the U.S. Trade Representative does in the U.S., and better education for businesses about the opportunity to contact policymakers online to voice their opinions. Once the government obtains these views, however, it has to commit to actually using them in making trade policy. This will be a longer process, but one that will lead to a more balanced trade policy that reflects the views of firms throughout China's economy.

### *Conclusion*

This paper has examined the roles of the SOEs and the domestic private sector in the trade policymaking process in China and placed them in the context of economic policymaking more broadly. It considered the shifting roles of the state-owned and private sectors and how the recent reforms have expanded the economic role of the private sector while preserving the political position of the large SOEs. It also analyzed China's recent entry into the WTO dispute settlement system as a plaintiff and found that large SOEs in strategic industries tend to dominate this emerging area of Chinese trade policy. SOEs continue to hold a privileged position as industry's voice on WTO policy thanks to their longstanding connections to the industry bureaucracy. While the SOEs' importance in the economy has lessened, they retain access to most of the monetary and political resources they've enjoyed for decades, and in many ways, their ability to influence policy has actually grown due to the structure of the reforms Hu has pursued. Their influence is reflected most recently in their participation in China's emerging use of the WTO dispute settlement system and other trade remedies. As China becomes more active in pursuing its national interests in the WTO (and in the trade regime generally), it needs to develop a formal mechanism for the private sector to help drive trade policy, as is seen in advanced economies. Doing so will help ensure that China's trade policymaking apparatus is better positioned for the future by including input from those most likely to drive China's economic growth.