



The World Trade Organization and Rule of Law in China: A First-year Assessment

by John N. Paden

Former U.S. President George H. W. Bush, in introducing Chinese President Jiang Zemin to an audience in Houston, in October 2002, characterized the U.S.-China relationship as the most important bilateral relationship in the world. He said that the future would be difficult and complex—especially related to trade and the broader issues stemming from the accession of China to the World Trade Organization (WTO) on December 11, 2001, after 15 years of negotiations with the U.S. and other WTO members.¹ Clearly, one of the context issues was how the “rule of law” could be encouraged in China to facilitate economic and commercial interactions with the international community.²

To assess these developments, the United States Trade Representative (USTR) was required to provide Congress with an annual report on Chinese compliance with the WTO agreements. This 50-page report was published in December 2002.³ Also in 2002, historic developments influenced the transition to WTO compliance and movement toward rule of law in China. They included the transition to a new generation of Chinese leaders, in November 2002;⁴ and the U.S. Trade Act of 2002, effective December 2, 2002,⁵ which reflected the increased U.S. concern with port and trade security. (Hong Kong and Shanghai are the largest ports that ship containers to the U.S.)

General Compliance of China with WTO agreements

In the past 20 years, China joined the global economy.⁶ China’s accession to the WTO hastened the country’s integration into the international community. The USTR report⁷ evaluated China’s compliance with import regulations (tariffs, customs and trade administration, non-tariff measures, tariff-rate quotas on industrial goods and other import regulations); export regulation; trading rights; internal policies affecting trade (non-discrimination, taxation, subsidies, price controls, standards and other internal policies); investment; agriculture; intellectual property rights (legal framework, enforcement of IPR laws and regulations); services (distribution, financial services, professional services, telecommunications, express delivery services and logistics); and legal framework (transparency, uniform application of laws and judicial review). The report noted that “other commitments are being phased in, including trading rights and distribution services that will benefit U.S. manufacturers, services suppliers and agricultural exporters and their workers.”⁸

The USTR reported that “China made significant progress in implementing its WTO commitments” Areas of concern included transparency (related to new

laws and regulations) and uncertainty and lack of uniformity in laws and policies.⁹ Other problem areas were agriculture, intellectual property rights and services.

The USTR noted that “as expected, the principal focus of China’s first year of WTO membership was on its framework of laws and regulations governing trade in goods and services, at both the central and local levels. China’s trade ministry, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), reported that the central government reviewed more than 2,500 trade-related laws and regulations for WTO consistency. By mid-2002, it had reportedly repealed 830 of these laws and regulations and amended 325 more. It had also drafted and adopted 118 new laws and regulations.

“Similar reviews were made at the local level, although the local governments were generally not as far along in their review process, in part because of the need to implement changes made by the central government. At the same time, some localities, particularly those in China’s eastern provinces, progressed in their review process. Beginning early in 2002, China also devoted considerable resources to the restructuring of the government ministries and agencies that oversee trade in goods and services.”¹⁰ China took “the necessary legal steps to allow for increased market access for foreign service

suppliers in a variety of sectors, including financial services, telecommunications, audio-visual services, tourism and travel-related services, constructions and engineering services, educational services and environmental services.”¹¹

China’s legal framework was essential to an evaluation of the country’s first year in the WTO. The USTR said, “In order to address major concerns raised by WTO members during its lengthy WTO accession negotiations, China committed to broad legal reforms in the areas of transparency, uniform application of laws and judicial review. Each of these reforms, if implemented, will strengthen the rule of law in China’s economy and help to address pre-WTO accession practices that made it difficult for U.S. and other foreign companies to do business in China.”¹²

According to the USTR, China did not provide for public comment before new laws were implemented, and it did not always translate new laws, “in large part because of the extraordinary number of laws and regulations issued during the last year.”¹³ The problem of uniform application of laws throughout China was partly an educational challenge. Concerning judicial review, “China agreed to establish tribunals for the review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rules on trade-related matters. These tribunals must be impartial and independent of the government authorities entrusted with the administrative enforcement in question, and their review procedures must include the right of appeal In August, 2002, the Supreme People’s Court issued *Rules on Certain Issues Related to Hearings of International Trade Administrative Cases*. These rules designated higher-level courts to hear cases involving administrative agency decisions relating to international trade in goods or services, or intellectual property rights The rules provided that foreign (or Chinese) enterprises and individuals may bring lawsuits in the designated courts raising challenges, under the *Administrative Litigation Law*, to decisions made by China’s administrative agencies relating to international trade matters. The rules also stated that when there is more than one reasonable interpretation of a law or regulation, the courts should choose an interpretation that is consistent

with the provisions of international agreements to which China has committed—such as the WTO rules. Because the rules only took effect on Oct. 1, 2002, foreign companies have little experience with their implementation.”¹⁴

General Movement toward the Rule of Law in China

There is a difference between the “rule of law”—in which laws are applied on an even playing field—and the “rule by law,” in which laws by a ruler are simply intended to control a population. In Chinese dynastic culture, there was always a philosophical tension between the followers of Confucius, who felt that moral discipline came from within an individual, and the followers of “Legalism” (*Fajia*), who argued that humans were not morally perfectible, and had to be constrained by laws. Legalism could be harsh and oppressive.

During the turmoil of the Cultural Revolution (1966–76), Mao invoked the Legalists to attack Confucianism. Students were told that the Legalists were reform-minded progressives and they were exhorted to “evaluate the Legalists and repudiate the Confucianists.”

With the opening up of China (1978–present), and especially in the mid-1990s, there was an official revival of “spiritual civilization,” linked to a long tradition in Chinese culture of hierarchy, order, harmony and respect for government authorities. This included a revival of interest in Confucius (i.e., Master Kung).¹⁵

Yet, the morally perfectible relationships of a Confucian era are hardly a guide to the modern commercial world in China. (Given the recent scandals in the U.S. by senior corporate lawyers, there is a need in the global economy for ethical individuals who can distinguish between legal loopholes and a larger sense of personal and business ethics.) Hence, in China, the lack of a credible rule of law tradition—and the reliance on an elaborate system of “connections”, i.e., *guanxi*—posed an enormous challenge to the establishment. It called for a transition from the “rule of men” to a “blindfolded,” or even-handed, administration of justice. Although China committed (politically and legally) to con-

tinuing links with the international community, this diverse community embodied several different jurisprudential systems, ranging from Common Law, to Civil Law, to Dutch-Roman Law, to at least four major jurisprudential systems within the Islamic tradition.

The Chinese government’s commitment to developing congruence with international commercial law focused on the treaty law of the WTO and on its dispute settlement processes.¹⁶ This approach was based on a quasi-judicial process with parallels to binding arbitration. The Geneva-based system is still evolving. Meanwhile, in China, a contract delineated binding arbitration model became the most common way of resolving commercial disputes.

China made enormous efforts to educate a new generation of law students about domestic and international commercial matters. Many U.S. law schools established agreements with Chinese universities, and even the American Bar Association became involved.¹⁷ The Hong Kong Special Administrative Region announced that it intended to market its comparative advantage in “rule of law” and “English language facility,” by providing a neutral international site for commercial arbitration.

The transition to a rule of law framework in China was contingent on larger political processes and commitments and the recent transition to a younger generation of leaders. The 16th Party Congress that began on November 8, 2002, produced a new team of leaders and the National People’s Congress (NPC) will likely ratify the new government officials in March 2003.

The Impact of New Chinese Leadership on WTO Compliance

The leadership succession in November 2002, meant that—for perhaps the first time in Chinese history—there was an institutionalized or “constitutional” process. Nathan and Gilley observed: “Jiang leaving office when he said he would. The previously chosen successor coming into power. Acceptance of the rule that no one should accept a new term in the Politburo after reaching the age of 70.

Choosing every member of the new Politburo through consensus.”¹⁸ Whatever the backroom struggles, it was agreed that a president of China will serve no more than two five-year terms.

Who were these new, younger leaders, and how did they relate to the reforms associated with the current leaders? The most obvious characteristic of the new team—the fourth generation—was its average age, about 60. (Hu Jintao, the president-designate, was 60 in December 2002, compared to President Jiang Zemin, who was 76.) Perhaps the key driver for the WTO accession reforms was Premier Zhu Rongji, now in his 70s, who will retire in March 2003. The premier-designate, Wen Jiabao, was 60.

The identity of the key third generation of leaders, Jiang and Zhu, is associated with Shanghai, which has always been a “window to the West” and an entrepreneurial engine for the Chinese economy. The fourth generation is more diverse: Hu is originally from Anhui, although his family migrated to Taizhou, in Jiangsu—not far from Jiang’s family home in Yangzhou. His father did business mainly in Shanghai. Wen is from the northern port city of Tianjin.

The third and fourth generations tend to be engineers. Hu graduated from Qinghua University with a degree in hydropower engineering. Although the fourth generation has less experience abroad, they are expected to continue the policies of economic reforms and links to the global economy. (Hu’s first trip to the U.S. was in spring of 2002.)

Hu was selected for grooming by Deng Xiaoping, in the early-1990s. Many of the other fourth generation leaders were selected or promoted by Jiang Zemin—including his close associate from Shanghai, Zeng Qinghong (aged 63). Wen Jiabao, known for his management skills, was originally associated with Party General Secretary Zhao Ziyang, who sided with the students during the Tiananmen incident. Wen subsequently worked to privatize the failing state-owned enterprises (SOEs).

The fourth generation of leaders will continue the policies of the third generation. They are technically competent and have

more domestic professional experience, but less international exposure. There is a balance of conservative and liberal forces within the nine-member Standing Committee of the Politburo. Hu Jintao will have to balance these forces. Hu’s career and priorities focus on domestic issues, and the commitment to economic reform seems to be irreversible.

Framework reforms in the rule of law domain are unresolved. Regarding WTO compliance, there is little doubt that this will be a priority, although the phase-in will not be hurried. It will be difficult to conform Chinese commercial practices to international standards. The fourth generation of Chinese leaders will be more attentive to domestic pressures—especially in agriculture and the urban informal labor market—in order to keep the whole system stable.¹⁹ The involvement of the entrepreneurial classes in the political system, which was promoted by Jiang Zemin, will press for the rule of law—as private wealth and property demand protection. Yet, labor unrest stemming from social transformations and growing unemployment are still regarded as “security” issues, and are dealt with outside a rule of law framework.

China is already a champion of freer trade and foreign direct investment, rather than a proponent of developing countries.²⁰ There have not been any major disputes brought against China at the WTO during its first year of membership. Clearly, both the third and fourth generation of leaders in China value stability and continuity.

Implications of Recent Concerns for Global Trade Security

The “war on terrorism” has reached into international trade. (Hong Kong continues to maintain separate trade offices overseas, and separate trade policies from China.) The U.S. signed agreements with Hong Kong for pre-departure security inspections, but at the time of writing this article—January 2003—negotiations were still underway with China. What were the issues?

First, the war on terrorism brought the U.S. and China much closer together on more issues than were possible prior to 9/11.

The APEC meeting in Mexico in October 2002, focused on international security. The U.S. and China shared intelligence on Afghanistan, and the U.S. put one of the groups in Xinjiang (northwest China)—the East Turkistan Islamic Movement—on the official list of terrorist organizations. There was an easing of official U.S. criticism of Chinese human rights issues. As a permanent member of the U.N. Security Council, China played a key role on issues of international security—in the Middle East, North Korea and the war on terrorism.

Second, the legal and technical ways in which international trade may be affected by security concerns remain to be decided. There are legal jurisdiction and sovereignty issues in the pre-departure inspections. According to the *U.S. Federal Register*:²¹ “This document amends the *Customs Regulations* to require the advance and accurate presentation of certain manifest information prior to loading at the foreign port and to encourage the presentation of this information electronically This information is required in advance and is urgently needed in order to enable U.S. Customs to evaluate the risk of smuggling weapons of mass destruction through the use of oceangoing cargo containers before goods are loaded on vessels for importation into the United States, while at the same time, enabling Customs to facilitate the prompt release of legitimate cargo following its arrival in the United States. Failure to provide the required information in the time period prescribed may result in the delay of a permit to unlash and/or the assessment of civil monetary penalties or claims for liquidated damages.”

The *Federal Register* continues: “Approximately 90 percent of world cargo moves by container; 200 million cargo containers are transported between the world’s seaports each year, constituting the most critical component of global trade. Nearly half of all incoming trade to the United States (by value) arrives by ship, and most of that is in sea containers. Annually, nearly six million cargo containers are offloaded at U.S. seaports. There is, however, virtually no security for this critical global trading system. And the consequences of a terrorist incident using a container would be profound Al Qaeda and other terrorist organizations

pose an immediate and substantial threat. And the threat is not just to harm and kill American citizens, it is a threat to damage and destroy the U.S. and the world economy.”

By the fall of 2002, Canada, the Netherlands, Belgium, France, Germany, Singapore, Hong Kong and Japan had agreed to pre-departure inspections by U.S. Customs officials, under this “Container Security Initiative” (CSI). But the legal status of pre-screening in China is a new issue that will require closer cooperation among major trading partners. This issue will be decided at the highest political levels in China, rather than through strictly legalistic negotiations. But because the issue is in the domain of sovereignty, on which China has always been sensitive, the negotiations with a new team of Chinese political leaders will need to be done urgently and effectively.

Conclusions

China moved toward WTO compliance in its first year since accession. Laws and regulations were amended or enacted at the central level, although the impact on the provinces was uneven. Issues of transparency remained central, since many of the new laws were not widely-publicized, nor translated in a standardized manner. Also, implementation remained a challenge, especially in the domain of intellectual property rights.

The commitment of the Chinese government toward a framework of laws was evident for several years, but accelerated after WTO accession. Clearly, time will tell whether a more recognizable rule of law will emerge—despite the lack of a historical legacy.

Relationships and connections remain important in building business confidence and resolving disputes, but as transactions become more complex and as the private sector becomes more significant within the overall economy, the need for an even-handed legal system becomes acute. Because of the centrality of quasi-judicial panels in the WTO dispute settlement process, some parallel type of binding arbitration in China may become the norm in business disputes.

The succession of a “fourth generation” to leadership during the first year of China’s accession to WTO membership raises questions about continuity and commitment. From all indications, the new leadership—although less familiar with the international environment—is likely to continue the longer-term policy of linking China with the global economy. Most of these new leaders are aware that this will involve legal reforms, and strict adherence to international obligations.

Finally, during the past year, the global war on terrorism raised issues of security in international trade, which had not been urgent in the pre-9/11 era. Port security is perhaps the most salient issue from the U.S. perspective—as reflected in the Trade Act of 2002. The need for pre-departure screening by U.S. Customs prior to lading in foreign ports is also of concern. These issues may test both the new leaders in Beijing, and the commitment of trading partners to develop new forms of cooperation to pre-empt terrorist disasters that could cripple or undermine the global economy. China and Hong Kong are key players in this drama, and most of the U.S.

West Coast ports rely on an unimpeded flow of containers from these Chinese ports. Since these new forms of cooperation involve issues of jurisdiction and sovereignty, hopefully, the U.S.-China relationship will rise to this challenge.

China’s membership in the WTO has been overwhelmingly positive, although the effect of new laws is unknown. One of the central questions of the 21st century is whether the Chinese policy-guided compliance with WTO regulations and dispute settlement processes will have a lasting effect on Chinese deep-seated perspectives on the rule of law. ☺

Endnotes

1. The U.S.-China agreement on WTO accession was signed in November 1999, and is available in its annotated form from the U.S. Department of Commerce. China was approved at the WTO meeting in Doha, Qatar, in November 2001.
2. The author was in Beijing and Guangzhou in December 2001 and January 2002, and was able to discuss the impact on China of WTO accession with a number of academic and business colleagues. For more details, see Kent Hughes, Gang Lin and Jennifer L. Turner, *China and the WTO*.

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- Domestic Challenges and International Pressures*, Washington D.C., Woodrow Wilson International Center for Scholars, 2002.
3. See United States Trade Representative, *2002 Report to Congress on China's WTO Compliance*, December 11, 2002.
 4. For background, see Andrew Nathan and Bruce Gilley, *China's New Rulers: The Secret Files*, New York, *New York Review of Books*, 2002.
 5. See *Federal Register*, Vol 67, No. 211, Oct. 31, 2002, Department of the Treasury, Customs Service. (Note: U.S. Customs has subsequently been moved to the new Department of Homeland Security.) The author participated in the U.S. Customs Service Trade Symposium, 2002, Washington D.C. (Ronald Reagan Building and International Trade Center), Nov. 20–22, 2002, which addressed, in detail, these new trade security developments.
 6. See Nicolas R. Lardy, *Integrating China Into the Global Economy*, Washington DC, Brookings Institution Press, 2002. *Also, see* recent issues of *Far Eastern Economic Review*.
 7. USTR, *op.cit.*
 8. *Ibid.*, p.2.
 9. *Ibid.*, p.3–4.
 10. *Ibid.*, p. 3.
 11. *Ibid.*, p. 4.
 12. *Ibid.*, p. 48
 13. *Ibid.*, p. 48.
 14. *Ibid.*, p. 50.
 15. The author participated in a U.S.–China academic conference in Beijing in 1996, and after the conference, the American delegation was taken to Qufu, in Shandong Province, to visit the gravesite and temple of Confucius. Most of the other visitors were ordinary Chinese who had come to this state-approved “theme park,” to re-connect with a sense of Chinese cultural history.
 16. According to the WTO Web site on dispute settlement, “The WTO’s procedure for resolving trade quarrels under the Dispute Settlement Understanding is vital for enforcing the rules and, therefore, for ensuring that trade flows smoothly. A dispute arises when a member government believes another member government is violating an agreement or a commitment that it has made in the WTO. The authors of these agreements are the member governments themselves—the agreements are the outcome of negotiations among members. Ultimate responsibility for settling disputes also lies with member governments, through the Dispute Settlement Body.” (http://www.wto.org/english/tratop_e/dispu_e.htm)
The author was able to observe and discuss the WTO dispute settlement process with judges, ambassadors and administrators at the WTO headquarters in Geneva in July 2001, as part of a GMU graduate Oxford-Geneva Trade program led by Prof. Stuart Malawer.
For a skeptical, albeit positive view, see Susan Esserman and Robert Howse, “The WTO on Trial,” *Foreign Affairs*, January/February 2003, p. 130 ff. *Also, see* the article by Stuart Malawer in this magazine.
 17. In October, 2001, after the Asia Pacific Economic Cooperation (APEC) summit in Shanghai, the Chinese Embassy in Washington D.C., hosted a reception (that the author attended) for the U.S.–China Business Council, and the “China section” of the American Bar Association (ABA), to facilitate the engagement of a younger cohort of U.S. law students with China interests into careers that might relate to commercial law in China.
For discussion of Hong Kong’s views of the APEC meeting, and the “rule of law,” see “Chief Executive Backs Additional APEC Counter Terrorism Moves,” *Hong Kong Economic & Trade Office*, Washington D.C., Oct./Nov. 2002, Vol. 6, No. 10; or check the Web site: APEC Mexico 2002: www.apec2002.org.mx/.
 18. Nathan and Gilley, *op.cit.*, p. 230.
 19. For details on each of the fourth generation leaders, see Nathan and Gilley, *op.cit.*, *passim*. For an update on how Hu sees his role, see “China’s New Leader Works to Set Himself Apart: Hu Makes Poverty An Early Focus,” *New York Times*, January 12, 2003.
 20. See Owen Brown, “China Takes Seat at WTO on Side of Free Traders,” *Wall Street Journal*, Dec. 17, 2002: “As China takes its place at World Trade Organization talks to design a new global-trade framework, it is surprising some observers by siding with the U.S. and Europe rather than with less-developed nations . . . Leading up to the next WTO ministerial meeting in Cancun, Mexico, in September, China appears to be sticking to the belief that trade liberalization is important for economic development . . .”
 21. *U.S. Federal Register*, *op.cit.*, p. 66318-19-20.