

Rule of Law in China: Chinese Law and Business

The Impact of the World Trade Organization on the Chinese Legal System

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Executive Summary

- It is still early days to appreciate fully the effects of China's World Trade Organization (WTO) accession in 2001. These will only become apparent as China implements all its commitments, which will take some years after accession (in some areas implementation is scheduled for 2007). As China becomes more accustomed to WTO rules and regulations, it will also adopt a more thorough compliance with the spirit of the WTO agreements. China will develop into a more responsible member of the international community by learning the norms and requirements through participation in the WTO.
- In the days of isolated pre-Open Door Policy (1978-79), the country was not exposed to the rules and regulations of the international community. The consequent lack of understanding of the norms in internationally accepted behaviour is one explanation for the lengthy WTO accession negotiations. Early entry and exposure to such rules and regulations was seen as the best way for China to learn WTO law.
- Given the scale of the changes necessary to bring the Chinese socio-legal system into line with WTO regulations, and the size of the Chinese market, the repercussions of China's full compliance with the WTO will be felt worldwide. The onus now lies with China to comply more fully with its WTO commitments.
- International Organizations (United Nations, WTO and specialist agencies) and governments (particularly active are the major trading countries known as the 'quad' in the WTO: US, EU, Canada and Japan) as well as the Chinese themselves (the central and local governments) have introduced WTO classes to educate the central and local officials, as well as personnel involved, on the requirements of membership of the trade regime. The WTO has had direct and indirect effects on China's socio-legal system, and as the rule of law and transparency are established in the trade sector, other sectors will be affected.
- While there is still a long way to go, the track record of China's implementation has been generally favourable. This is most evident in the absence of disputes with China before the Dispute Settlement Mechanism, the judicial arm of the WTO. However, since many of the WTO commitments are broad and vague in anticipation of further definitions, member states' expectations tend to exceed these commitments, and whilst China has attained a good basic level of compliance, it will face increasing pressure from the international community to go further still.

The Impact of the World Trade Organization on the Chinese Legal System

Since China's accession to the World Trade Organization (WTO) in 2001, speculation on the implications for the legal, social and economic development of the country is rife. Bookshops in Beijing now feature 'WTO sections' displaying popular and specialist books on the topic. Of all the current 149 member states, not one member has a population so well versed in the complex international trade regime. The WTO is presented as a panacea for China's smooth entry into the global economy. But the international trade regime is often used by the government to justify and legitimize potentially unpopular domestic reforms to the political and legal systems, in order to assuage any social unrest.

Since China only entered into the WTO in 2001, it is still early days to gauge the full impact of the WTO in China. The members of the WTO formally accepted China as the 143rd member in the trade regime on 11 December 2001, but the process of accession did not take place overnight. WTO-related reforms were initiated as early as 1986, when the Chinese government began its bid to join the WTO (then General Agreement on Tariffs and Trade [GATT]). To evaluate the impact of the WTO on the Chinese legal system, one needs to appreciate the actions of the Chinese government in preparation for accession, and the reforms China is currently undergoing to implement and comply with its commitments under the WTO.

Clearly, one first needs to understand the WTO legal system and how it applies to the member states before examining the case of China. Like all international legal commitments, the WTO must be implemented domestically to have any effect. Here it is examined through a survey of China's efforts at implementation. This involves an analysis of the legal and economic reforms China has undergone in the lead up to, as well as since, accession to the WTO.

The WTO

The WTO is an international trade regime based on market economy principles with the aim of trade liberalization. The WTO superseded the GATT on 1 January 1995 at the completion of the Uruguay Round negotiations (1986–94). The trade agreements on which GATT was founded were incorporated into the WTO. The WTO has continuing negotiations on new topics, the current round being known as the Doha Round.

The WTO consists of 151 countries as members (as of 27 July 2007) and its own secretariat in Geneva, Switzerland. It is headed by Director General Pascal Lamy, with 635 working staff, and has an annual budget of 175 million Swiss francs (2006).

The main function of the WTO are:

- To administer WTO trade agreements;
- To provide a forum for trade negotiations;
- To handle trade disputes;
- To monitor national trade policies;
- To provide technical assistance and training for developing countries; and
- to cooperate with other international organizations.

The WTO governs transactions in trade for both goods and services. The legal framework of the WTO comprises:

- GATT 1994;
- General Agreement on Trade in Services (hereinafter the GATS);
- Agreement on Trade-related Aspects of Intellectual Property Rights;
- Agreement on Trade-related Aspects of Investment Measures;
- Agreement on Agriculture, Textiles and Clothing, Subsidies and countervailing Measures; and
- Agreement on Technical Barrier to Trade WTO Agreement

These agreements, built upon GATT 1947, differ in that members cannot choose agreements, but are bound by all agreements in the WTO. They can, however, have interpretations for how these agreements are implemented for that particular country.

China's socio-legal tradition

The principles underlying the WTO are in stark contrast to those underpinning the socio-legal system in China. The main difficulties for China in implementing commitments under WTO lie in two areas – the legal and economic.

One of the significant obstacles to implementation is that China was previously a socialist-planned economy, a position at odds with the free market ethos of the WTO. Although China has adopted a 'socialist market economy' founded upon Marxist-Leninist-Maoist-Dengist ideology, there are still legacies from its socialist past. Deng Xiaoping (1904–1997), the ruler of China after Mao, chose an eclectic combination of reforms pursuant to its Open-Door Policy in order to ease China out of its isolation. The Open-Door Policy and Deng's economic reforms allowed China to gradually open up to world trade and enter into the global economy.

In the legal realm, the rule of law has traditionally been weak, Chinese legal culture being based on Confucianism, Daoism, and Legalism. These traditions are more accommodating to the notion of 'rule of man' (*renzhi*) as opposed to 'rule of law' (*fazhi*). In China, law was seen as an instrument of governance for the rulers, and not something that protects the weak individual from the state. This is fundamentally different from the Western notion of rule of law, in which law is independent from the state and the exercise of authority.

Further to the tradition of rule of man, as one Chinese expert, Lieberthal, writes, 'China had literally no legal system and no law in a Western sense as of 1977'.¹

The People's Republic of China (PRC) was founded in 1949, and once the Communist Revolution was proclaimed, the Guomindang (Republican) laws were declared invalid. China under Mao witnessed a period of lawlessness, from the disastrous efforts at development of the Great Leap Forward (1958–62), which left the country in economic and social chaos, to the Cultural Revolution (1966–76) which purged the legal institutions and legal expertise in the country. From 1977, China was governed by decrees, bureaucratic regulations and the personal orders of officials. The codes were deliberately ambiguous and vague in order to accord these officials more discretion; indeed, many of the codes were not publicly available at all.

China and WTO Accession

The accession of China to the WTO has often been heralded as a turning point in its legal reform. Such claims are exaggerated and can be misleading. The WTO agreements require domestic implementation and changes to China's domestic legal system, which is particularly difficult, given the nature of this system the intransigence of aspects of socialist ideology. In common with any other international agreement, it is essentially up to the country itself to implement the agreement, though the WTO has more 'teeth' when it comes to enforcement.

In order to join the WTO, a prospective member requires a two-thirds majority vote from the existing WTO members. The accession negotiations are conducted at two levels, which run parallel with each other. Firstly, there are multilateral negotiations within the WTO framework, held between the acceding member and the members of the 'Working Party to China's Accession'. The multilateral negotiations survey the acceding member's trade regimes while gauging the reforms needed for it to comply with WTO rules and regulations. Eventually the Working Party aims to produce an 'accession protocol', laying down the conditions for the acceding member's entry.

1. Lieberthal, K. (1995) *Governing China: From Revolution Through Reform*. New York: W.W. Horton & Co., p. 150.

Secondly, there are bilateral negotiations, intended to reach agreement on 'market access' for each WTO member in the newly acceding country. These are held between the acceding country and any WTO member asking for market access. The bilateral negotiations cover topics such as tariff reduction, elimination of non-tariff barriers, and the services schedule commitments. Each WTO member has the right to enter into negotiations, and the results of each set of bilateral agreements are extended to all WTO members through the 'most-favoured nation treatment', a general requirement making it necessary for rights given to any one WTO member to be equally accorded to all other members.

Since a new member country must have a two-thirds majority vote, the most important bilateral negotiations are conducted between the major trading countries. Within the WTO, these are known as the 'quad states', and comprise the US, EU, Canada and Japan. As long as the acceding state has reached bilateral negotiations with the quad states, it is anticipated that a two-thirds majority will be reached in the vote of the WTO General Council. China's bilateral negotiations were concluded in 1999, with the consequence that China's trade regime was brought further into line with the WTO.

China after WTO accession

China's commitments under the WTO comprise the following:

- China's Protocol to Accession and its nine Annexes;
- Schedule of Commitments (China's Goods and Services Schedules); and
- Working Party Report (WPR).

The incorporated provisions of the WPR acquire the same binding force as those in the main text of the protocol. This collection of documents which form the WTO accession package comprise the WTO commitments. China's accession package is the lengthiest legal document in WTO legal history. Most other protocols of newly acceding countries are only two pages long, while China has an eleven-page long main text. This disparity is indicative of the

unique legal, economic, political and ideological conflicts between the Chinese trade regime and the principles embodied in the WTO, and reflects the level of reservations held by member states over China's ability to comply with WTO commitments.

The commitments imposed on China are unique in many respects. Firstly, it is the only WTO country with respect to which the 'phase-in' approach was adopted. Because China is a large country with vast economic disparities between the more affluent coastline regions in the east and the impoverished inland west, WTO commitments are being implemented first in the more economically competitive areas, and subsequently in the less stable areas, allowing time for their development. While some areas began implementation in 2001, some will not begin until 2007.

Secondly, the number of WTO commitments imposed on China is unprecedented. These commitments go beyond WTO requirements (WTO-plus commitments) and are designed to deal with the particular problems raised by the membership of non-market economies.

WTO-plus agreements for China

- Rule of law
 - Transparency
 - Judicial review
 - Uniform administration
- Market economy
- Investment liberalization
 - National treatment
 - Foreign investment
- Transitional review

The WTO's commitments most pertinent to a discussion of its impact on the Chinese legal system are those relating to the rule of law. In general terms, there are two principal approaches to the rule of law: firstly, a more formal or functional approach, and secondly, a more substantive definition based on constitutional values. The first of these is more relevant to this analysis, since the WTO does not envision the rule of law with constitutional values, it being an international regime for the liberalization of trade rather than once concerned with human rights.

According to the formal approach, a society based on the rule of law should have prospective (not retrospective) and relatively stable laws, open and clear rules that are impervious to corruption, access to courts, and an independent judiciary.

The WTO commitments relating to the rule of law are:

- 1) Publication and Administration of Trade Regulations (Article X of the GATT 1947)
- 2) GATT Article XXIV (China has also agreed to control regional local governments to be in compliance with WTO)
- 3) GATT Article X and XXIV:
 - a) Uniform Administration ('uniform, impartial and reasonable manner')
 - b) Transparency ('all sources must be published and readily available')
 - c) Judicial Review (central government must address areas where WTO is violated and provide a meaningful remedy)

In the case of China this means:

- transparency in trade-related areas;
- legislation to be public and easily obtainable (limited to trade-related areas);
- WTO inquiry points to be established; and
- Transitional Review Mechanism (TRM) once a year (China was allowed to accede without complying with WTO commitments initially, so there is an annual survey of compliance for the first couple of years.)

China's implementation of the WTO commitments

As far as the implementation of the WTO commitments is concerned, China has been active in legislation. The ministry in charge of new legislation, the Legal Affairs Office of the State Council, has recruited new lawyers to keep pace with the work. China has passed 2000 new laws, abolished 800, and announced 300 laws to be in compliance with WTO. WTO inquiry points have been established in major cities. Moreover, the previously confusing publication of laws has been unified into a single publication: the MOFCOM Documentary Bulletin of China's Foreign-

Related Economy. This was realized by the State Council's 'Notice on Further Doing Well the Work Relevant to Implementing the Transparency Provisions of China's WTO Accession Protocol' which was passed on 30 March 2006. The respective Ministry website has also begun to publish its laws and regulations, and it is becoming significantly easier to obtain information on laws and regulations governing trade after WTO accession.

In the Fifth Session of the Ninth National People's Congress, Premier Zhu Rongji stated that China must work at improving the system of foreign-related economic laws and statutes so that they are rendered compatible with domestic conditions and WTO rules; it should also publicize information about the WTO, and provide training to public servants.

This was followed by the 2001 Plan for National Economic and Social Development and the Draft 2002 Plan for National Economic and Social Development, in which consideration of 'international practice' was eluded, and it was decided that central and local laws and regulations would be reformed in order to be in line with the WTO.

These developments signal the Chinese government's dedication to implementing the WTO commitments. However, while there have been significant developments in the establishment of 'commercial rule of law', the laws are still vague and ambiguous in character and the implementation and enforcement of the WTO commitments remain problematic.

Evaluation of WTO impact in China

In the lead up to, and the aftermath of, WTO accession, China has taken steps to improve the transparency of its legal system. However, there are still some difficulties in obtaining access to the laws for the more obscure and controversial sectors (such as telecommunications) that are considered to impinge upon national security interests. Furthermore, the quality of law is variable, often too open to interpretation, and there remains more to be done to improve transparency.

Enacting legislation and copying existing laws are relatively easy for China to achieve. The more penetrating reforms, such as the rule of law and transparency, take longer. The Chinese traditions that run counter to the establishment of the rule of law, such as *renzhi* (rule by man) and *guanxi* (social connections) are still deeply rooted, and will take years to reform.

One positive effect of the WTO is the proliferation of WTO programmes and classes held in China by international organizations, foreign and Chinese governments. These are being developed in the name of capacity-building to implement better the rule of law. The classes teach professionals how to draft clear, adequate laws (particularly important in the more technically demanding areas of law such as banking and financial services), and provide guidance for implementation and enforcement. By developing avenues for transfer of expertise, information on legal and economic reform is infiltrating the populace. The WTO is hereby empowering the Chinese population and providing further impetus for establishing the rule of law in China.

Conclusion

The WTO is a complex legal framework. Since its founding principles are based on transparency and the rule of law, the anticipated outcome of an established 'commercial rule of law' in China will have significant direct and indirect effects on its socio-legal system. Once there is a 'commercial rule of law', there will be spill-over effects for China's legal system in general. The commercial rule of law is still in the process of being established. The process has taken many

years, and will continue for some time to come. China learned the technical legal requirements of the WTO agreements through the accession negotiations, and is still in the process of learning through participation in the WTO. Domestically, the WTO classes that have proliferated since accession have been successful in bringing better compliance and raising awareness of a society based on the rule of law. While commercial rule of law and WTO compliance are far from being perfect, and though these effects are difficult to gauge in the early days, it is apparent that the WTO is responsible for providing some impetus for the establishment of a 'commercial rule of law'.

Policy implications

- The WTO is providing an impetus for legal and economic reform, as well as developing knowledge and expertise in China.
- The environment for foreign trade and investment has significantly improved, with legislation now far less opaque. While this is still a long way from Western democratic standards, it is a step forward.
- Since WTO commitments are gradually phased in, it would be prudent to continue to observe developments in the early years of WTO accession, before making any business decisions regarding entry into China.
- The WTO is not an institution for business or individuals. Although it is a regime that pertains to international trade, it is primarily the member states (i.e., governments) that have the right to representation. While there is some debate around the possibility of reform of the WTO, for the time being, businesses do not have rights there unless their respective countries take the matter to the WTO.



The Foundation

The mission of the Foundation is to study, reflect on and promote an understanding of the role law plays in society. This is achieved by identifying and analysing issues of contemporary interest and importance. In doing so, it draws on the work of scholars and researchers, and aims to make its work easily accessible to practitioners and professionals, whether in government, business or the law.

Rule of Law in China: Chinese Law and Business

The main objective of the programme is to study the ways in which Chinese law and legal institutions encounter and interact with the social environment, including economic and political factors, at local, regional, national, and international levels.

The Foundation's perspective in pursuing this objective is that of entrepreneurs considering investment in China, the lawyers advising them, executives of an international institution or non-governmental authority, or senior public officials of another country. The combination of this objective and our particular perspective constitutes a unique approach to the study of the role of law and its relationship to other aspects of society in China.

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