

World Trade Law and the Rise of China

Struggles over Subsidy Rules

*Nina Teresa Kiderlin**

1. Introduction

It seems intuitive to think that if the distribution of political power shifts, law eventually follows, as new powers want political changes to ultimately be reflected in the law. However, established actors typically want the law to remain stable and therefore resist legal change. When and how are shifts in global power structure then brought into international law?

One of the greater shifts in geopolitics in recent history has been the rise of China, and it has put the international order under significant strain.¹ The question this chapter will explore is to what extent this shift has resulted in change in international law, and especially in world trade law. The WTO has been a key arena of conflict between the US and China in recent years, well before the Trump years.² What happens when a new, potentially powerful, (state) actor enters the scene of an already existing and established legal regime such as international trade law? How did China, whose international trade law profession was underdeveloped (or virtually non-existent) prior to its accession to the WTO, manage to use the WTO dispute settlement system to push for change.

International trade law is a particularly suitable field for an inquiry into the effects of geopolitical shifts on international law, because—especially in the form it found in the WTO Agreements—it is widely seen as a reflection of a particular economic vision associated with the dominant powers of the 1990s. The WTO Agreements tend towards neoliberal market liberalization, mainly due to pressure from the US and, to an extent, the European Union during the Uruguay Round. Developing countries challenged this dominance in the Doha Round and

* PhD Researcher in Anthropology and Sociology, Graduate Institute of International and Development Studies, Geneva, Switzerland.

¹ Gregory Shaffer, *Emerging Powers and the World Trading System* (CUP 2021) 11.

² Aseema Sinha 'Understanding the "Crisis of the Institution" in the Liberal Trade Order at the WTO' (2021) 97 *International Affairs* 1521; John Mearsheimer 'The Inevitable Rivalry' (2021) 100 *Foreign Affairs* 48; Marco Bronckers 'Trade Conflicts: Whither the WTO' [2020] *Legal Issues of Economic Integration* 221.

prevented the further extension of this approach through treaty-making, but they did not achieve a rebalancing on this route either as negotiations largely ended in gridlock. Meanwhile, societal contestation—particularly in the area of environmental regulation—has created legitimacy issues for the WTO, adding to the pressures the organization finds itself under, but has not led to formal changes in existing agreements either.³

Yet, change in trade law does not necessarily have to come through state-led processes. In fact, this field of international law is particular not only because of its ideational orientation, but also because of the centrality of the ‘judicial’ path of change, embodied in the WTO dispute settlement system and the jurisprudence of the panels and the Appellate Body (AB).⁴ In light of the clogged nature of state or multilateral paths, the focus for change agents in this field soon shifted towards the judicial path, and it is here that we have seen most movement, especially under the influence of the AB from the mid-1990s until 2019, when the AB itself became blocked as the US prevented the appointment of new members. Change processes in world trade law over the past decades have then also largely come about through shifts in the interpretation by WTO dispute settlers.⁵

China, too, has been among the change agents using the judicial path at the WTO, and it has been quite successful in using it for its own interests and to advance its global economic and political position.⁶ This was aided by the fact that, as we will see in more detail later in the chapter, China invested significant resources into building its own trade law capacity to further global influence.⁷ This contributed to the country being perceived as a credible rival to Europe and the US in shaping, changing, and developing international trade law. The change in turn has resulted in political shifts, impacting the political (im-)balance between China and the Western world.

This chapter traces China’s rise and its consequences at the WTO, especially with a view to understanding how the country utilizes home-grown capacity for international trade law, and how these developments can embody a global political shift in power. In the WTO context the AB could achieve (lasting) impactful change and might have therefore been an obvious choice of forum to push for change. In other areas of international law, where one does not have a similar focal point or decisive

³ Robert Howse, ‘The World Trade Organization 20 Years On: Global Governance by Judiciary’ (2016) 27 *European Journal of International Law* 9.

⁴ Richard Steinberg, ‘Judicial Lawmaking at the WTO: Discursive, Constitutional, and Political Constraints’ (2004) 98 *American Journal of International Law* 247; Gregory Shaffer, Manfred Elsig, and Sergio Puig, ‘The Extensive (but Fragile) Authority of the WTO Appellate Body’ (2016) 79 *Law & Contemporary Problems* 237.

⁵ Howse (n 3); Gregory Messenger, *The Development of World Trade Organization Law: Examining Change in International Law* (OUP 2016).

⁶ Shaffer (n 1).

⁷ Gregory Shaffer and Henry Gao, ‘China’s Rise: How it Took on the US at the WTO’ (2018) 1 *University of Illinois Law Review* 115; Shaffer (n 1) 18.

body, it might be less likely that change can be pursued (successfully) through judicial bodies.

Pressures of geopolitics are especially encapsulated in the case of subsidy regulation at the WTO—the focus of our inquiry here. Subsidy regulation, a seemingly niche topic, provides a magnifying glass through which we can observe how disagreements between economic and political systems play out in a specific issue-area. The WTO's subsidy rules were not ideally suited to dealing with economies with a blurred boundary between public and private actors, and China soon pushed back against the wide application of these rules on its state-owned entities. This led to a (limited) interpretive shift among WTO dispute settlement bodies, but also to contestation on the part of, in particular, the US, which saw this issue as increasingly significant in the context of the developing trade conflict with China in the early 2010s. As we will see below, the issue seemed relatively settled for several years before the AB took a step back towards the US position later in the decade, when the crisis over AB appointments was already well advanced. Subsidy disciplines have become an element in discussions about general WTO reform,⁸ and one could even go as far as to argue that the future of the WTO hinges on them as they represent the ultimate test for whether the institution can accommodate a strong non-market based economy—and whether it can strike a balance between the demands of different types of economies within it.⁹

2. China's Challenge to International (Trade) Law

The impact of China's rise on the international order has been much debated in recent years, and observers diverge on whether China will grow within existing rules and institutions or whether, and to what extent, it is bound to challenge them.¹⁰ For international law, too, expectations differ, though many commentators highlight the renewed emphasis on state sovereignty and challenges to human rights-related norms as well as pushes towards a broader accommodation of authoritarian forms of governance.¹¹ As for WTO law, however, expectations have been largely about a relative degree of continuity—avoiding major ruptures and instead working within the system to generate a greater alignment with its interests—yet potentially

⁸ Shaffer (n 1).

⁹ Dukgeun Ahn, 'Why Reform is Needed: WTO "Public Body" Jurisprudence' (2021) 12 *Global Policy* 61.

¹⁰ John Ikenberry (2008) 'The Rise of China and the Future of the West: Can the Liberal System Survive?' (2008) 87 *Foreign Affairs* 23.

¹¹ Tom Ginsburg, 'Authoritarian International Law' (2020) 114 *American Journal of International Law* 221.

coupled with moves towards creating more favourable structures in a regional context.¹²

China has struggled with multiple aspects of international trade law and policy since its accession to the WTO, which took fifteen years to negotiate, and which contained agreements widely seen as imposing heavy burdens of adjustment on the country—heavier burdens yet than on other accession states.¹³ Much of this struggle is related to China's political economy and its particular state-centred set-up even after the end of the Cold War, when many formerly Communist states adapted to a more market-based, neoliberal, privatized economic model. Generally, the central issue between China and the WTO, no matter how many disputes are adjudicated, returns to the seemingly incompatible nature between China's legal system and the legal and economic structure and concepts underlying the WTO.

The most obvious path towards change in WTO rules would have been the multilateral one—the different 'rounds' of multilateral trade negotiations in the WTO context. As China's accession to the WTO coincided with the launch of the Doha Round, many observers assumed that China would play an active role in those negotiations and ultimately have a (significant) impact.¹⁴ However, their prediction did not materialize. This could be due to the negotiation approaches adopted by China, which were different from those of other, more central actors at the WTO. At the beginning, China seemed to be a more quiet presence at the negotiations and only towards the end of the Doha Round did it attempt to become part of the core decision-making group.¹⁵ Despite the fact that it was a member of the G-20 and had submitted its first negotiating proposal only six months after accession, it operated not as a lead actor but instead often rather as an observer.¹⁶ A variety of explanations have been advanced for this behaviour. One possibility could be that the Chinese government, which had been under the spotlight and scrutiny of the WTO community for so many years during accession negotiations, needed some time to implement the newly assumed commitments which were, as mentioned, more stringent than those of other WTO members upon accession.¹⁷ Due to that, China attempted to argue that they should be considered on a par with

¹² Henry Gao, 'How China Took on the United States and Europe at the WTO' in Gregory Shaffer (ed), *Emerging Powers and the World Trade System* (CUP 2021) 174; Henry Gao, 'A New Chinese Economic Law' in Shaffer (ed), *Emerging Powers and the World Trade System*, 222.

¹³ Julia Qin, 'WTO-Plus Obligations and their Implications for the World Trade Organization Legal System—An Appraisal of the China Accession Protocol' (2003) 37 *Journal of World Trade* 483. So far, only Russia has had a longer negotiation process to accession—it took eighteen years.

¹⁴ Henry Gao, 'China's Participation in WTO Negotiations' (2012) 1 *China Perspectives* <<https://journals.openedition.org/chinaperspectives/5823>> accessed 17 June 2022.

¹⁵ *ibid.*

¹⁶ *ibid.*

¹⁷ Aaditya Mattoo, 'China's Accession to the WTO: The Services Dimension' (2003) 6 *Journal of International Economic Law* 299; Nicholas Lardy, *Integrating China into the Global Economy* (Brookings 2002).

other recently added members and not make the same level of concessions during the Doha Round as other leading economies, which meant they attempted to not make aggressive demands and to keep a lower profile so as to not attract attention from other states.¹⁸ In this light, it is possible to interpret China's 'lack of success' during the Doha Round as a strategic choice, albeit an ultimately unsuccessful one as the flexibility awarded to recently added members was not extended to China. In a similar vein, some scholars have argued that China had a lack of expertise in terms of procedural and substantive rules.¹⁹ Furthermore, developing countries and established large trading countries alike regarded China as a threat instead of an ally, complicating the access to informal information.²⁰

The Doha Round soon ran into difficulties, in particular due to deadlocked North-South relations, and actors paid more attention to other paths of change, especially the judicial one, given the particularly strong institutionalization of dispute settlement in the WTO context. This held for China, too, and it did not only concern the subsidy issues this chapter focuses on. Originally a hesitant participant, let alone initiator, in WTO litigation, China had changed its approach by the mid-2000s. Their cases pertained to a variety of issues, amongst others import tariffs and the non-market economy status of China at the WTO.²¹ The increased focus on dispute settlement was accompanied by attempts to change procedural rules, for example by requesting special and differential treatment in DSU negotiations with a view to requiring developed countries to exercise due restraint in their cases against China.²² China also proposed to boost the rights of third parties to allow them to attend all substantive meetings of the panel instead of only the first meetings.²³ This shift towards litigation, however, would not have been possible without serious investments in capacity, which have recently been highlighted, especially by Greg Shaffer and his co-authors.²⁴ It is to these efforts that we will now turn.

3. Generating Trade Law and Litigation Capacity

As mentioned above, in the years directly following accession China was more a silent observer than a rule maker or challenger. However, as of the mid-2000s

¹⁸ WTO, Ministerial Conference, 5th session, Cancun, Statement by HE Mr Lu Fuyuan, Minister of Commerce of China (2003) WT/MIN(03)/ST/12.

¹⁹ Gao 'China's Participation in WTO Negotiations' (n 14).

²⁰ *ibid.*

²¹ Mark Wu, 'The 'China, Inc.' Challenge to Global Trade Governance' (2016) 57 *Harvard International Law Journal* 261.

²² Specific Amendments to the Dispute Settlement Understanding—Drafting Inputs from China (2003) TN/DS/W/51/Rev.1.

²³ *ibid.*

²⁴ Shaffer (n 1).

it changed its behaviour and began contesting rules of international trade law through litigation. This shift to the judicial path was crucial to China's more recent successes and position of influence at the WTO, as I will discuss below. China (as well as other countries) spent their early years at the WTO sometimes trying to engage in proceedings through statements and operated largely through the multi-lateral pathway.²⁵ However, as Nicolas Lamp demonstrates, many countries chose not to pursue multilateral options further and ultimately shifted to the judicial path in order to gain more influence at the WTO and to push the organization (and with it the field of international trade law) to adapt to their regional or domestic priorities.²⁶

In the case of China, this shift is particularly remarkable as international trade law is one of very few areas in which the country agreed to conflict resolution by means of an international court or quasi-court.²⁷ Yet the expertise necessary for countries to succeed through litigation does not materialize overnight but requires a significant effort. Therefore, it is important to take a closer look at what is underlying this shift on a domestic level.

China's accession to the WTO has not just been a catalyst for restructuring their state-owned enterprises (SOEs) but has also spurred the development and formation of the international trade law profession in the country.²⁸ From the start, the Ministry of Justice was acutely aware of their internal shortcomings in terms of lack of English language fluency and trade law capacity.²⁹ They set out a ten-year strategy to rectify these deficits as early as 2001. This strategy plan outlined that training abroad for currently practising lawyers and law students would be crucial to build a legal profession, which could compete with those of other countries at the WTO. The Ministry placed particular emphasis on incentivizing foreign-trained Chinese lawyers to return and practise trade law domestically in order to fulfil the demands of the country's 'market economic construction and development'³⁰ between 2001 and 2010. Building this capacity was a top priority of the Department of Trade and Commerce and the Department of Treaty and Law within the Ministry

²⁵ See Nico Krisch and Ezgi Yildiz, 'The Many Paths of Change in International Law: A Frame' in Nico Krisch and Ezgi Yildiz (eds), *The Many Paths of Change in International Law* (Oxford University Press 2023).

²⁶ See Nicolas Lamp, 'Arrested Norm Development: The Failure of Legislative-Judicial Dialogue in the WTO' Working Paper, Queen's University, 2021.

²⁷ Henry Gao, 'China's Ascent in Global Trade Governance: From Rule Taker to Rule Shaker, and Maybe Rule Maker?' in Carolyn Deere-Birkbeck (ed), *Making Global Trade Governance Work for Development* (CUP 2011) 153

²⁸ On the following, see especially Henry Gao, 'How China Took on the United States and Europe at the WTO' in Shaffer (ed), *Emerging Powers and the World Trade System* (n 12) 174.

²⁹ Ministry of Justice, China, 'Notice No. 030, Opinions of the Ministry of Justice on Accelerating the Reform and Development of the Legal Profession after China's Accession to the WTO' (2001) <www.lawinfochina.com/display.aspx?lib=law&id=2970&CGid> accessed 17 June 2022. LawinfoChina is a legal database run by Beijing University.

³⁰ *ibid.*

of Foreign Affairs in the early 2000s.³¹ Subsequently, the Department of Treaty and Law organized study trips to Washington DC for delegations of selected scholars, practising lawyers, and ministry employees where they were taught at Georgetown University by Professor John Jackson.³² Simultaneously, the government put in place programmes for Chinese law professors to assist the Ministry of Commerce in developing, enhancing, and implementing their WTO strategy.³³

In the early years, post-accession China relied heavily on non-Chinese law firms to litigate disputes at the WTO, as there was no domestic law firm with experience in the area.³⁴ Yet the government insisted on additionally hiring domestic firms to support international (often French) firms and learn from their legal practices and knowledge.³⁵ In the early 2000s around ten domestic law firms worked on WTO cases, narrowing to five over the years, one of which is part of the original group of ten, while the others are more recent additions. The remaining five involved in WTO cases are amongst the largest 'full-service' firms in the country, as opposed to the original ten which were mainly boutique firms.³⁶ The lawyers practising in the currently hired law firms are younger overall and have significant experience in firms abroad (in Europe and the US) whilst those in the early days were older, distinguished domestic lawyers, without experience practising abroad but with strong domestic government ties.³⁷ This is exemplary for the development of the Chinese international trade law capacity domestically. Domestic law firms were further incentivized to be involved with WTO cases as these gave the firms direct access to government officials, particularly in the Ministry of Commerce, and increased influence over other areas of regulation that is drafted by the Ministry, such as the regulation of competition laws and foreign investment. There is a clear distinction between cases that are argued before a WTO panel—in these instances the government hires foreign (American or European) and domestic law firms to collaborate.³⁸ If cases do not reach the stage of litigation before a panel, or in cases in which China acts as a third party in panel proceedings, the Chinese government primarily hires domestic law firms.³⁹

³¹ Sida Liu and Hongqi Wu, 'The Ecology of Organizational Growth: Chinese Law Firms in the Age of Globalization' (2016) 122 *American Journal of Sociology* 798.

³² Shaffer and Gao (n 7).

³³ *ibid.*

³⁴ Han Liyu and Henry Gao, 'China's Experience in Utilizing the WTO Dispute Settlement Mechanism' in Gregory Shaffer and Ricardo Meléndez-Ortiz (eds), *Dispute Settlement at the WTO: The Developing Country Experience* (CUP 2011) 137.

³⁵ Randall Peerenboom, 'Economic Development and the Development of the Legal Profession in China' in Margaret Woo and Mary Gallagher (eds), *Chinese Justice: Civil Dispute Resolution in Contemporary China* (CUP 2013) 114.

³⁶ *ibid.*

³⁷ Peerenboom (n 35); Liu and Wu (n 31).

³⁸ Shaffer and Gao (n 7).

³⁹ *ibid.* 151.

Simultaneously, China attempted to expand their capacity at the WTO secretariat which is often a strong force behind the drafting of panel and AB reports.⁴⁰ In 2010, there were only five Chinese staff members in the WTO Legal Affairs Division and the AB secretariat out of 629 in total and compared with 181 French and 72 British staff members.⁴¹ This could be partly attributed to the WTO language requirements of French or Spanish, which led China, India, Brazil, and other developing countries to submit a proposal for diversifying the WTO secretariat.⁴² By 2021, the numbers of Chinese staff members had increased to sixteen⁴³—still a modest number in absolute terms, but a threefold increase over the situation a decade earlier.

This indicates that, from the early days of Chinese accession to the WTO, the government was acutely aware of how to best use the tools at their disposal and that they had a strategic plan for how to push their own interests, using the same avenues available to everyone else. Their efforts at building own capacity play a crucial part in China's attempts to change international trade law in order to align its interpretation with China's own economic and political vision and to avoid having to submit to the neoliberal, US-centric status quo prevalent in the 1990s.⁴⁴ A case in which these attempts—and some of their success—is observable are the changes around subsidy regulation at the WTO. To appreciate the impact of those changes it is important to first consider the historical context from which they emerged.

4. Subsidies and State-Owned Enterprises in China

China's large state-owned sector differed from (Eastern European) non-market economies in that China did not embrace mass privatization whilst other countries often implemented large-scale privatizations early in their economic reform process.⁴⁵ China instead opted to develop a 'socialist market economy', in which the market sets prices whilst public ownership remains dominant and coexists with a smaller private sector. In the late 1990s, China did reduce state ownership,

⁴⁰ See Joost Pauwelyn and Kristof Pelc, 'Who Guards the Guardians of the System? The Role of the Secretariat in WTO Dispute Settlement' (2022) 116 *American Journal of International Law* 534.

⁴¹ Pasha Hsieh, 'China's Development of International Economic Law and WTO Legal Capacity Building' (2010) 13 *Journal of International Economic Law* 997.

⁴² WTO, Committee on Budget, Finance and Administration—Joint Proposals on the Improvement of Diversification of the WTO Secretariat (4 November 2009) WT/BFA/W/191, by Brazil, China, Cuba, Ecuador, India, Pakistan, and South Africa.

⁴³ WTO, 'Overview of the WTO Secretariat' <www.wto.org/english/thewto_e/secre_e/intro_e.htm> accessed 17 June 2022.

⁴⁴ James Gaathii and Sergio Puig, 'The West and the Unraveling of the Economic World Order: Thoughts from a Global South Perspective' in David Sloss (ed), *Is the International Legal Order Unraveling?* (OUP 2023).

⁴⁵ Julia Qin, 'WTO Regulation of Subsidies to State-Owned Enterprises (SOEs)—A Critical Appraisal of the China Accession Protocol' (2004) 7 *Journal of International Economic Law* 863.

promoting foreign investment and private enterprises, as well as allowing SOEs to be sold or go bankrupt.⁴⁶ By 1999, SOEs made up a 28 per cent share of the gross national industrial output, compared to 76 per cent in 1980.⁴⁷

The remaining sectors dominated by SOEs were oil, energy, metal, chemicals, machinery, finance, insurance, rail and air transportation, telecommunications, and medical services. Many of them were economically inefficient due to their historical SOE structure,⁴⁸ which resulted in substantial, non-performing loans being extended from state-owned banks to a large number of SOEs.⁴⁹ The Chinese government anticipated increased market competition following their entry into WTO, evident in their attempts to reform the SOE sector in the late 1990s, selling off SOEs at increased pace, restructuring and listing them on domestic or foreign stock exchanges.⁵⁰ In that sense, the WTO accession can be understood as another step in Chinese SOE reform. Nevertheless, China continued providing subsidies to SOEs, which can be grouped under three columns: subsidies to sustain and revive loss-making SOEs, subsidies to privatize and restructure SOEs, and subsidies provided to foster key SOEs.⁵¹ Some of these might have actually been motivated by the drive to reform the SOE sector.⁵² However, they might still negatively affect the trade interests of other WTO members, clearly presenting a challenge to the system. Balancing the interest in SOE reform requiring subsidization and at the same time protecting the interests of other members was bound to be difficult for the WTO.

China became a member of the WTO in 2001. In the years leading up to accession, the overwhelming expectation from policymakers and academics was that China would reform their SOEs, privatize and liberalize them, and adapt to the predominant neoliberal WTO system. Some were acutely aware that the systems of, on the one hand, private enterprises operating in the existing world trade and investment structure and a large, protected, privileged, state-owned sector on the other hand were incompatible and could not easily coexist.⁵³ Shortly after the accession it became clear that one of the areas of strong contention in the years to come would be possible subsidy reform.⁵⁴ Early expectations that China would

⁴⁶ *ibid.*

⁴⁷ Xiaolu Wang 'State-owned Enterprise Reform: Has it Been Effective?' in Ross Garnaut and Ligang Song (eds), *China 2002: WTO Entry and World Recession* (Asia Pacific Press 2002) 29.

⁴⁸ *ibid.*

⁴⁹ US-China Economic and Security Review Commission '2004 Report to Congress' (2004) 77.

⁵⁰ Julia Qin, 'WTO Regulation of Subsidies to State-Owned Enterprises (SOEs)—A Critical Appraisal of the China Accession Protocol' (2004) 7 *Journal of International Economic Law* 863.

⁵¹ Qin, 'WTO Regulation' (n 45).

⁵² *ibid.*

⁵³ Gary Hufbauer, 'China as an Economic Actor on the World Stage: An Overview' in Frederick Abbott (ed), *China in the World Trading System: Defining the Principles of Engagement* (Kluwer Law International 1998).

⁵⁴ John Jackson, 'The Impact of China's Accession on the WTO' in Deborah Cass, Brett Williams, and George Barker (eds), *China and the World Trading System* (CUP 2003) 19.

adapt to the WTO system were not fulfilled, and instead China began lobbying efforts to mould wider WTO frameworks to adapt them to their own economic understanding.⁵⁵

The Accession Protocol set out a number of provisions directly and indirectly targeting the management of subsidies in an economy with a large number of state-owned enterprises.⁵⁶ The most prominently featured ones are provisions around an SOE-based specificity test and authorization for the importing country to permanently use alternative benchmarks to identify and calculate Chinese subsidies. The Accession Protocol also excludes China from invoking the privatization exception that is available to other developing country members under the Agreement on Subsidies and Countervailing Measures (SCM Agreement).⁵⁷ The Chinese Accession Protocol refers here to the 'right to trade' related to the import and export of goods.⁵⁸ It was interpreted narrowly, meaning that in practice the extension of obligations to non-discriminatory and non-discretionary treatment extends the obligation from mere border measures and applies to all enterprises (whether private, state-owned, or joint ventures).⁵⁹ This limits China's ability to utilize the exception provisions the General Agreement on Tariffs and Trade (GATT) had originally allowed for developing and transitioning members.⁶⁰ China agreed not to invoke any of the exceptions normally in place for developing countries, which grant special treatment with regard to domestic subsidies.⁶¹

Under the Accession Protocol China is not obliged to privatize their SOEs. Instead, the Protocol requires China to ensure that its SOEs will operate in line with market economy principles.⁶² Furthermore, China agreed to eliminate all export subsidies upon accession, which is a deviation from past practices in which developing and transition economy members had seven to eight years to eliminate subsidies.⁶³ The Protocol also requires China to notify the WTO of any subsidy (within the meaning of Article 1 of the SCM Agreement), but the notification does not strictly include the obligation to identify subsidies provided by state-owned banks.⁶⁴

⁵⁵ Messenger (n 5).

⁵⁶ Protocol on the Accession of the People's Republic of China, WT/L/432 (2001) WTO.

⁵⁷ Certain subsidies related to developing country members' privatization programmes are not actionable multilaterally (SCM Agreement, art 29). Developing country members (whilst respecting countervailing measures) are entitled to more favourable treatment regarding termination of investigations if the level of subsidization or volume of imports is small.

⁵⁸ Accession Protocol (n 56) art 5.1.

⁵⁹ *ibid* art 5.2.

⁶⁰ *China—Measures Related to the Exportation of Various Raw Materials* (30 January 2012) Report of the Appellate Body, WT/DS394-5-8/AB/R, 293, excluding the possibility of China's recourse to art XX GATT for its obligation to eliminate export duties under art 11.3 of the Accession Protocol, as (unlike art 5.1) there was no *specific* reference to 'China's right to regulate in a manner consistent with the WTO Agreement'.

⁶¹ Report of the Working Party on the Accession of China (WTO 2001) WT/MIN(01)/3, para 171.

⁶² *ibid* para 46.

⁶³ Accession Protocol (n 56) s 10.3, SCM Agreement, arts 27.2, 27.3, 27.4, 29.

⁶⁴ Accession Protocol (n 56) s 10.1.

China has privatized a large number of former state-owned enterprises before and after WTO accession, but the government has retained ownership of some strategically important companies.⁶⁵ Many of these enterprises have been performing well economically, largely due to their close relation to the government and its support as well as the possibility of accessing financing through state-owned commercial banks.⁶⁶ In particular, this access to financing streams has given rise to the argument that these enterprises have an unfair advantage in the marketplace. The US has therefore argued that many of the state-owned enterprises and state-owned commercial banks are ‘public bodies’ under Article 1.1(a)(1) SCM Agreement, that they are therefore subject to WTO subsidies disciplines, and that countervailing duties (CVDs) can be used in response to subsidies provided by them. As a result, the US has introduced CVDs on many goods from China.⁶⁷

For China then, the question of what constitutes a ‘public body’ became of pressing concern with a view to their SOEs. This raised broader questions about the regulation of subsidies in the WTO context and especially its interpretation in a context—that of a non-market economy—for which it was not initially conceived.

5. Subsidy Regulation at the WTO

Historically, subsidy regulation within international trade law broadly, and at the WTO specifically, has been used by different global actors as the basis to push for and advance specific assumptions and state structures concerning the relationship between state and market. However, many legal issues in the field remained unclear for many decades.⁶⁸ The 1947 GATT did not actually define the term subsidy. A subsidy code was originally developed by the Tokyo Round 1973–79 (although it did not contain a precise definition of a subsidy either) and the Uruguay Round elaborated on the original Subsidies Code and incorporated it into the WTO. The SCM Agreement, part of the package of WTO Agreements, was more specific than any of the previous documents in that it attempted to define the term ‘subsidy’, though it leaves underspecified a number of elements, among them the term ‘public body’.⁶⁹

‘Subsidy’ is defined by Article 1.1 of the SCM Agreement as a financial contribution that is made by a government or any public body within the territory of a member through a (potential) direct transfer of funds or liabilities, government

⁶⁵ Peter Nolan, ‘Globalisation and Industrial Policy: the Case of China’ (2014) 37 *The World Economy* 747

⁶⁶ *ibid.*

⁶⁷ ‘Countervailing Duty Investigation of Coated Free Sheet Paper from the People’s Republic of China—Whether the Analytical Elements of the Georgetown Steel Opinion Are Applicable to China’s Present-Day Economy’ (US Department of Commerce 2007) C-570–907.

⁶⁸ Messenger (n 5).

⁶⁹ *ibid.*

revenue, or a government providing goods and services beyond general infrastructure, or a government making payments to a funding mechanism directly or through a private body, or the conferring of a benefit.⁷⁰ The three key elements are the 'financial contribution' by 'government or public body', which confers a 'benefit'. Government support for business is a common occurrence in all types of economies, but if it is labelled as subsidization, it entails legal consequences and in particular makes it possible for other countries to enact CVDs to offset the benefit derived from the subsidy. Yet, the line between government support and subsidization is difficult to draw and has given rise to significant contestation. The US understood the SCM Agreement as an opportunity to form a body of rules cementing the transatlantic agreement under US hegemony and to influence the manner in which other states engaged in privatizations.⁷¹ Over time, it emerged that the US and Europe acted as partners in trade regulation vis-à-vis developing countries.⁷² Traditionally, the US negotiators sought to include in WTO disciplines as many forms of governmental subsidies as possible, except those which are part of technology and environmental programmes.⁷³

The SCM Agreement reflects this in part, but the openness of some of its terms allows for ongoing contestation. Especially the meaning of 'public body' has continued to be a battleground where transatlantic concepts and approaches of subsidy regulation have been challenged by others, in particular China and to some extent India. Problems with it arise especially for economies in which state-owned enterprises occupy an important role, as the SCM Agreement seems to give preference to states that do not involve governmental bodies in the market and relies on a model of a liberal state in which public and private are separated. This issue has been of particular importance to China due to the large number of state-owned enterprises, as government subsidies had historically caused much concern with their trading partners.⁷⁴ Signalling this, the China Accession Protocol is the only WTO discipline containing rules on subsidization of SOEs, setting out criteria under which subsidies to SOEs are to be treated as 'specific' and therefore 'actionable' under the SCM Agreement.⁷⁵ In terms of general rules, GATT Article XVII (State Trading Enterprises) is the only WTO provision referring explicitly to SOEs intending to ensure that members do not make use of state trading enterprises to circumvent or avoid GATT obligations.⁷⁶ Whilst the SCM Agreement

⁷⁰ Agreement on Subsidies and Countervailing Measures (15 April 1994) art 1.1, Marrakesh Agreement (hereafter SCM Agreement).

⁷¹ Sarooshi (n 50).

⁷² Messenger (n 5).

⁷³ *ibid.*

⁷⁴ Qin, 'WTO Regulation' (n 45).

⁷⁵ *ibid.*; Accession Protocol (n 56) art 10(2).

⁷⁶ WTO, *Canada—Measures Related to Exports of Wheat and Treatment of Imported Grain* (6 April 2004) WT/DS276/R, paras 6.39, 6.89, 85; *Canada—Measures Relating to Exports of Wheat and Treatment of Imported Grain* (30 August 2004) WT/DS276/AB/R, para 85 (stating that art XVII 1(a) is an 'anti-circumvention' provision).

does not per se differentiate between SOE and private entity subsidization it does contain exceptions related to SOE subsidies. First, it provides an exception for subsidies granted by a developing country regarding a privatization programme and secondly, it contains an exception for subsidies utilized by a transition economy member facilitating transformation from centrally planned to market economy.

It is challenging to identify any 'hidden subsidies' in non-market economies as the benchmark of the market is missing. Approaches developed with a view to this challenge in the GATT prior to the creation of the WTO tend to start from a pure version of a country 'which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State', but they eschew less clearcut cases.⁷⁷ After the end of the Cold War, most former non-market economies transformed from centrally planned economies to market economies and the issue became less pressing. One member country that remained a non-market economy was Cuba, which normally informs the WTO that it does not maintain or grant subsidies falling within the meaning of Article 1(1) and Article 2 of the SCM Agreement.⁷⁸ With very little practice at an institutional level concerning subsidies from non-market economies, issues of Cuban export subsidization were largely dealt with through individual countries' national laws on countervailing duties.⁷⁹

6. Shifts in the WTO Case Law

While the definition of subsidies—and especially that of 'public bodies' as the authors of subsidies—was not entirely settled by the SCM Agreement, several decisions of WTO panels developed a clearer stance focused on government control, thus opening the door relatively wide to include a host of SOEs among public bodies. The 2005 *Korea-Commercial Vessels* case was in many ways exemplary of this trend. The case centred on the Korean export-import bank, which offered financing and loan guarantees to support domestic businesses, and which—according to the South Korean argument—could not be regarded as a 'public body' as it pursued commercial interests.⁸⁰ The panel, however, did not focus on whether a commercial or governmental purpose was pursued, or whether the bank acted on the basis of governmental authority. Instead, it found that the SCM Agreement envisioned a straightforward approach to the distinction between public and private bodies. For the panel, the decisive criterion here was whether an entity is

⁷⁷ Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (10 November 1980) BISD 26S/26-28.

⁷⁸ WTO, *Notification of Subsidies by Cuba* (1 July 2003) G/SCM/N/95/CUB.

⁷⁹ John Jackson, *The World Trading System: Law and Policy of International Economic Relations* (MIT Press 1997); Robert Lantz, 'The Search for Consistency: Treatment of Nonmarket Economies in Transition under United States Antidumping and Countervailing Duty Laws' (1995) 10 *American University International Law Review* 993

⁸⁰ *Korea—Measures Affecting Trade in Commercial Vessels* (7 March 2005) WT/DS273/R.

controlled by the government, in which case any action by that entity falls under Article 1.1(a)(i) of the SCM Agreement.⁸¹ The same test was pursued in *EC—Large Civil Aircraft*,⁸² and it came to be regarded as the settled state of the law.⁸³

Up until that point, it had been US policy not to apply CVDs to countries considered as non-market economies (NMEs), such as China. Yet, starting in 2006, the US changed course, distinguished the Chinese economy from the (Soviet) model that had led to the earlier policy, and began to impose CVDs on a host of products from China (as well as other contemporary NMEs), with significant economic ramifications.⁸⁴

As part of a challenge to this new practice, the earlier settlement around the notion of a public body in subsidy regulation came undone. In *US—AD/CVDs (China)*, China sought to obtain a different interpretation of the meaning of the term ‘public body’ with respect to state-owned enterprises and banks declared as such by US authorities.⁸⁵ The US contended that, as a public body in the past had been determined by governmental control, SOEs were automatically to be considered as ‘public bodies’. China, in contrast, argued that previous panel decisions should not be followed and presented its own interpretation. The panel sided with the US, even as it noted that there was no general definition for ‘public body’.⁸⁶ It pointed out that it would be challenging to come up with an abstract definition as different jurisdictions defined ‘public bodies’ differently in their own law, and ‘some of these go well beyond government agencies or similar organs of government, and include, inter alia, government-owned or -controlled corporations providing goods and/or services.’⁸⁷ The panel reviewed the provisions in French and Spanish and came to the conclusion that the main question that had to be answered was whether state-owned enterprises and state-owned commercial banks are public or private bodies specifically under the SCM Agreement.⁸⁸ The panel focused on the relationship between public and private, not on the one between ‘public body’ and ‘government’, thus distinguishing the issue from that before the AB in *Canada—Dairy*,⁸⁹ which had taken governmental and non-governmental functions into account. As a result, the panel reaffirmed the previous jurisprudence and focused

⁸¹ *ibid* paras 7.49–50.

⁸² *European Communities and Certain Member States—Measures Affecting Trade in Large Civil Aircraft* (30 June 2010) WT/DS316/R.

⁸³ Daniel Bethlehem and others, *The Oxford Handbook of International Trade Law* (OUP 2009).

⁸⁴ Matthew Kennedy, ‘China’s Role in WTO Dispute Settlement’ (2012) 11 *World Trade Review* 555.

⁸⁵ *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China* (22 October 2010) WT/DS379/R. See also Dukgeun Ahn, ‘United States—Definitive Anti-dumping and Countervailing Duties on Certain Products from China’ (2011) 105 *American Journal of International Law* 761.

⁸⁶ *ibid*.

⁸⁷ *US—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China* (n 85).

⁸⁸ *ibid*.

⁸⁹ *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products* (13 October 1999) WT/DS103/AB/R W/DS113/AB/R.

on control as the distinctive criterion, with the public sector under state control and private enterprises privately controlled:⁹⁰ '[w]e consider that interpreting "any public body" to mean any entity that is controlled by the government best serves the object and purpose of the SCM Agreement.'⁹¹ Majority government ownership was taken to be 'clear and highly indicative evidence of government control, and thus of whether an entity is a public body for purposes of the SCM Agreement.'⁹²

This was not the outcome China had pushed for, and it accordingly brought the case before the AB. China argued that ownership in and of itself was not determinative and that the key criterion should not be whether an entity is controlled by the government, but instead whether the entity exercises governmental *authority*.⁹³ The AB largely followed this argument.⁹⁴ It found that the US had to demonstrate that an SOE exercised 'government functions', creating constraints on US CVD practices against Chinese imports.⁹⁵ The AB stated that governmental control or delegation may, but need not, be indicators of the public nature of a body: 'the precise contours and characteristics of a public body are bound to differ from entity to entity, State to State, and case to case.'⁹⁶

Even though this move generated considerable legal uncertainty,⁹⁷ many saw it as a momentous move: it 'effectively transformed the "public body" test into a "government action" test.'⁹⁸ It was also a move taken over the explicit opposition of important WTO members, including not just the US, but also the EU, Canada, Mexico and Turkey, among others.⁹⁹ As was to be expected, the AB decision was strongly contested by the US Trade Representative as it destabilized the control test set forth in previous decisions and challenged existing US CVD practice.¹⁰⁰ If implemented, it would have largely removed benefits provided by SOEs from the remit of CVDs as the burden of evidence to demonstrate actual exercise of governmental authority was too high,¹⁰¹ especially because SOEs in China are mostly

⁹⁰ *US—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China* (n 85) para 8.69.

⁹¹ *ibid* para. 8.79.

⁹² *ibid* para. 8.135.

⁹³ Messenger (n 5).

⁹⁴ *US—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China* (n 85) 611.

⁹⁵ *ibid* 318, 543.

⁹⁶ *ibid*.

⁹⁷ Joost Pauwelyn, 'Treaty Interpretation or Activism? Comment on the AB Report on *United States—Ads and CVDs on Certain Products from China*' (2013) 12 *World Trade Review* 235.

⁹⁸ See the statement by Turkey, in WTO, Dispute Settlement Body, Minutes of Meeting (9 June 2011) WT/DSB/M/294, para 107. See also Ahn, 'Why Reform is Needed' (n 9).

⁹⁹ See hereafter *US—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/R (n 85) paras 8.42–8.52.

¹⁰⁰ Melissa Lipman, 'WTO Rejects US Duty Double-Counting in China Fight' (*LAW360*, 11 March 2011) <www.law360.com/articles/231712/wto-rejects-us-duty-double-counting-in-china-fight> accessed 17 June 2022.

¹⁰¹ Weihuan Zhou, Henry Gao, and Xue Bai, 'Building a Market Economy through WTO-Inspired Reform of State-Owned Enterprises in China' (2019) 68 *International and Comparative Law Quarterly* 977.

non-transparent as regards their governance structure, which will often make it impossible for an investigating authority to provide the evidence required.¹⁰²

The US did not shift its approach either and continued to rely on ‘meaningful control’ as the core criterion. Yet, even despite this lack of implementation, the AB decision represented a victory for China in terms of pushing forward its own views and agenda. Several important countries—among them Brazil, India, and Saudi Arabia—had supported the Chinese position in the proceedings. And even governments that disagreed on substance recognized that the AB finding would ‘serve as a reference for the conduct of any investigating authority’, and that no grounds existed to call into question the legitimacy of the decision.¹⁰³

The AB approach was consolidated in the following years, especially in response to a broader challenge by China to US CVD determinations. In 2014, a WTO panel found that these determinations, based as they were on the previous criteria (government control and ownership), were not in compliance with the standard set out by the AB in 2011.¹⁰⁴ Most third-party interveners had suggested that the panel follow the AB, and the US did not even appeal this point. In a parallel case, however—brought by India and concerning SOEs with a similar role to China’s—the panel initially decided not to follow the AB’s approach, applied the traditional, ‘meaningful control’ standard, and sided with the US.¹⁰⁵ It was, however, soon reversed on appeal. The AB’s decision in late 2014 largely insisted on the prior AB jurisprudence and, while indicating some flexibility, continued to focus on ‘governmental authority’ as the core yardstick.¹⁰⁶

By the mid-2010s, therefore, the legal standard applied in such cases had clearly changed compared to what it was a decade earlier. The shift in the understanding of ‘public body’ under the SCM Agreement may not have become fully consolidated, as contestation and instances of non-compliance continued, especially on the part of the US. It nevertheless resulted in a new balance of argument and provided a new reference point for the legal debate, reflected, for example, in the way in which the law came to be presented in trade law textbooks.¹⁰⁷ Even though the typical threshold for ‘subsequent practice’—with a concurring practice or agreement of the parties to a treaty—had not been met, the law had, for all practical purposes,

¹⁰² Chad Bown and Jennifer Hillmann, ‘WTO’ing a Resolution to the China Subsidy Problem’ (2019) 22 *Journal of International Economic Law* 557.

¹⁰³ See eg the statement by Mexico and the European Union, in WTO, Dispute Settlement Body, Minutes of Meeting (n 98) paras 103 and 112.

¹⁰⁴ *United States—Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India* (14 July 2014) WT/DS436/R.

¹⁰⁵ *ibid.*

¹⁰⁶ *United States—Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India* (8 December 2014) WT/DS436/AB/R.

¹⁰⁷ See eg Joost Pauwelyn, Andrew Guzman, and Jennifer Hillman, *International Trade Law* (Wolters Kluwer 2016) 507; Peter van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization: Text, Cases and Materials* (CUP 2017) 783.

changed, and it would have been unprofessional to restate the law on the basis of the previous control test.

A few years later, this relative consolidation was again called into question. Several reports by panels and the AB after 2018 were somewhat more deferential to US views and further added to the uncertainty about the applicable standards.¹⁰⁸ Still, they kept generating friction, including through a separate opinion of one AB member, and the US appealed even a favourable panel ruling out of opposition to the starting point chosen, which continued to focus on ‘governmental functions’.¹⁰⁹

These decisions were already adopted in the midst of the crisis surrounding, and eventually incapacitating, the AB. The ‘public body’ jurisprudence also features prominently among the points of concern of the US regarding the AB,¹¹⁰ and it is likely to have contributed to the US challenge to the AB and its decision to block the appointment of new members (a development also discussed by Mark Pollack in his chapter in this volume¹¹¹). The EU, too, has raised concerns about the ‘narrow interpretation’ of the notion of ‘public body’ and identified subsidies through SOEs as one of the areas in which a ‘rebalancing of the rules’ of the WTO is necessary.¹¹² Without a functioning dispute settlement system, understandings of the current state of the law are in any event bound to diverge more over time.

7. Conclusion

Power shifts do not translate automatically into changing international legal rules. Instead, rising powers need to find pathways to align the law more closely with their visions and preferences, and they will often find the typical, state-driven processes of multilateral negotiations blocked because of a reluctance of other countries to accommodate their rise. This has been on display most vividly in the trade context, in which WTO negotiations since the onset of the Doha Round have been fraught with controversy and have hardly led to meaningful results, partly because of claims for a stronger role by a coalition of developing countries, in particular the BRICs. Other state-led paths for change at the WTO—especially through decisions of intergovernmental bodies—were also not used, or not usable, by governments.¹¹³

¹⁰⁸ See Ahn, ‘Why Reform is Needed’ (n 9) 64.

¹⁰⁹ *ibid.*

¹¹⁰ US Trade Representative, Report on the Appellate Body of the World Trade Organization (February 2020), 82–89. <https://ustr.gov/sites/default/files/Report_on_the_Appellate_Body_of_the_World_Trade_Organization.pdf> accessed 17 June 2022.

¹¹¹ Pollack, this volume.

¹¹² EU, ‘Concept Paper: WTO Modernisation’ <<https://www.wita.org/atp-research/eu-concept-paper-on-wto-reform/>> accessed 17 June 2022.

¹¹³ See Lamp (n 26).

China, a rising power and with misgivings about the outcome of the accession negotiations, understood early during its membership that it had to shift away from, or at least complement, a negotiation-driven multilateral path if it wanted to inform policy and change norms in its own interest. International trade law lent itself to such a shift—especially a shift to a judicial path—as it is (or was then) organized around a central dispute settlement body holding much power when it comes to attempts to change legal norms in the field. The clogged paths of multilateralism then resulted in the judicial pathway being more or less the only path open to change attempts.

As we have seen in this chapter—and as is developed much further by Shaffer in his recent book—the Chinese government invested significantly in its capacity to use this path to its advantage, in particular by creating domestic legal expertise in WTO law and urging Chinese law firms to generate capacity in the field. It also pushed for greater representation in the WTO secretariat in order to enable its views to be better reflected in the preparation of decisions, including those of panels and the AB in dispute settlement. As a result of its greater confidence in this field, by 2006 China not only defended its trade policies as a respondent in WTO cases, but it also began bringing its own cases against the US and the EU.¹¹⁴ As a result, China began to shape WTO jurisprudence and in effect international trade law with a view to constraining US and EU attempts to impose measures against Chinese imports.

It is difficult to causally link Chinese investments to particular outcomes, but it is clear that the Chinese push towards litigation has borne fruit in various respects.¹¹⁵ In this chapter, I have traced its attempt to change the subsidies regime in order to constrain the use by other countries, in particular the US, of CVDs against benefits deriving from state-owned entities, including banks. As we have seen, this attempt was relatively successful as the AB in the 2010s moved away from the common understanding of a crucial term—‘public body’—that had prevailed until then.

Subsidy reform is an example of China playing the Western game, and rather successfully at that. It is imperative not to re-read this story in terms of China making its own rules, but instead as one of China using strategies which were also at the disposal of, and often used by, Western countries. The rules of international trade law were defined largely by Western countries, and the WTO dispute settlement mechanism was a way of giving them teeth. China has been challenging them not by actively pushing back against the rules themselves, but rather by occupying the spaces made available by existing rules. As a result of this, through the work of its lawyers China has taken on a leading role in developing transnational legal processes in international trade law, sometimes with ripple effects and wide-reaching

¹¹⁴ Cui Huang and Wenhua Ji, ‘Understanding China’s Recent Active Moves on WTO Litigation: Rising Legalism and/or Reluctant Response?’ (2012) 46 *Journal of World Trade* 1281.

¹¹⁵ Wu (n 21); Shaffer and Gao (n 7).

consequences for other members and their respective economic and political systems. The AB itself moved to the centre of a power contest between states and their fundamentally different understandings and visions for a global economy.

International legal change in this instance—and in other areas of WTO areas as well—has travelled on the judicial pathway, with a limited ability of (even important) states to block shifts in meaning brought about by the AB. Even as the US vigorously contested the reinterpretation of ‘public body’, most actors in the field soon acknowledged that the law had changed. The contestation prevented full consolidation, though, and it had more tangible effects later on, once the US had moved towards the ‘option of incapacitating the AB by blocking new appointments. It was at that point that panels and the AB returned to a greater measure of openness to US policies, but it was too late to rescue the AB.

This points to a series of potentially important insights about change in international law. It seems to confirm the framing paper’s conjecture that change can indeed take place despite major divergences among states if alternative paths are available, as in this case the judicial pathway. It also suggests that it is then the institutional dynamics on the relevant pathway that condition outcomes and determine to what extent the positions of states have an influence. In this case, both the Chinese and the US positions are likely to have had an impact on the WTO panels and the AB—in line with the finding by Sergio Puig and Jeff Kucik in their contribution to this volume that strong signals about challenges (especially non-compliance) provoke responses by the AB¹¹⁶—yet their positions were not determinative of the outcome. However, we also see that the relative autonomy of the judicial pathway had serious limits once the US shifted to all-out opposition and, thanks to the institutional rules in place at the WTO, managed to unilaterally disempower the AB. Institutional rules vary across institutions, of course, and discontent with the European Court of Human Rights may have had a more limited impact in part because of that difference.¹¹⁷ But backlash can take different forms, and states may find ways of derailing change if institutions overstretch their *marge de manoeuvre*. The paths of change in international law are hardly ever straight.

¹¹⁶ Jeffrey Kuick and Sergio Puig, this volume.

¹¹⁷ See also Mikael Madsen, Pola Cebulak, and Micha Wiebuch, ‘Backlash against International Courts: Explaining the Forms and Patterns of Resistance to International Courts’ (2018) 14 *International Journal of Law in Context* 197.