



Convenient Compliance: China's Industrial Policy Staying One Step Ahead of WTO Enforcement


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Abstract

Through case studies of China's WTO trade disputes in the automobile and wind turbine sectors, I argue that China's compliance with WTO rulings reflects Beijing's skillful navigation through the WTO's dispute-resolution process rather than socialization to international norms. China liberally implements industrial policies and removes them after they come into dispute at the WTO — strategies that I characterize as “convenient compliance.” By the time China removes the challenged measures, it often no longer needs them, since it has already achieved its goals and can still build up a reputation as a responsible WTO member by complying with the organization's rulings. The dynamics of the global supply chain certainly complicate foreign business groups' interests and countries' domestic political calculations regarding trade disputes with China.

China's entry into the World Trade Organization (WTO) in 2001 was hailed as a significant step forward in opening up China's markets and curbing governmental practices that placed foreign firms at a competitive disadvantage. While moving from being a cautious observer to an active participant in the WTO, China has demonstrated an outstanding record of compliance with the organization's dispute settlement rulings; in most cases, Beijing has either reached agreement with the complainant over the disputed practices or removed measures the WTO finds inconsistent with China's WTO obligations. As such, China's record at the WTO appears to confirm international relations and legal studies scholarship on international organizations' effectiveness in socializing and pressuring China for further economic liberalization.



However, China's achievement in this regard is overshadowed by foreign governments' and businesses' increasing criticisms regarding their diminishing access to the Chinese market and Beijing's continuing use of WTO-inconsistent industrial policy measures. In recent years, trade disputes involving China at the WTO have increased, focusing on the issues of subsidies, anti-dumping, favorable treatment of domestic companies, and discrimination against foreign businesses or imports. This begs the question of how to reconcile two different pictures: China's continuing reliance on industrial policy measures that contradict WTO rules and its record of successful compliance within the WTO's dispute-settlement process. Conventional wisdom views China's compliance with the WTO rulings as a measure of China's socialization to international norms and the effectiveness of WTO's dispute-settlement process in addressing trade concerns with China, as compared to the era of bilateral negotiations. But if China's compliance with the WTO settlement process is a result of China's socialization into international standards, why do we not see a simultaneous decrease in China's adoption of WTO-inconsistent measures? What does China's continuing reliance on industrial policy measures and ability to flout WTO rules reveal about the trade organization's limits? In the relationship between the WTO and China, who is socializing whom and who is limiting whom?

In examining the pattern of China's compliance with WTO dispute settlements, this article argues that China keep its industrial policies one step ahead of the WTO umpire by *conveniently* complying later with WTO dispute rulings. Under the WTO system, China does not hesitate to implement WTO-inconsistent regulations as a way to protect infant industries, develop strategic industries, and nurture national champions. Because the legal process at the WTO's Dispute Settlement Body (DSB) takes months or even years, China continues to benefit from disputed policies while they are being reviewed and then can repeal them once the challenge succeeds. Also, DSB rulings mostly accomplish the removal of the offending measures rather than punishing the country that violated the provisions. Thus, it is in China's best interest to adopt industrial policy measures first and remove them afterwards when they are in dispute. In doing so, China not only achieves its developmental purposes of putting those measures in place but also builds a reputation as a responsible WTO member by complying with the DSB rulings — a practice that I characterize as *convenient compliance*. Thus, China's compliance reflects Beijing's *realpolitik* calculation of achieving its economic development goals by navigating through the limitations of the WTO's dispute-settlement process, rather than reflecting China's socialization to international norms.

I also contend that multinational companies (MNCs) are not necessarily the main drivers of economic liberalization in China, as is often assumed in the literature. MNCs implicitly or explicitly support protectionist measures in China either because they fear retribution from Chinese government officials or because they benefit from gaining even small pieces of the ever-enlarging pie of Chinese trade. Global supply chain dynamics certainly complicate the issue of initiating trade disputes with China. First, interests between those economic actors who benefit from inexpensive Chinese imports and those who are hurt by them diverge. Second, interests also diverge between businesses without clear investment or contract ties with China and those with



existing operations in China who are dealing with the country's regulatory system on a daily basis. Firms' form of market entry and their mode of operation in China often shape their attitudes toward initiating trade disputes with Beijing.

In an effort to substantiate China's pattern of "convenient compliance," I examine two recently completed trade disputes. First, I look at the dispute over China's Measures Affecting Imports of Automobile Parts (DS 340), which the United States brought to the WTO in 2006 because of its adverse impact on American automobile parts exports to China. This is the first WTO case where China allowed the dispute to go through the full panel process. The second case I examine is China's Special Fund for Wind Power Equipment Manufacturing (DS 419), where the United States and the European Union contested China's subsidies for domestic wind turbine manufacturers that use domestic rather than imported goods.

I chose these cases as representative and indicative examples of China's record of convenient compliance at the WTO. First, both have been viewed as positive examples of China's removing contested measures upon the WTO's final decision. Second, both the auto and the wind turbine industry have received strategic support from Chinese governments at various levels. Lastly, both cases show how China can continue to pursue its developmental goals by adopting other measures to replace the measures that were contested at the WTO. The auto case has continued to have an impact with the recent dispute the United States brought to the WTO in September 2012 regarding China's subsidies for local automakers, and the wind case has had an impact on other green energy industries, such as solar panels.

This article begins by introducing my empirical puzzle and delineating the literature review on the WTO's and MNCs' impact on socializing and liberalizing China. I then explain my theoretical framework of convenient compliance and provide two trade dispute cases in the automotive and the wind turbine sectors. In so doing, I demonstrate how developing countries flout WTO rules, which in turn raises important systemic issues not only for the WTO, but also for free market principles in coping with the challenges raised by a large transitional economy like China.

Empirical Puzzle: What's behind China's Compliance to the WTO's Dispute Settlement?

From its WTO accession till August 2014, China has participated in 155 disputes — 12 cases as a complainant, 31 cases as a respondent, and 112 cases as a third party. China is expected to be part of more trade disputes, given that it became the world's largest exporter starting in 2009 and that the scope for trade friction increases as countries trade more. In fact, China was a party to only two of the 93 trade disputes at the WTO between its accession in 2001 and the end of 2005, but in 2009, China was a party to half of the fourteen new WTO disputes initiated in that year.¹ And in

¹ China's designation as the non-market-economy in WTO partly contributed to increasing disputes on trade remedies by allowing complaining party to either use the constructed cost of producing the same good in a third country or the normal



2010, China was involved in 26 of the 84 cases filed at the WTO. The United States accounts for the lion's share of cases against China — as it has initiated 50 percent of the WTO disputes targeting China and participated in 70 percent of all WTO cases against China (which include disputes initiated by the EU). WTO members have mostly challenged Chinese industrial policy measures that favor state-owned enterprises (SOEs) and other domestic companies, discriminate against imports, and restrict foreign companies' access to Chinese markets. The issues involved in these disputes include intellectual property rights, trading rights, and distribution services for products such as semiconductors, auto parts, and more recently renewable energy components. Over the years, China has shown “aggressive legalism” by being active in initiating disputes at the WTO, as it realizes its ability to use membership in the organization to defend its rights and interests.² The eleven cases China has initiated at the WTO have so far targeted only two members — the U.S. (eight cases) and the EU (three cases). Nine of these cases have concerned trade remedies targeting anti-dumping, countervailing measures, and safeguard measures (Figure 1).

China's compliance record in WTO dispute settlements has been quite outstanding. In the 11 completed cases where China was the respondent, Beijing has either reached agreement with the complainant over the disputed practices or has removed the measures that the DSB has found to be inconsistent with China's WTO obligations. Of the eight completed cases where China was the complainant, Beijing has won four cases, received mixed rulings in another, and lost the remaining three cases. This record suggests that the WTO has been more effective in addressing countries' trade concerns with China when compared with the era of bilateral trade negotiations. What does China's increasing compliance with WTO procedures say about international institutions' impact on transitional economies like China? And what about China's continued reliance on industrial policies and discriminatory measures that contradict WTO principles and tilt the playing field against foreign business and imports?

The “liberalization group” of analysts in international relations and international legal studies expected China to accelerate its economic liberalization by preparing a level playing field for foreign companies and imports and increasingly comply with WTO rulings. First, according to these neo-liberal scholars, the WTO facilitates trade liberalization among nations by providing, monitoring, and enforcing rules on a multilateral basis. Its DSB enforces trade rules by evaluating a country's potential WTO rule violations upon the request of other countries' trade representatives.³ By entering the WTO, China abolished more than 800 of its trade-related rules during the first few months of 2002 and it had adopted, revised, or abolished an additional 2,300 pieces of legislation by the end of 2005.⁴

value of the cost of production in a surrogate country as a benchmark for determining China's dumping practices (Hufbauer, Wong, and Sheth 2006); Zeng and Liang 2010, 562–588.

² Nakagawa 2007, 837-867; Gao 2005, 315-353; Qin 2007; Qin 2008, 1-43.

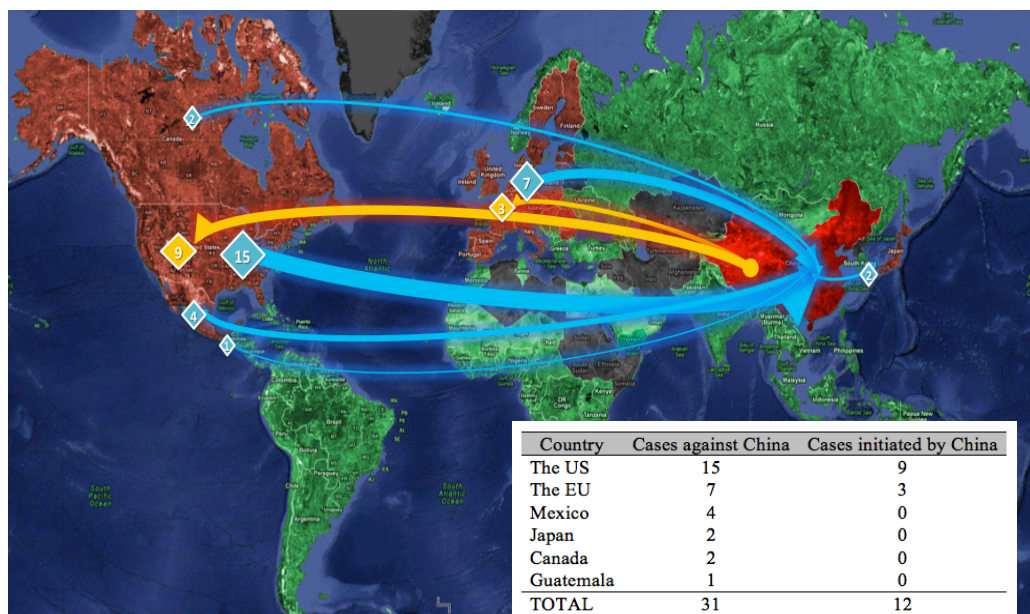
³ Busch and Reinhardt 2004; McRae 2004, 3–6.

⁴ WTO 2012.



Constructivist scholars, meanwhile, highlight international institutions' ability to teach and socialize member countries to adopt international norms.⁵ According to this argument, China's participation in the WTO leads China to incorporate WTO principles and terms into the Chinese government's standard operating procedures and to mobilize domestic agents who share the idea of economic liberalization and compliance with WTO rules. These processes of learning and norm diffusion take place through the establishment of networks between domestic and transnational actors,⁶ or an "acculturation" process whereby a state "adopts the beliefs and behavioral patterns of the surrounding culture" through micro-processes of mimicry, identification, and status maximization.⁷ Scholars in international legal studies also believe that once countries join international legal agreements, they change behaviors and abide by those agreements out of the reputational concern of being considered a responsible member of the international community.⁸ However, these socialization and learning arguments would be more persuasive if we had witnessed China's compliance with WTO rulings improve over time.

Figure 1. WTO Dispute Cases involving China (2001-August 2014)



Source: WTO, Dispute settlement: the map of disputes between WTO members, available at: http://www.wto.org/english/tratop_e/dispu_e/dispu_maps_e.htm?country_selected=CHN&sense=e

⁵ Johnston 2001, 487-515; Ford 2003; Harpaz 2010, 1155-1186; Hempson-Jones 2005, 702-721; Kent, 2002, 343-364; Kent 2007; Wolfe 2005, 339-365.

⁶ Risse and Sikkink 1999, 1-38.

⁷ Goodman and Jinks 2004.

⁸ Simmons 2000, 819-835.



Another group of scholars speak about how WTO rules are more constraining for developing countries than developed countries. According to Robert Wade (2003) and Linda Weiss (2005), WTO rules diminish developing countries' room to maneuver by prohibiting industrial policy measures that developing countries may want to use in labor- and capital-intensive manufacturing industry.⁹ Most importantly, the WTO's Agreement on Trade-Related Investment Measures (TRIMs) prohibits popular non-tariff barriers such as imposing requirements on foreign companies regarding local content, trade balancing, export performance, technology transfer, and domestic sales. On the other hand, other WTO rules permit — or at least do not explicitly prohibit — advanced countries to pursue more restrictive industrial policy in technology-intensive industries. For example, governments in developed countries can offer substantial support for venture capital financing of high-tech start-ups or provide strategic financing for pre-commercial technologies and product development.¹⁰ Thus, Wade and Weiss argue that developed countries craft WTO rules to best suit their current developmental trajectory, thereby putting developing countries at a systemic disadvantage.

Lastly, MNCs are often seen as an export-lobbying group pressuring China for further liberalization and demanding greater market access.¹¹ MNCs are also seen as representing values such as free market competition and the rule of law, and pushing those agendas in their home and operating countries. However, as I will demonstrate in my case analysis, MNCs can serve as supporters of continued Chinese protectionism, depending on their form of market entry and mode of operation in China. Moreover, it is important to note that MNCs are not a unitary actor with an identical interest in pressuring China to live up to its promises. The dynamics of the global supply chain complicate MNCs' political calculus in contesting Chinese trade measures at the WTO, as some economic actors in their home countries benefit from cheap Chinese products while others are hurt. Interests also diverge between businesses that do not have clear investments or contracts with China and those that do.

Despite expectations that China would abandon its more protective industrial policies, the Chinese government has increased its reliance on WTO-inconsistent measures as a key instrument for managing the economy during the past decade, especially since the 2008 financial crisis that led to a severe contraction in China's export market. Though foreign governments and businesses have complained for decades about the bureaucratic maze they face in the Chinese market, their concerns have been increased in recent years due to a series of regulatory changes that appear directly intended to shut out foreigners. In its report from 2009 to 2011, the U.S.-China Economic and Security Review Commission frequently criticized China's restrictions on foreign firms' market access, disregard for intellectual property rights, forced technology transfers, and the many direct and indirect subsidies to Chinese exporters. From 2010 to 2012, the EU

⁹ Wade 2003, 621–644; Weiss 2005, 723–749.

¹⁰ Weiss (2010) discusses South Korea's CDMA technology that is now widely used in India and the US as a representative example of government's provision of financing of pre-commercial technologies and product development. She also discusses how the US federal government is the world's biggest venture capitalist by far, spending more than \$40 billion in loans and grants to encourage private firms to develop green technologies.

¹¹ Frieden 1991, 425–451; Milner 1988.



Chamber of Commerce in China released a 650-page report detailing hundreds of protectionist hurdles that still impede foreign businesses nearly ten years after China's accession to the WTO. In July 2010, the heads of two of Europe's largest companies complained directly to former Chinese Premier Wen Jiabao about Beijing's discrimination against foreign businesses. Jürgen Hambrecht, the chief executive of BASF, said his company's access to the China market was contingent upon forced technology transfers, while Peter Loescher, the chief executive of Siemens, complained about the uncompetitive advantage given to domestic companies in the Chinese government's public procurement contracts.¹²

These concerns are not unfounded. China's Government Procurement Law announced in 2009 includes provisions that direct provincial governments and relevant agencies to buy only from certain product catalogs.¹³ China's 12th Five-year plan of 2012 designates seven key sectors in the Chinese economy, including biotech and new technology, as the focal points of strategic industrial policies. For foreign businesses, China has been a "pay-to-play" market with mandated joint venture requirements, local content requirements, and forced technology transfers in key industries as the price of market admission.¹⁴ Simultaneously, China continues to create national champions mainly by developing SOEs as the main drivers of economic development, rather than fully privatizing them.¹⁵

With state sponsorship, these SOEs not only block international businesses' entry into China's key industrial sectors, but they also bring their inexpensive products and services to international markets and compete with global companies. In light of existing conventional wisdom regarding the liberalizing effect of China's entry into the WTO, how should we understand the empirical puzzle of China's continued (and even increased) implementation of industrial policies that favor domestic companies? What does China's flouting of international rules and increased room for policy maneuvering reveal about China's late entry into the global economy and the WTO's effectiveness in promoting free market principles?

Convenient Compliance: How China's Industrial Policy Stays ahead of WTO Enforcement

Wade and Weiss insightfully point out how the restrictive nature of WTO rules diminishes developing countries' room for policy maneuvering. I agree with them in that the need for strategic government involvement in the market is more pressing for the late developers to catch

¹² "Why Foreign Businesses in China Are Getting Mad", *The Time*, 9 September 2010.

¹³ The 2009 draft known as Indigenous Innovation Accreditation suggested adoption of a complicated licensing system that required companies to register their IPR in China before registering elsewhere to qualify. In June 2010, the U.S. Chamber of Commerce in D.C. regarded the policies as "a blueprint for technology theft on a scale the world has never seen before (p.4)."; McGregor n.d.

¹⁴ McGregor, James. 2010. "Time to Rethink U.S.-China Trade Relations", *The Washington Post*, 19 May 2010.

¹⁵ Huang 2008.



up earlier developers, as best illustrated by the “East Asian Developmental State”.¹⁶ In 1993, the World Bank explained East Asia’s breathtaking economic growth by pointing to the region’s market-conforming policies.¹⁷ After decades of consensus that industrial policy does not work for developing nations, the World Bank is now recommending its use; Justin Lin (2012), a former chief economist of the World Bank, has discussed government’s important role in fostering comparative advantage;¹⁸ another economist, Ha-Joon Chang, claims that creating comparative advantage requires a government to identify winners and encourage resources to move into industries with the highest growth prospects.¹⁹ The 2008 financial crisis further renewed interest in strong government in both developed and developing countries.²⁰

Where I diverge from Wade and Weiss is that developing countries still have a lot of room to maneuver under the WTO system and achieve their developmental goals by conveniently complying with the WTO rulings after the dispute is resolved. China has little hesitation and few restraints in implementing WTO-inconsistent measures as a way to protect infant industry, develop strategic industries, and nurture national champions. China benefits from these regulations at least temporarily, because the legal process takes months to years, and can remove them when they are ruled invalid at DSB.

There are two other aspects of the WTO review process that allow China to subsequently conveniently comply with the DSB rulings. First, formal WTO dispute settlement is a four-stage process consisting of 1) consultations, 2) panel proceedings, 3) an appellate review, and 4) an implementation stage (see WTO Dispute Settlement System) (Figure 2). Disputes arise when one WTO member country considers another member to be violating a WTO rule. The process begins with a written request for consultations by a complaining party, which grants the two sides 60 days to reach a “mutually satisfactory solution.” If bilateral consultations fail, the complaining party may request that a panel be established to hear the case. A panel has up to 45 days to be appointed and about six months to conclude its investigation. WTO panels typically take around a year to complete their proceedings and issue a decision. The disputing parties can then either accept or implement the panel decision or can they appeal to the Appellate Body, which may take up to 90 days to issue its own decision. The Appellate Body’s decision is final, and the countries have no choice but to comply. If the responding member loses, it has to correct the violating measure within a reasonable time period or negotiate mutually acceptable compensation. If the responding member still refuses to comply, compensation and suspension of concessions (the use of countermeasures) can be used, but most countries eventually just abide by the decision. The complete dispute resolution process takes between six months and six years, which creates huge incentives for countries to engage in rule-breaking in the near term and then resolve any disputed

¹⁶ Johnson 1982; Amsden 1989; Woo-Cummings 1999.

¹⁷ World Bank 1993.

¹⁸ Lin, and Monga 2010; Lin 2012.

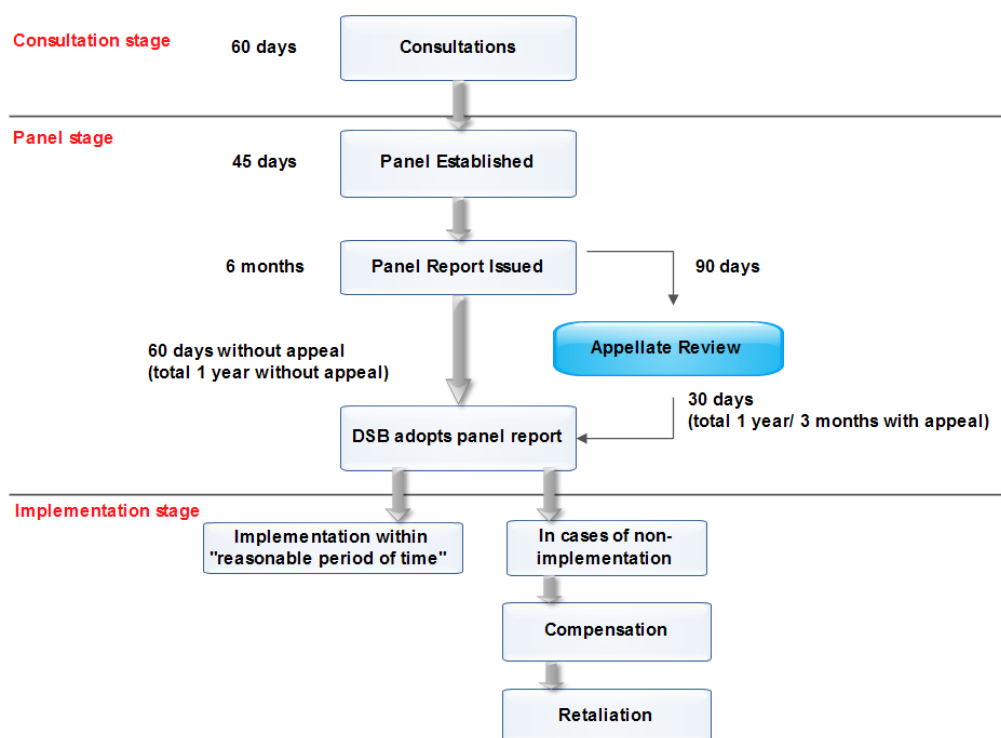
¹⁹ Lin and Chang 2009, 483–502.

²⁰ Aggarwal and Evenett 2010, 221–244, 2012, 261–283.



measures only after the WTO's final ruling. Even before bringing the case to the WTO, member countries have to investigate the contested issue.

Figure 2. Steps in a WTO Dispute Proceeding



Besides these bureaucratic delays, DSB rulings are prospective, covering only losses commencing as of the date of the ruling and not as of the date of violation. Winning a trade dispute depends on more than the final ruling; sometimes the real victory comes from China buying time for domestic industry adjustment and signaling its policy preference to MNCs operating in the country. By navigating through the WTO's loopholes, China not only achieves its goal of putting these economic measures in place, but demonstrates its responsibility by complying with the DSB rulings — a practice that I characterize as *convenient compliance*. Convenient compliance allows China to craft their protective industrial policies in such a way to stay ahead of WTO enforcement. Thus, I argue that such convenient compliance demonstrates how a transitional economy like China can maneuver under the WTO system through strategic *realpolitik* calculations rather than through international norm adoption.

The second aspect of the WTO process that allows China's convenient compliance has to do with the role of private parties in the dispute process. Private parties do not have standing in the WTO, but they often petition their country's trade representatives to bring a dispute to the WTO and provide evidence regarding relevant Chinese government policies. Unlike the literature viewing MNCs as export-lobbying group, I contend that MNCs often support continued Chinese



protectionism depending on their form of market entry and mode of operation in China. For example, the joint venture (JV) ownership requirements between global automakers and Chinese SOEs in the automotive sector, inevitably pits regional JVs against each other to succeed in a fragmented market, rather than promoting competition between domestic and foreign firms. Thus, the operations of the global auto companies are more affected by *intra-state trade barriers more so than by inter-state trade barriers and tariff regulations*. This render their interests diverge from independent auto parts makers who manufacture in their home countries and ship to China. Thus, MNCs operating in China often support protectionism at the national and sub-national levels rather than pushing for further economic liberalization.²¹

Sometimes, fear of Chinese government retribution prevents MNCs from contesting Chinese behaviors or bringing evidence to support a case at the WTO. Chinese officials can flex their muscles through measures such as blocking market entry, delaying permits, withholding raw materials, and detaining finished products at ports. The Office of the United States Trade Representative (USTR) frequently complain how most U.S. companies are unwilling to file formal complaints and only privately share information about Chinese rule-breaking.²² The U.S. Motor and Equipment Manufacturers Association, for example, will not issue any public information on additional costs or losses caused by China's auto policy and local content rule, let alone reveal the names of any companies involved.²³ In the recent WTO case involving the Chinese dumping of solar panels in the U.S. market, SolarWorld Industries America was the only one of the seven solar companies willing to publicly state its support for the case, while the rest .

When problems arise, individual companies and industries are forced to choose between either tacitly accommodating or squaring off against China's governments at various levels.

It is equally important to note that MNCs are not a unitary actor with an identical shared interest in pressuring China to live up to its promises. First, global supply chain dynamics complicate the domestic political payoff in contesting Chinese measures at the WTO, as some economic actors within home countries benefit from inexpensive Chinese products and others are hurt. In America's solar panel dispute with China, the parties who would benefit from cheap Chinese imports, such as panel installers and individual consumers, have opposed opening the dispute case at the WTO, while solar panel makers have pressured the U.S. government to initiate a trade dispute. Second, foreign businesses without clear investments or contracts with China and those companies that are active in China have diverging interests. Business interest groups who do not have direct investments in China tend to make dispute cases proactively. For example, the United States started its investigation on China's clean energy policies in 2010 upon request by the United Steelworkers Union, a group with no direct sales contracts at risk in China.

²¹ Oh 2013, 920–945.

²² USTR 2010a.

²³ Miller and Miller 2007.



Case Study Analysis: Convenient Compliance in Action

This section examines China's two completed WTO trade disputes that are representative of China's compliance pattern with the WTO rulings. The first case is China's Measures Affecting Imports of Automobile Parts (DS 340). In 2006, the United States, followed by the EU and Canada, contested China's tariffs on imported cars that adversely affected exports of automobile parts to China. This is the first case that China allowed to go through the full panel process (consultation, panel proceedings, and appeal), and also the first time Beijing implemented an adverse WTO ruling after losing its appeal in 2010. The second case is China's Special Fund for Wind Power Equipment Manufacturing (DS 419), where the United States and the EU contested China's subsidies for domestic wind turbine manufacturers that used domestic instead of imported goods.

Driven Away: Trade Dispute over China's Tariffs on Imported Automobile Parts

Labeled as “the machine that changed the world the automotive industry remains one of the most strategic industries for national economic development due to its potential for job creation and industrial capacity-building.”²⁴ It is not an overstatement to say that no country has succeeded in building an automotive industry without government involvement and the use of protective industrial policy. China is certainly no exception. The Chinese Central government designated the automotive sector as a pillar industry in the seventh five-year plan in 1986. Faced with the need to invite foreign auto companies into China for technology and know-how learning, Beijing imposed strict ownership and local content regulations starting in the early 1980s to manage the impact of foreign investment. Foreign automakers have to form a JV with Chinese SOEs with maximum 50 percent ownership and meet the local content rate of 80 percent by the third year of operation. These local content requirements hampered many JVs' operations in China: foreign companies had to push rapid localization by striving to develop local suppliers at the risk of lower vehicle quality, or their operations suffered and sometimes failed.²⁵

China's WTO entry in 2001 changed the rules of the game by introducing new tariff regulations and liberalization measures. Particularly, complying with the WTO's TRIMs forced China to eliminate performance requirements imposed on foreign investors, such as subsidizing export performance, establishing local content requirements, and maintaining separate regulations for domestic and imported products. In June 2004, China's National Development and Reform Commission (NDRC) promulgated the “Policy on Development of Automobile Industry” as one of the newly detailed liberalizing measures including the removal of local content requirement. It also lowered the tariffs on imported cars from 80-100 percent to 25

²⁴ Womack and Jones 1991.

²⁵ Examples include the failures Guangzhou-Peugeot in 1998, Beijing-Jeep (American Motor Company) in 1999, and Nanjing-Fiat in 2007.



percent and reduced tariffs on imported parts and components from 15-50 percent to 10 percent by July 2006 (Table 1). Foreign businesses in the auto sector could now source their inputs based on their profit calculations and market strategies rather than on political considerations. Such measures widened operational room for MNCs to extract higher returns on their investment by importing necessary parts and components.

Table 1. International Context: Chinese Automotive Market before and after WTO Entry

Policy	Pre-WTO entry	Post-WTO entry
Foreign ownership	Limited to 50%	
Number of JVs for foreign manufacturer	Two per vehicle segment	No change
Import tariffs on vehicles	-1980s: 200% -1990s: 80-100% on passenger cars; as low as 9% on other vehicles	25% by 2006
Import tariffs on vehicle components	15-50%	10% by 2006
Import quota	-Varied by year, depending on number and value of imported vehicles -30,000 vehicles a year allowed from foreign car makers	-\$6 billion per year -20% annual increase until elimination in 2006
Import licensing	No direct import by foreign enterprises	Import rights granted within 3 years of accession
Local content requirement	-First year of production: 40% -Second year: 60% -Third year: 80%	Elimination on accession
Distribution, retail, after-sales service of foreign makers	-Manufacturers must use Chinese distributors for sales, and domestic firms for service -Limited to wholesale by JVs -No sales office for JVs	Distribution, sales, and service rights for foreign firms phased in over 3 years
Automotive financing	Foreign non-bank financial institutions are prohibited from providing financing	They are permitted in selected cities prior to gradual national rollout

Source: Compiled by the author from Holweg *et al.*, (2005) and Noble *et al.* (2005).

However, to counteract the negative impact of removing local content regulations and lowering tariffs, Beijing adopted significant restrictions on imported auto parts in 2004. If a vehicle produced in China had more than 60 percent of imported parts in terms of either value or number, it would be viewed as a completely imported car and charged a 25 percent tariff instead of the normal 10 percent tariff on parts. The relevant rules stipulate that “all vehicle



manufacturers in China that use imported parts must register with China's Customs Administration and provide specific information about each vehicle they assemble, including a list of the imported and domestic parts to be used, and the value and supplier of each part."²⁶ Such regulations aim to continue pressuring foreign automakers and parts makers to localize operations in China, while hindering the market entry of independent foreign parts makers into China. The Chinese governments and SOEs have less leverage with independent parts makers outside of the JV framework.

Foreign parts makers outside of China widely criticized such measures as barriers to market entry and acted as a strong export-lobbying group. They argued that the tariffs constituted a discriminatory charge in favor of auto parts originating in China and served as a subsidy for automakers to use domestic rather than imported parts.²⁷ Pressured by domestic auto parts makers, trade representatives from the U.S., the E.U., and Canada contested China's tariffs on imported auto parts at the WTO in March/ April 2006. China imported an average of CAD 256 million in Canadian auto parts annually from 2003 to 2005; €1.6 billion from the EU in 2004; and USD 681 million from the United States in 2005. The complaints argued that China violated the following WTO rules: 1.) The 1994 GATT Article II "Schedule of concessions," because tariffs are in excess of the maximum allowed for in China's schedule of commitments that they made as a condition of WTO entry; 2.) GATT Article III "National treatment on internal taxation and regulation" and TRIMs Article II "National treatment and quantitative restrictions," because of discrimination against foreign auto parts in favor of domestically produced auto parts; 3.) Agreement on Subsidies and Countervailing Measures (SCM Agreement) Article III "Prohibited subsidies," since Beijing was providing subsidies contingent upon the use of domestic over imported goods—local content subsidies; and 4.) Protocol on the Accession of the People's Republic of China to the WTO and the Working Party Report on the Accession of China, in which China agreed to "not to treat auto parts as whole cars."

Beijing argued for the necessity of the measures as corrective actions to prevent importers from illicitly importing whole cars by splitting shipments of auto parts into kits and circumventing the higher taxes on finished cars. In July 2008, the DSB panel ruled that China's measures "subject imported auto parts to an internal charge in excess of that applied to like domestic auto parts (GATT Article III.2)" and "accord imported auto parts less favorable treatment than like domestic auto parts" (GATT Article III.4), thereby requesting China bring the measures into conformity with Beijing's WTO obligations. The Appellate Body rejected China's appeal and confirmed the panel's findings in December 2008. After four years of WTO dispute process, Beijing in August 2009 informed the DSB that the Ministry of Industry and Information Technology and the NDRC had halted the implementation of relevant provisions (Table 2).

²⁶ Measures at issue include 1) Policy on Development of Automotive Industry (Order No. 8 of the National Development and Reform Commission 21 May 2004); 2) Measures for the Administration of Importation of Automotive Parts and Components for Complete Vehicles, Decree No. 125, which entered into force on 1 April 2005); and 3) Rules on Verification of Imported Automobile Parts Characterized as Complete Vehicles (General Administration of Customs Public Announcement No. 4, which entered into force on 1 April 2005).

²⁷ USTR 2008.



Table 2. Proceedings of DS340 on Measures Affecting Imports of Automobile Parts in China

Stage	Year	Month	Procedures
Consultation	2006	Mar. 30	The U.S. and the EU request DSB consultations with China
		Apr. 13	Canada joins the consultations
		May	Consultations failed
Panel Proceedings	2006	Sept. 5	The U.S., EU, and Canada request the panel creation
		Oct. 26	WTO sets up a dispute resolution panel
	2007	May, July	Panel holds meetings with the parties
		2008	Mar. 20
	Jul. 18		Panel rules against China
Appealing	2008	Sept. 15	China appeals panel report
		Dec. 15	Appellate Body confirms panel decision
	2009	Jan. 12	DSB adopts panel ruling
Implementation	2009	Sept.1	China removes the relevant measures

These rulings potentially benefit auto parts exporters around the world by removing the measures against imports into China, while hurting China’s domestic auto parts producers that had been sheltered from foreign competition.²⁸ But to what extent does the ruling actually affect the auto parts makers and auto manufacturers operating in China? However, the ruling has had less impact than expected on auto parts sourcing and imports for the global automakers operating in China. U.S. auto parts exports to China increased from \$893 million in 2008 to \$937 million (4.9 percent) in 2009, and again 36.4 percent to \$1.3 billion in 2010. Still, it is hard to tell whether the removal of tariffs on imports is the direct result of the increase. The U.S. auto parts trade deficit has been steadily increasing since 2001 with its largest deficit with Japan (Figure 3), and almost 80 percent of American auto parts exports went to Canada, Mexico, the EU, and Japan in 2009 and 2010 than to China. Luxury vehicles sold in China—such as BMW and cars with engines of 2.5 liters or more—are mostly produced in foreign countries and exported to China, so removing the measure on imported auto parts did not significantly affect them. Complaints over China are particularly loud in U.S. domestic politics because China usurped the U.S. as the world’s largest auto producer and auto market in 2009, with annual vehicle sales of 13.6 million units and with the most growth potential in the world.²⁹

Furthermore, the development of global supply chains complicates domestic political calculations in contesting Chinese measures at the WTO. The automakers already operating in China have been relatively less affected by the ruling because of their localized supply chain. China’s current top two automakers, Shanghai Volkswagen and Shanghai GM, entered China in 1985 and 1997, respectively—both before China’s entry into the WTO and its elimination of local content requirements. These two automakers had achieved over a 90 percent supply localization

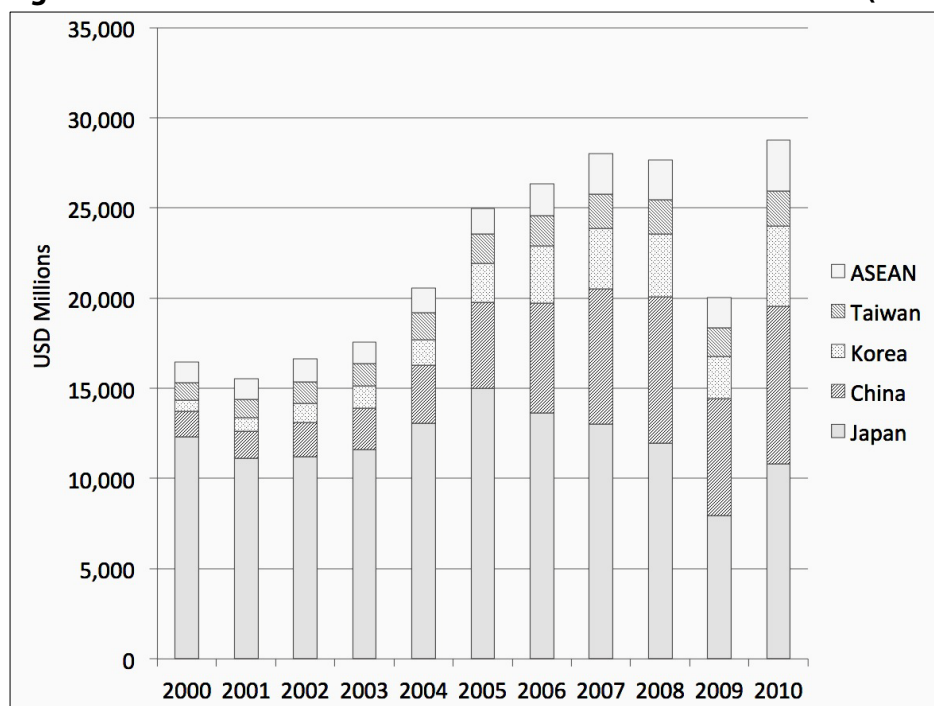
²⁸ A WTO ruling does have one big advantage over bilateral antidumping and anti-subsidy cases – it targets policies that distort trade all over the world, while antidumping and anti-subsidy cases protect only a country’s home market.

²⁹ In China, per capita car ownership was remarkably low at 6.9% as of 2011; World Bank 2011.



rate by the end of 1990s. Puzzling enough, even late entrants Hyundai and Toyota, who began operations in China in 2001 and 2002, also achieved over 90 percent of localization within three years of beginning their operations.³⁰ Supply localization was not only a political condition, but also a market strategy to survive in one of the most competitive and fragmented auto markets in the world. In his interview with *The New York Times* (2009), President of GM China Kevin Wale commented that, “China’s decision to comply with the WTO rules on the tariffs on the imported automotive parts will have virtually no impact on our operation.”

Figure 3: The U.S. Auto Parts Trade Deficit with Asian Countries (2001-2010)



Source: U.S. Department of Commerce (2011).

The WTO ruling’s minimal impact on auto MNCs operating in China shows how these company’s interests diverge from those of export-lobbying groups in home countries. For example, GM and Hyundai’s local Chinese suppliers are not directly benefiting from the enlarged market access to China, thus less concerned about the market entry of independent auto parts suppliers from abroad. China’s requirement that these MNCs form JVs with Chinese SOEs has created a distinctive pattern of encouraging *intra-national* competition between regional JVs rather than competition between foreign and domestic companies. In these interactions, MNCs are hardly the consistent champions of economic liberalization that they are often taken to be in the literature, but rather are allies of sub-national actors in supporting local protectionism to succeed in a competitive and fragmented market.³¹

³⁰ Oh 2013, 920–945.

³¹ Ibid.



China's first WTO case of undergoing the full dispute settlement process demonstrates how China's convenient compliance have succeeded. China had already achieved its goal of protecting infant industry and nurturing local suppliers, while pressuring global automakers to further localize their supply chains (including R&D centers) during the four years of DSB panel proceedings from 2006 to 2010. Simultaneously, China built up its reputation of being a responsible member of the international trade community by complying with the final ruling. Moreover, China's policy agenda has had a clear signaling effect to MNCs about China's preference to develop local suppliers rather than relying on imported cars and parts. Global automakers with JV partnerships in China continuously receive implicit and informal pressure to develop local car brands, as well as to transfer technology and operational knowledge, as a condition for constructing new factories or increasing their production capacities in China.

China's efforts to boost the auto sector have not ended with these efforts to resolve tariffs on imported automotive parts. In September 2012, the U.S. opened a new case against China at the WTO over China's stimulus plan for domestic automakers that started in March 2009—Anti-Dumping and Countervailing Duties on Certain Automobiles from the U.S. (DS 440). The stimulus plan for China's domestic auto sector includes lowering the sales tax on vehicles with small engines (a move which favored Chinese local brands), creating a \$1.5 billion fund to promote technological innovation, and offering subsidies for the development of proprietary brands and exports of autos and auto parts.³² China's effort to revitalize its domestic auto sector through new industrial policy measures suggests the ongoing nature of China's convenient compliance, which keeps Beijing one-step ahead of WTO rule enforcement.

Blown Away: Trade Disputes over China's Wind Power Subsidies

Another round of escalated trade tensions in recent years has occurred in the renewable energy sector, which includes wind turbines and solar panels. Faced with the need for greater energy independence and environmental protection, governments in both developed and developing countries have heavily invested in clean energy technology. The recent global economic crisis has further spurred countries to increase their promotion of the green energy industry as a new driver of industrial upgrades and job creation. For example, the U.S. government increased energy subsidies from \$17.9 billion in fiscal year 2007 to \$37.2 billion in 2010.³³ The total includes a mix of direct expenditures, tax expenditures, loan guarantees, and research, development, and deployment spending.³⁴ Still, the United States' investment record on green energy is overshadowed by China, which overtook the United States in 2010 with 26.8 percent of global

³² USTR 2009.

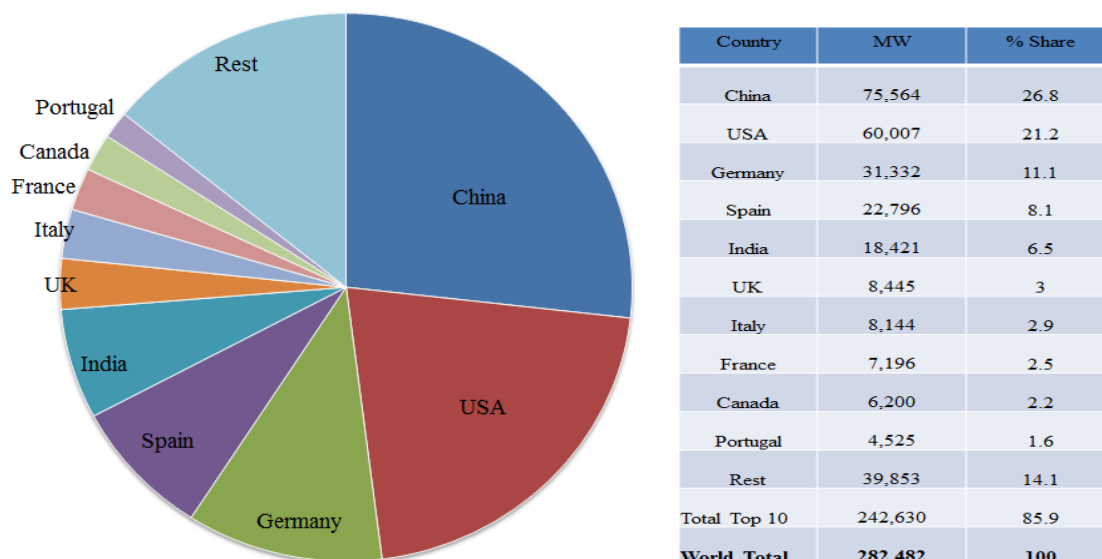
³³ EIA 2011.

³⁴ Morris, Nivola and Schultze 2012.



wind capacity to claim the world’s largest installed wind-power capacity, after having only one GW worth of wind towers in 2005 (Figure 4).³⁵

Figure 4: Global Top 10 Countries by Cumulative Wind Capacity (Dec. 2012)



Source: GWEC (2013).

China’s rapid ascent as a world wind power has been accompanied by a parallel rise of Chinese wind turbine producers. From 1996 to 2005, foreign companies—including Denmark’s Vestas, America’s GE Energy, Spain’s Gamesa, and India’s Suzlon—held 75 percent of China’s wind turbine market. In 2004, China had only eight small domestic companies manufacturing turbines, and the market for component suppliers was only beginning to emerge. However, by the end of 2007, there were 40 domestic turbine manufacturers, 20 of which already had products on the market; by the end of 2008, there were 70 domestic turbine manufacturers, 30 of which had products in the market.³⁶ Consequently, Chinese companies, led by Sinovel and Goldwind, controlled more than two-thirds of the country’s wind turbine market by 2009. Foreign companies’ market share plummeted to 14 percent, and foreign companies have not won a single central government-funded wind energy project since 2005 (Figure 5). In the meantime, China’s largest turbine manufacture, Sinovel, established itself as the world’s third-largest turbine producer in 2009. What explained the astronomical rise of Chinese local companies vis-à-vis foreign wind-turbine producers over half a decade?

Beijing started to strategically develop the wind turbine industry since 2003 and to empower provincial governments to approve wind power projects of less than 50,000 kilowatts. In 2005, the NDRC quietly increased the local content requirement on wind turbines from 40 to 70 percent, while substantially hiking tariffs on imported components. As the Chinese market for wind

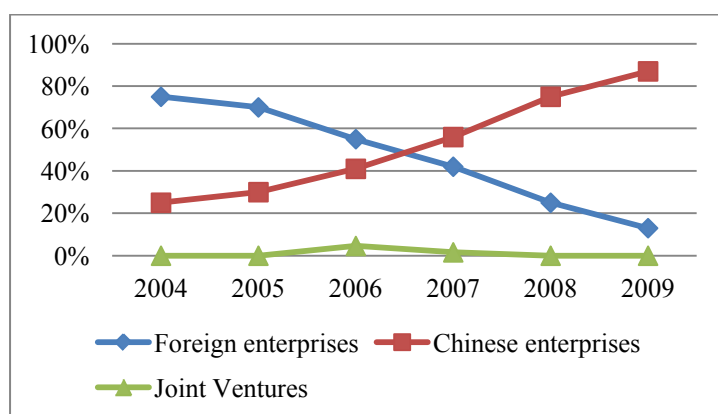
³⁵ GWEC 2010a.

³⁶ GWEC 2010b.



turbines exploded, foreign manufacturers were unable to expand their supply chains quick enough to meet the increased demand. In the meantime, China’s 2006 Renewable Energy Law dramatically increased government subsidies for wind energy projects, enabling dozens of local companies to spring up. Mainly through licensing technology from small European turbine producers, Chinese local companies took up the slack of market share rapidly and cost-effectively.³⁷ China’s 2007 Foreign Investment Industry Guidance Catalogue listed wind turbine manufacturing as an encouraged industry for foreign participation, while foreign involvement in the manufacturing of wind turbines over 1.5 megawatts was restricted to JVs or partnerships in order to promote the upgrading of domestic wind turbine capabilities. Technology transfers — together with government financial subsidies, preferential tax policies, and preferential treatment in project tendering and bidding — have fueled the rapid growth of China’s domestic wind turbine companies.

Figure 5: Market Share of Domestic and Foreign Wind Turbines in China by Annual Installed Capacity (2004-2009)



Source: Junfeng Li, *et al.*, *China Wind Power Outlook* (2010), p.37.

Following a USTR investigation, the United States challenged China’s Special Fund for Wind Power Equipment Manufacturing (Special Fund) subsidies at the WTO in October, 2010. The investigation stemmed from a 5,800-page petition filed by the United Steelworkers on China’s unfair support for domestic producers of wind and solar energy products, advanced batteries, and energy-efficient vehicles, among other products.³⁸ The Special Fund took the form of grants (ranging from \$6.7 million to \$22.5 million) to Chinese wind turbine manufacturers that agreed to use key components made in China. This enabled domestic brands of wind turbines to be 10 percent cheaper than domestically made foreign brands and 20 percent cheaper than imports.

³⁷ Goldwind’s licensing arrangements with Repower allowed it to innovate upon the transferred technology and know-how with little indigenous knowledge. It also signed licensing arrangements with Vensys to gain experience related to larger turbine designs (Lewis 2007).

³⁸ USTR 2010b.



During WTO-mediated consultations in February 2011, the U.S. stated that Article 3 of the SCM Agreement prohibited Chinese subsidies to domestic manufacturers under the Special Fund program because subsidies were conditioned on the use of domestic over imported goods. U.S. trade representatives also attacked China’s subsidies on transparency-related grounds, because China has submitted only one subsidy notification to the WTO since its entry. This violates Article 25 of the SCM Agreement on members’ obligation to regularly submit information about all of their subsidy programs. China has also failed to translate program specifics into one of the official WTO languages (English, French, and Spanish). Following those initial consultations with the United States, China resorted to formally revoking the legal measure in June 2011 that propped the Special Fund program (Table 3).

Table 3. Proceedings of China’s Fund for Domestic Wind Turbine Makers (DS 419)

Stage	Year	Month	Procedures
Pre-litigation	2010	Sept. 9	The United Steelworkers Union petitions to the U.S. government to investigate China’s prohibitive government incentives for domestic wind power equipment manufacturers under Section 301 of the Trade Act of 1974
		Oct. 15	USTR launches an investigation in response to the petition
Consultation	2010	Dec. 22	The U.S. files a request for consultations
		Jan. 1	E.U. requests to join consultations
	2011	Jan. 17	Japan requests to join consultations
		Feb. 16	The U.S. holds consultations with China
Implementation	2011	June 7	The U.S. announces that China has terminated the Special Fund, but transparency concerns related to China’s bidding process remain unresolved

During consultation, China’s wind industry continued to grow and its installed capacity quickly surpassed that of any other country in the world. Chinese manufacturers have had ample time to scale up production to compete with established companies, and have controlled more than two-thirds of the Chinese domestic market since 2009 (Table 4). In 2009, the European Chamber criticized Beijing’s tendering for the wind power sector as it inserted criteria that only Chinese companies could meet in order to purposely exclude foreign bidders. It also pointed out that none of the 25 valuable contracts under the government’s \$584 billion stimulus package were awarded to a foreign company.³⁹ Despite the removal of some of these measures, Chinese players can now independently manufacture and dominate the market for 1.5 MW wind turbines, the main size installed on today’s wind farms.

³⁹ “China Closes Doors to European Businesses”, *The Telegraph*, 2 September 2009.



Table 4: Market Share of Top 10 Wind Turbine Manufacturers in China (%)

*Chinese companies marked in black

Rank	2007		2009		2011	
	1	Gold Wind	25(%)	Sinovel	25.3(%)	Goldwind
2	Sinovel	21	Goldwind	19.7	Sinovel	16.7
3	Gamesa	17	Dongfang	14.8	Guodian United Power	16.1
4	Vestas	11	Guodian United Power	5.6	Minyang	6.7
5	Dongfang	7	Minyang	5.4	Dongfang	5.4
6	GE	6	Vestas	4.4	XEMC	4.1
7	Suzlon	6	XEMC	3.3	Shanghai Electric	4.0
8	Hangtian	2	GE	2.3	Vestas	3.7
9	Zhejiang Yunda	2	Suzlon	2.1	Huachang	3.5
10	Nordex	1	Gamesa	2.0	China Southern Rail	2.5

Source: Compiled by the author from various sources (including Li. *et al.*, 2007, 2010, 2011; GWEC 2007, 2010a, 2010b, 2013; BTM Consult, 2011).

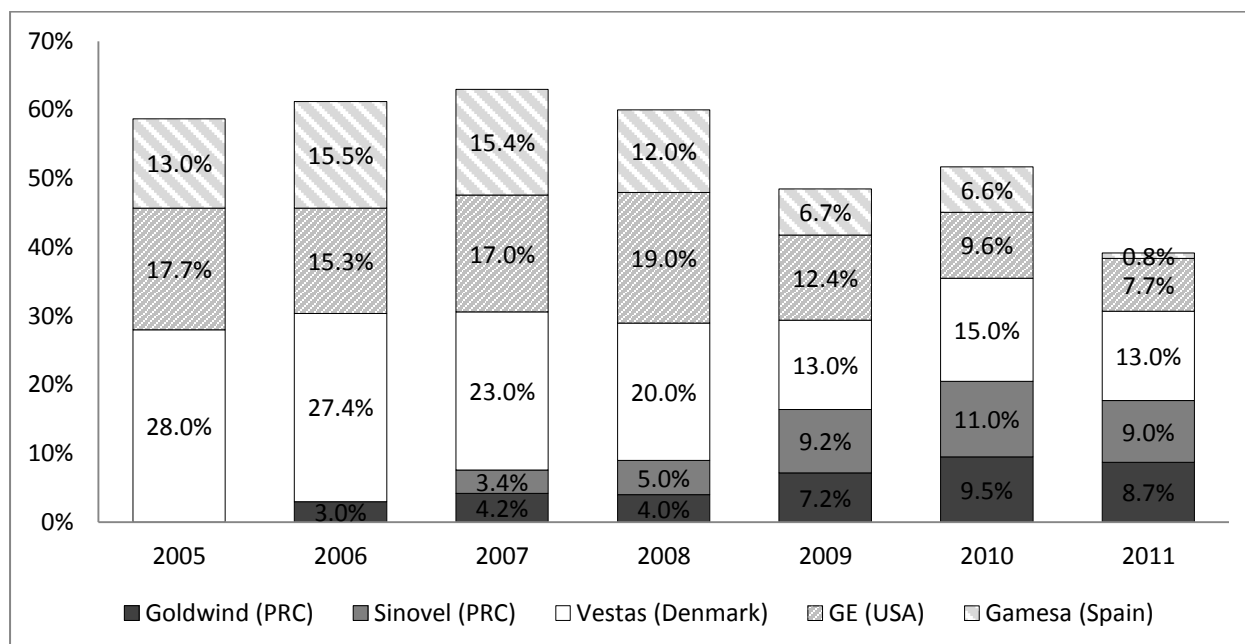
Foreign business' concerns are not limited to the diminishing access to the Chinese wind turbine market, but are also increasingly focused on competing with Chinese companies in the global market and on inexpensive Chinese products flooding their home markets. With state sponsorship, Chinese national champions have rapidly dominated the global wind turbine industry. In 2008, three Chinese companies made the list of the world's top ten wind turbine manufacturers — Sinovel (no.7), Goldwind (no.8), and Dongfang (no.9). In 2011, the world's top ten manufacturers accounted for 78.5 percent of the global market, the top four Chinese companies accounting for 26.7 percent — Sinovel (no.2), Goldwind (no.3), Guodian United Power (no.8), and Mingyang Windpower (no.10) (Figure 6). In competition with MNCs, Chinese companies have expanded manufacturing capacity for alternative energy technologies. In 2011, Goldwind and Sinovel alone secured €8.7 billion in overseas expansion funding from the China Development Bank, while the European Investment Bank, hampered by the European debt crisis, could only provide €6.2 billion in funding for all renewable energy projects in the EU.⁴⁰ In April 2011, Sinovel signed an agreement with the Greek Public Power Corporation to supply up to 300 MW of onshore capacity in Greece, with the potential for additional offshore development. In August 2011, XEMC VWEC secured a supply agreement with Irish developer Gaelectric for 13.6 MW of wind turbine capacity, which includes an additional pilot offshore turbine.⁴¹

⁴⁰ "Wind Rush: Asian Typhoon Hits Debt-Crisis Europe", *Breaking Energy*, 15 November 2011.

⁴¹ 'Wind Rush' 2012.



Figure 6. Market Share of Global Top 10 Wind Turbine Manufacturers



Source: For 2005/ 2006, WWEA (2007); For 2007/2008, BTM Consult (2010); For 2009, Li *et al.* (2010: 6); For 2010, BTM Consult (2011); For 2011, Li *et al.*, (2012: 25); Cleantech (2012).

Chinese companies also flood global markets with inexpensive products. The Wind Tower Trade Coalition, consisting of four U.S. manufacturers, asked the U.S. Department of Commerce and the International Trade Commission to investigate and slap tariffs on Chinese manufacturers for dumping wind towers in the U.S. market below cost. The trade coalition lists nearly 40 separate Chinese subsidy and assistance programs — ranging from cash grants and subsidized steel to tax breaks — that allegedly allow Chinese wind tower manufacturers to engage in predatory pricing in the U.S.

A similar story has unfolded in the solar industry. In recent years, China has emerged as the world’s leading supplier of solar modules, surpassing Japanese and German solar cell and module vendors. Currently, Chinese firms provide 65 percent of solar panels worldwide and account for nine of the world’s top ten solar producers.⁴² According to Milan Nitzschke, a vice president at SolarWorld in America, “Chinese companies have captured over 80 percent of the EU market for solar products from virtually zero only a few years ago” and “EU manufacturers have the world’s best solar technologies but are beaten in their home market due to illegal dumping of Chinese solar products below their cost of production”.⁴³ Diverging interests among companies in complainant countries complicate the dispute process. To illustrate, a trade group representing solar panel manufacturers has called for tariffs of more than 100 percent on imports of Chinese

⁴² “The Downside of China’s Clean Energy Push”, Bloomberg Businessweek, 21 November 2012.

⁴³ “Solar Trade Complaint Filed Against the Chinese, This Time in Europe”, SustainableBusiness.com News, 27 July 2012.



solar panels. On the other hand, the Coalition for Affordable Solar Energy, consisting of 25 U.S. companies that purchase and install solar panels, opposes tariffs that would increase the price of modules and therefore the price of solar energy, thereby undermining the success of the U.S. solar industry and prolonging U.S. reliance on fossil fuels.⁴⁴

Implications for the WTO

Analyzing China's socialization into international institutions through the lens of WTO dispute settlements is still in its infancy because of China's relatively new WTO membership status. Between its accession in 2001 and the end of 2005, China was a party to only two of the 93 trade disputes at the WTO, but by the end of 2010, China was involved in 26 of the 84 cases filed with the organization. Foreign countries have increasingly relied on the WTO's DSB as the main instrument for addressing trade concerns with China, while China has grown confident in dealing with trade disputes within the WTO, as it sees the benefits of engaging in a multilateral forum rather than in bilateral and retaliatory trade disputes. To that end, China has certainly been accustomed to WTO rules, to the extent that it now games the system through convenient compliance.

The story of the trade disputes in the auto and wind sectors follows an arc traced in other economic sectors of how China's industrial policy is faster than the WTO enforcement regime by achieving its economic developmental goals as well as improving its reputation as a responsible WTO member. Unlike Wade and Weiss's concerns about the WTO restricting Beijing's trade policies, China has a lot of room to develop national champions that can compete in the domestic and global markets and provide incentives for MNCs to be a part of its protectionism. When a large transitional economy like China flouts WTO rules, this in turn raises important systemic issues — not only for the WTO, but also for free market principles. This is especially important for the following reasons. First, countries are increasingly resorting to WTO's DSB as the main instrument for addressing bilateral trade disputes. Second, economic and trade liberalization have proceeded through litigation and interpretation of WTO rules, due to failures in the WTO's Doha round of negotiations in the past decade. Lastly it begs the question of who is socializing whom between China and the international legal agreements. ■

⁴⁴ "Chinese Solar Cells & Panels Get Low U.S. Tariff, & U.S. Solar Energy Industries Association Responds", Clean Technica, 20 March 2012.



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Her recent articles have appeared in *China Quarterly* and *Asian Survey*. Prior to coming to Bryn Mawr, she served as a post-doctoral fellow at the Center for the Study of Contemporary China at the University of Pennsylvania for the year 2012-2013. She has also served as a visiting lecturer at the Shanghai branch of the French school of management, École Supérieure des Sciences Commerciales from 2009 to 2012.

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