CHINA'S TRADE DEVELOPMENT STRATEGY AND TRADE POLICY REFORMS:

Overview and prospect

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Overview and Prospect

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China's Trade Development Strategy and Trade Policy Reforms: Overview and Prospect

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China's Trade Development Strategy and Trade Policy Reforms: Overview and Prospect[1]

Sheng Bin[2]

China has become both the largest trading power and inward FDI receipt country in 2014. The impressive economic and trade performance are attributed to sound development strategy and on-going institutional reforms during the past thirty-five years. In particular, China's joining the WTO in 2001 and fully engaging in regional and bilateral trade agreements in recent years provide a striking momentum for its rule-based, market-oriented trade and investment liberalization. In November 2013, the new Chinese leadership's focus on deepening economic reform in China led to a milestone Decision reached at the Third Plenum of the 18th Central Committee of the Chinese Communist Party (CCP), which depicted the vision of comprehensive and far-reaching economic reform in the near future. The expected reforms are also considered as a strategic response to address the emerging trading rules and disciplines, focusing on regulatory coherence, which are intensively negotiated in some mega-regional trade pacts, such as the Trans Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP).

The paper attempts to offer a comprehensive review and assessment of China's trade development strategy and trade policy reforms since China initiated its domestic economic reform and open-door policy, and also to analyze the prospect of future reforms, including some challenges that China would need to address in the context of a changing global business environment.

The following paper is organized as follows. Part I explores the historical development of China's trade development strategy during 1978-2014 in order to demonstrate how China's trade development strategy evolves from import substitution to export promotion, then to trade liberalization, and further to new trade competitiveness agenda. Part II will describe China current trade policy objective, institutional framework, and approaches to achieve the goals. Part III will analyze and evaluate some selected key trade policy measures, including tariffs, non-tariff

1 I am grateful to the valuable comments and suggestions of Dr. Harsha Singh and research assistance of Miss Guo Ting, my Ph. D. Student. The paper does not represent any standpoint of the author's home institution. The author therefore bears sole responsibility of expression in the paper.

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barriers (NTBs), trade facilitation, export restrictions, services, and other measures affecting trade. In Part IV, the institutional decision-making process of trade policy in China is elaborated to illustrate how bureaucracies in the central government, local governments, business associations (including state-owned enterprises and foreign enterprises), and other stakeholders have been playing and imposing the impacts in the procedure. Part V analyzes how China will address the new challenges of transition of trade development model and formidable trade reforms in the future.

I. Evolution of China's trade development strategy in the context of changing world economy

Trade development strategy is the policy to stimulate production and trade of some sectors by changing the relative price of exportable and importable goods. The evolution of China's trade development strategy could be divided into two major phases by the historical accession to WTO in 2001. In the "pre-accession-to-WTO" phase, China's trade development strategy evolved as four stages from 1980 to 2001, namely, "import substitution and marginal export promotion" (1980-1983), "export promotion neutralizing import substitution" (1984-1990), "export promotion and marginal trade liberalization" (1991-1993), and "radical trade liberalization" (1994-2001). They reveal the central government's strategy of trade and industrial policies for the economic institutional reform and open-door policy.

As for the "post-accession-to-WTO" phase, China has transformed trade development strategy focusing on import substitution or export promotion to a new sustainable development-friendly, internal and external demand coordinated, import and export trade balanced strategy, under the framework of overall economic development blueprint. From 2001 to date, China has been undergoing three stages in terms of trade policies, namely, "fulfilling commitments to access to WTO and continued trade liberalization" (2001-2005), "trade policy adjustment and growth pattern transformation" (2006-2008), and "addressing and recovering from the global financial crisis" (2008-now).

Stage I: Import substitution and marginal export promotion (1980-1983)

China had followed the former Soviet Unions' style of industrialization since 1949 and import substitution had been a longstanding key element in Chinese trade policy until the early 1990s. Stressing on the development of heavy industries, China implemented import substitution strategy through "forward-linkage" that the industrialization was initially fostered from down-stream sectors in which China had the least comparative advantages in order to supply capital equipment and intermediate goods for other sectors. It contrasted to the strategy of other East Asian countries, which pursued the "backward-linkaged" industrialization, starting from labour-intensive sectors by producing and exporting nondurable consumer goods and then gradually inducing demands from capital and technology intensive sectors.[3] The strategy which China had followed for nearly three decades before the economic reform led to high cost of economic inefficiency, bottleneck of essential industrial intermediate goods, shortage of foreign exchanges and consumer goods, and low average real wage.

The strategy was changed in 1980 due to the well-known economic reform and open-door policy initiated by Mr. Deng Xiaoping. Significantly, exports in labour-intensive sectors, such as textiles, apparel and footwear, boomed once producers could recognize and foresee the “right” relative price in the market. Export incentive policies, however, still seemed to be marginal in terms of the degree of offsetting import substitution. Regional preferential policies, foreign exchange retention system, and secondary foreign exchange market (FEACs, Foreign Exchange Adjustment Centres) were only put into practice on an experimental basis.

Stage II: Export promotion neutralizing import substitution (1984-1990)

In the mid-1980s, export promotion measures, mainly including export tax rebate, export subsidy, foreign exchange retention quota and multiple exchange rates system, were formally established and gradually generalized nation-wide through the trade reform schemes implemented in 1984 and 1988.[4] However, import trade barriers, quota and licensing requirements in particular, still remained high. In addition, real exchange rate was overvalued about 32% in average due to the hyperinflation that occurred in 1985 and 1988, and the discrepancy between official exchange rate and FEACs rate were increasing considerably from 1986 to 1990.[5] Thus, the trade development strategy in this period could be defined as “export promotion neutralizing import substitution” or “protected export promotion” under which both exportable and importable sectors were fostered to expand at the expense of non-trade sectors. However, the overall trade orientation at the period was still biased towards import substitution in the economy.

Such dual-structure incentive measures are strongly related to the political economy of China’s economic reform in the mid of 1980s. Owing to complicated political constraints, the perspective of China’s economic reform still looked ambiguous and uncertain with a lack of consensus over the proper course among senior party leaders. Under such circumstances, it is politically wise to proceed reforms by following an evolutionary, experimental and incremental approach. Therefore, the trade development strategy of “protected export promotion” exactly accommodated to the situation. Specifically, new interest groups of export sectors were encouraged to grow, while inefficient state-owned industrial sectors were still shielded from the external

[3] Sheng Bin, *Political Economy of China's Foreign Trade Policy*. Shanghai: Shanghai People’s Press and Shanghai Sanlian Press, 2002.
[4] Yang Shujin, Zhu Tong, and Sheng Bin, *China's Foreign Trade Reform*. Guiyang: Guizhou People’s Press, 1998.
[5] Sheng Bin, *Political Economy of China's Foreign Trade Policy*. Shanghai: Shanghai People’s Press and Shanghai Sanlian Press, 2002.

competition in the traditional regime of import substitution. Such strategy seemed more politically sustainable and economic viable than radical trade import liberalization.

Stage III: Export promotion and marginal trade liberalization (1991-1993)

With the increasing efficiency and competitiveness of Chinese economy, the significant trade policy changes happened in 1991. Much bolder trade liberalization was launched to reduce tariff rates, import mandatory plans, import quotas and licenses. Furthermore, import adjusting duty, export subsidies and import substitution measures were declared to be eliminated. The price system turned more sound through trade liberalization, and production and trade pattern became more "natural" in economic sense. The economic distortion was gradually lessoned.

However, the level of trade protection still remained high, if compared to the international level. The average applied tariff rate was 43%, and the coverage ratio of non-tariff barriers was 51%.[6] The restrictiveness and distortion of foreign exchange control system remained unfavourable to export sectors. The real exchange rate of RMB was overvalued about 44% in average. Additionally, export licensing requirement and export tax system were consolidated in enforcement to relieve export dumping and low-price competition in international market.

Stage IV: Radical trade liberalization (1994-2001)

China Communist Party (CCP) announced to establish "the Socialism Market System with Chinese Characteristics" in 1992[7]. It provided a more creditable, predicable, and foreseeable commitment to pursue market-oriented economic reforms. Since then, the central government launched a series of massive reforms, including finance, banking, budget, taxation, trade, state-owned enterprises, administrative organizations, etc. Under such circumstances, it was the high time for China to start a more radical trade liberalization process. Meanwhile, the Chinese delegation began formal and substantial trade negotiation with main GATT contracting parties in order to resume its "legal status in the GATT"[8] (later changed into "the accession to WTO" after WTO was founded in 1995), so that China had to address seriously market access requirements raised by trade partners.

In 1994, the Chinese government promulgated the *Foreign Trade Law* that laid out the legal foundation for modern Chinese trade policy regime.[9] A number of trade

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[6] World Bank, *China Foreign Trade Reform: Meeting the Challenge of the 1990s.* Washington D. C., 1993.

[7] The Chinese government made its explicit intention to establish a outward-oriented "socialist market economy" regime set by the 16th National Congress of the Communist Party in October 1992. The new goal was manifested in the Memorandum on China's Foreign Trade Regime (L/6125) drafted by the GATT Working Party in the same year, which deems to be a watershed between the conclusion of China's trade policy review and launching specific market access negotiations.

[8] China began negotiations on the resumption of its status in the GATT in 1986.

[9] The major Chinese trade-related laws and regulations are listed in Appendix Table1.

reform measures were taken to meet internal targets and external pressures. Not only the average level of trade barriers was significantly reduced, but the protection structure was adjusted to tend to be "trade neutral" as well. Producers, therefore, could calculate their input and output at international prices and substitute capital and intermediate goods into cheaper labours in production[10]. More significant reforms occurred to the foreign exchange system. The current account was completely liberalized in 1997, which made China eventually meet the IMF's standard of eliminating foreign exchange control. The dual exchange rate system was also abolished by merging into a unified, managed and floated rate in 1994. It actually depreciated RMB nearly 50 percent in official rate, which remarkably reduced over-valuation of RMB and increased currency competitiveness for Chinese exports.

Stage V: Fulfilling commitments to access to WTO and continued trade liberalization (2002-2005)

China became a formal member of the WTO in December 2001. From 2002 to 2005, China fully implemented WTO commitments and effectively promoted the well-designed, market-oriented and rule-based economic and trade liberalization, which led to a significant increase on the transparency of trade laws and regulations as well as the management of trade policies.

The most striking reform was the amendment of the *Foreign Trade Law* in December 2004. According to the new law, trade approval system was cancelled[11], and all domestic enterprises and individuals could enjoyed trading rights of exports and imports, which were only entitled to foreign enterprises and some selected large state-owned enterprises and monopolistic trade companies. The "designated trade" approach was also abolished in 2003, and the transparency of import and export purchase procedures of state trading enterprises was improved, in particular by providing information of pricing mechanism of state trading.

In terms of legal and policy framework, a large number of trade-related laws and regulations were reviewed and revised, including the central government regulations, implementation details, local and interim regulations, so as to abolish all national treatment regulations and measures which were inconsistent with the WTO. Procedures and institutions of judicial review of administrative action were also established. If any party is not satisfied with a decision, the case may be reviewed under the *Administrative Reconsideration Law*, or an appeal may be made to the court. In addition, *Administrative Permission Law*, which provided an overall legal and administrative framework for China's WTO commitments, was implemented since

[10] World Bank, *Globalization and China's Integration into the World Economy*. Washington D. C., 1997.

[11] However, the right to trade of goods distribution in China was still not automatically granted to importers, and distribution services were to be open in accordance with the GATS schedules of specific commitments.

2004.[12] They significantly increase transparency, consistence and coherence of trade policy and measures.

China also took steps to implement numerous specific market access commitments pursuant to schedules set forth in the WTO accession agreement, including reducting tariff rates, eliminating non-tariff barriers, and expanding services market access for foreign providers.[13] Specifically, China bound all tariff lines and average applied MFN rate dropped from 15.6% in 2001 to 9.7% in 2005, with the manufactured goods tariffs declining from 14.3% to 8.9%, and agricultural products decreasing from 23.2% to 14.6% during the same period. Some sectors such as automotive and auto parts, textiles and clothing, and IT products were particularly experiencing large tariff reductions. In terms of non-tariff barriers, most of import licenses, import quotas and specific tender requirements were removed before January 2005. Import licensing procedures was simplified, and new import licensing system came in force mainly for the environmental, health and safety purpose. Tariff quotas remained only for certain agricultural products and fertilizer trade. Restrictions on textiles and electromechanical products were also canceled. Furthermore, all trade-related investment measures, including foreign exchange balancing requirements, local content requirements and export performance requirements in previous FDI laws and regulations were completely removed according to the WTO TRIMs agreement. Finally, China made extensive service liberalization commitments beyond the average of developing countries, covering more than 100 sectors over 160 sectors in the GATS list, particularly in the areas of great commercial significance such as banking, securities, insurance, telecommunications, retail and distribution services. National treatment was implemented in all service sectors except for subsidies and restrictions on movement of natural persons for some domestic service providers. All service management agencies were regulated independently from service providers, except express delivery and rail transportation. All of these steps were of great importance to deepen China's integration into the international trading system, as well as to facilitate and strengthen China's economic reforms.

China also showed impressive willingness to adhere to the new rules of trade-related intellectual property rights (IPRs) compromised in the Uruguay Round. China revised several pieces of legislation, including the *Copyright Law*, the *Patent Law* and the *Trademark Law*, to achieve an appropriate balance between the protection of IPR and the promotion of competition. The enforcement of IPR protection was strengthened, although questions remained about the sufficiency of fines and criminal penalties to deter IPR violations.

<u>Stage VI: Trade policy adjustment and growth pattern transformation (2006-2008)</u>

[12] WTO Secretariat, *Trade Policy Review Report: People's Republic of China*, WT/TPR/S/161, 2006.

[13] Following information and data in this paragraph is abstracted from WTO Secretariat, *Trade Policy Review Report: People's Republic of China*, WT/TPR/S/161, 2006.

China's momentum towards trade liberalization reform began to slow down since 2006, because of domestic criticism about China's weakness in its WTO negotiations[14] and a lack of consensus within China's government on priorities of economic market-oriented reform, particularly on how to deal with state-owned enterprises. During the period, the average tariff rate was not significantly further reduced. More tariff quotas were, however, abolished and in 2008 only very limited goods, such as grain, sugar, wool, cotton and fertilizer, were subjected to tariff quota restriction. [15]

With the dismantling of trade barriers in Chinese export markets after accession to WTO, China's exports boomed rapidly, and therefore caused a huge rise of trade surplus. The share of current account surplus to GDP reached the historical peak, 11%, in 2007. Under such circumstances, China had to promote trade growth pattern transformation in order to address domestic inflation and international pressure brought by huge trade surplus. One of critical trade policy adjustment was to strengthen export restrictions on industrial goods and some agricultural products, including those using large amounts of natural resources, high energy consumption, high pollution and low technology content. The main measures include: increasing export taxes, lowering rebates of VAT on exports, increasing export quotas and licensing, enlarging product catalogue of prohibited processing trade.[16] These policies played an essential role of upgrading export industries, reducing trade friction, ensuring domestic supply and achieving sustainable development.

During 2006 and 2008, trade frictions between China and its trading partners were getting increasingly serious. There were 12 cases with China as defender reported in the WTO dispute settlement mechanism. The US, EU, Canada, Mexico and other countries requested for consultations on China's auto parts import, tax exemptions and implicit subsidies of domestic companies, IPR legislation and enforcement, trading and distribution rights of audio-visual products, preferential loans and other incentive measures. For most of cases, China finally accepted the WTO panel's decision and revised or abolished policies that were found to be WTO-inconsistent. [17]

<u>Stage VII: Addressing and recovering from the global financial crisis (2008-now)</u>

Financial turmoil broke out in the midst of 1998, and it soon exerted a negative

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[14] Chinese political leaders had to respond to the public idea that China's national interests were sold out in the WTO negotiation. According to the Protocol, China was compelled to agree to permit WTO members to use discriminatory and transitory measures to constraint Chinese exports. They include: a special selective safeguard which could be used against Chinese exports for twelve years after the accession; an additional safeguard provision for China's textiles and apparel experts which would be in force until the end of 2008; a non-market economy status for the purposes of anti-dumping rules until the end of 2015; a Transitional Review Mechanism which would review China's implementation record annually for the first ten years of its membership.

[15] WTO Secretariat, *Trade Policy Review Report: People's Republic of China*, WT/TPR/S/199, 2008.

[16] WTO Secretariat, *Trade Policy Review Report: People's Republic of China*, WT/TPR/S/199, 2008.

[17] WTO, *WTO Dispute settlement Database*, http://www.wto.org/english/tratop_e/dispu_e/find_dispu_cases_e.htm#results.

impact on China's trade situation. Exports fell for the first time since July 2001, while imports also decreased rapidly. Trade balance turned from surplus to deficit, which caused an unprecedented negative contribution to economic growth. Facing such a deteriorating condition, the priority of China's trade policy changed from curbing trade surplus to stabilizing external demand and stimulating internal demand.

On one hand, China took steps to stabilize exports by promoting trade financing and trade facilitation, loosening export control and enhancing rebates of VAT on exports. China's exchange rate regime was temporarily restored into the previous system of pegging to US dollar, and the authority stopped the RMB appreciation that had kept on since 2005. Cross-border RMB clearance pilot program and currency swap arrangement were also implemented since April 2009. In addition, the regulation of outbound FDI was relaxed and its approval procedure was simplified.[18]

On the other hand, China took some temporary actions of import protection to buffer shocks of financial crisis. Preferential tariff rates on some goods were canceled temporarily. The government enlarged the automatic licensing list of import goods. Trade remedy measures were launched more frequently than before. Public procurement in the huge fiscal stimulus was preferred to purchasing domestic products and services by administrative instructions. Several new laws and regulations were promulgated to protect domestic industries (for example, a new postal laws was enacted to protect domestic courier service sector). However, those trade restrictive measures which were introduced by China after financial crisis were essentially moderate if compared with other countries.[19] The process of trade liberalization was not reversed by the global economic recession. Actually, during the financial crisis, China still maintained her pace of trade liberalization, such as announcing of a new action plan of IPR protection in 2008, offering national treatment in the area of government procurement for foreign companies, and deepening service openness in tourism and financial information sectors.

China's trade policy adjustments successfully helped her to go through the global crisis and improve the trade performance, especially on the outset of crisis. With the gradual recovery of world economy and external demand, China's foreign trade turned to a positive growth in November 2010, and achieved a rapid growth since 2011.

II. Current objective and institutional structure of China's trade regime

According to the *Foreign Trade Law*, China's main trade policy objectives are to accelerate its opening to the outside world, develop foreign trade, and promote sound economic development. To meet these objectives, the Government intends to: increase manufacturing value added and ensure continued growth in exports and, in

[18] Policy information is gathered from various source of official announcement.
[19] OECD, WTO and UNCTAD, *Report on G20 Trade and Investment Measures*, March 2010.

this regard, "effectually" import energy, key raw materials, technologies, and equipment, and reform customs and port clearance procedures; utilize foreign capital to improve industrial structure and technological capabilities, including by encouraging FDI in new and high-technology industries, modern services, agriculture, and the central and western regions; and to encourage qualified domestic companies to invest abroad including by giving them more credit, insurance, and foreign exchange support and to strengthen "guidance and coordination for enterprises investing abroad".[20]

China is dedicated to achieve these trade policy objectives by means of multi-tracks, namely, multilateralism, bilateralism, regionalism and unilateralism.

Firstly, China wishes to achieve this trade policy objective by further strengthening the multilateral trading system as embodied in the WTO, and has been actively participating in the *Doha Development Agenda* (DDA) negotiations. Since its accession to WTO, China has fully honored its extensive commitments of the WTO accession and made important contributions to safeguarding the multilateral trading system. China has earnestly and actively participated in the daily operation of the WTO and supported the WTO in launching the monitoring and surveillance of trade measures against protectionism since the outbreak of the international financial crisis. China has repeatedly stressed its intention to make every effort toward reaching agreement in the on-going negotiations. China has applied for membership to engage in the negotiation of *Trade in Service Agreement* (TISA) and is engaged in the expansion of the *Information Technology Agreement* (ITA II), playing a constructive role in promoting the initiative of *Environment Goods Agreement* (EGA), and endeavoring to achieve an earlier accession to the *Agreement on Government Procurement* (GPA).

Secondly, China has been intensifying its pursuit of bilateral/regional arrangements involving free trade agreements (FTAs), which China believes to serve as new platforms and complement the multilateral trading system. China considers that an FTA can provide an institutional guarantee to the development of bilateral/regional trade and economic relations and benefit businesses and consumers in the participating countries and economies, by helping expand trade, achieve market diversification, reduce consumer prices, lower producer costs, drive economic growth and create new job opportunities. China continues to promote trade and investment liberalization and facilitation through regional, sub-regional and bilateral opening up and cooperation. These include 12 signed bilateral FTAs or closer economic partnership arrangements (CEPAs) with 20 countries and areas; 6 FTAs with 22 countries and regions under negotiations; sub-regional economic cooperation mechanisms such as the China-Japan-Korea FTA negotiations, "10+X" regional cooperation schemes and the Regional Comprehensive Economic Partnership (RCEP)

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[20] Extract from the Government report to the National People's Congress, presented by Premier Wen Jiaobao in March 2005.

initiatives with ASEAN and other Asia-Pacific economies. Recently, China has launched new initiatives to further open up inland and border areas, speed up the construction of infrastructure connecting China with neighbouring countries and regions, and accelerate its logistics and transportation cooperation with the countries along the "Silk Road Economic Belt" and the "Maritime Silk Road". Financial institutions and resources have been established to implement these national and regional development strategies. Finally, bilateral investment treaty negotiations with other countries and regions will be expedited, particularly with the US and EU to reach a high-quality agreement addressing pre-establishment national treatment, negative list, competitive neutrality, and state-investor dispute settlement mechanism.

Thirdly, the Chinese Government has launched a new round of reform in a most profound and comprehensive fashion, and promoting opening up process an important objective among other tasks. Since its accession to the WTO, China has largely established an economic and trading system both in line with its national conditions and in conformity with international rules. The Chinese Government will push forward a new round of high standard opening-up, particularly in areas of services sector, capital account liberalization and deregulation. China will also focus on unifying laws and regulations on domestic and foreign investments, exploring a regulatory model based on negative list approach, and creating a fair and competitive business environment for both domestic and foreign investors. The Third Plenary Session of the 18th National Congress of the Communist Party of China (CPC) held in November 2013 approved a *Decision on Major Issues Concerning Comprehensively Deepening Reforms*, which calls for the construction of a united and open market system with orderly competition that will play a decisive role in allocating resources. The CPC also worked out a detailed roadmap and a time-frame for the implementation of the reforms. To this end, 330 major reform measures covering 15 areas have been set. The main part related to trade policy is "establishing an open economic system". According to the Decision, further liberalization will be achieved in general manufacturing, and the streamlining of special customs supervisory areas will be accelerated. Service sectors such as finance, education, culture and medical sectors will enjoy an orderly opening-up to market access, while nursery, pension, architecture design, accounting and auditing, trade and logistics, and e-commerce restrictions will be eased. In addition, enterprises and individuals will be encouraged to invest overseas through greenfield investment, mergers and acquisitions, equities and joint investment. The Decision also stresses that reforms will be carried out in market access, customs supervision and inspection and quarantine management. Emerging issues such as environmental protection, investment protection, government procurement and e-commerce will reach a high-quality global standard by accelerating bilateral and FTAs negotiations. Finally, construction of free-trade zones will be sped up. Based on practices in the China (Shanghai) Pilot Free Trade Zone (FTZs), three new FTZs, Guangdong, Tianjin and Fujian, have been recently approved by the central government.

III. Assessment of China’s selected key trade policy measures

Tariffs

Since China joined the WTO, its average applied MFN tariff rates have been close to its bound rates. China bounds 100% of its tariffs, at ad valorem rates ranging from 0% to 65% for agriculture products and from 0 to 50% for non-agricultural products[21]. The average applied MFN rate in 2013 was 9.4%, reduced remarkably since 2001 when the average stood at 15.6%. The tariff continues to be higher for agricultural products at 14.8%, showing a significant decline from the average of 23.1% in 2001. The average tariff on non-agricultural products has changed from 14.4% in 2001 to 8.6% in 2013. The percentage of tariffs that exceeded 15% (international tariff peaks) has declined slightly to 14.4%, down from 40.1% in 2001.[22] These indicate the great achievements of import liberalization during past fifteen years since China acceded to the WTO.

On the other hand, the distribution pattern of China’s applied MFN tariff has not changed substantially. The dispersion in applied MFN rates, indicated by the coefficient of variation, has remained unchanged since 2005, at 0.8%. Some 40% of all tariffs ranged from 5% to 10%, unchanged since 2001. But the percentage of duty free tariff lines to all lines increased from 3% in 2001 to 9.8% in 2013, while the percentages of lines with duty higher than 25% was reduced from 10% to 2.2% during the same period.[23] Furthermore, China's overall tariff is subject to negative escalation between unprocessed and semi-processed products and escalation between semi-processed and fully processed products, which suggests that imports of semi-processed products would face lower tariff barriers than raw materials and fully processed goods. Although the overall average tariff rate has declined since 2001, the pattern of escalation has remained low and largely unchanged.[24]

There are considerable variations within the bound and MFN applied tariff rates by sector, which shows import sensitivity of some sectors or products for the sake of national economic security, industrial development and strategic protection. Found in the Table 1, some agricultural goods (such as cereals, sugars, tobacco and cotton) are levied high tariffs in China. Several non-agricultural sectors are facing tariff peaks (maximum tariff rate is three times higher than average tariff) with very low duty-free share of imports, including chemicals, machinery and transport equipment (automobiles in particular), which are found to be very competitive for the exports of industrialized countries.

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[21] The classification of agriculture products and non-agricultural products is in WTO definition.

[22] WTO Secretariat, *Trade Policy Review Report: People’s Republic of China*, WT/TPR/S/161, 2006; WT/TPR/S/300, 2014.

[23] Ibid.

[24] The negative escalation is especially pronounced between semi-processed and processed products in food, beverages and tobacco sector, and between unprocessed and semi-processed products in textiles and clothing sector.

Table1: China's tariff structure (2013)

Product groups	Final bound duties				MFN applied diuties			Imports	
	AVG	Duty-free in %	Max	Binding in %	AVG	Duty-free in %	Max	Share in %	Duty-free in %
Agricultural products									
Animal products	14.8	9.4	25	100	14.1	13.8	25	0.3	4.6
Dairy products	12.2	0	20	100	12.3	0	20	0.2	0
Fruit, vegetables, plants	15.0	4.8	30	100	14.8	4.9	30	0.4	1.6
Coffee, tea	14.9	0	32	100	14.9	0	32	0.1	0
Cereals & preparations	23.7	2.6	65	100	23.0	8.8	65	0.4	0
Oilseeds, fats & oils	11.6	6.2	30	100	10.9	9.1	30	1.1	0.2
Sugars and confectionery	27.4	0	50	100	28.7	0	50	0.0	0
Beverages & tobacco	23.9	2.4	65	100	23.5	2.1	65	0.3	3.1
Cotton	22.0	0	40	100	22.0	0	40	0.8	0
Other agricultural products	11.9	10.3	38	100	11.8	8.5	38	0.6	2.7
Non-agricultural products									
Fish & fish products	11.0	6.6	23	100	10.6	5.0	23	0.3	0.0
Minerals & metals	8.0	5.7	50	100	7.8	5.9	50	21.4	47.3
Petroleum	3.3	50.0	9	100	5.3	16.7	9	16.1	88.2
Chemicals	6.7	0.5	47	100	6.8	0.4	47	11.3	0.9
Wood, paper, etc.	5.0	23.0	20	100	4.5	35.8	20	2.6	84.8
Textiles	9.7	0.2	38	100	9.6	0	38	1.4	0
Clothing	16.2	0	25	100	16.0	0	25	0.2	0
Leather, footwear, etc.	13.7	0.7	25	100	13.5	0.6	25	1.8	0.2
Non-electrical machinery	8.4	7.9	35	100	8.2	9.2	35	9.9	37.3
Electrical machinery	8.8	26.6	35	100	8.9	23.9	35	18.4	85.7

Notes:

Source: WTO, World Tariff Profiles, 2014.

Non-tariff barriers

China has three categories of imports: permitted, restricted and prohibited. Most imported goods fall under the category of permitted. However, even these imports may be subject to automatic licenses to monitor their volume for statistical purposes. Ministry of Commerce (MOFCOM) and the General Administration of Customs of the People's Republic of China (GACC) jointly issue an annual *Catalogue of Goods subject to Automatic Licensing*. In 2013, there were 442 tariff lines at the HS 8-digit level included in this Catalogue. Restricted goods are administered through non-automatic licenses and/or quotas. Import restrictions are maintained because of public security and welfare, and to protect exhaustible natural resources. MOFCOM together with the GACC and the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), issue a *Catalogue of Import Goods Subject to Licensing*. In 2013 there were 86 lines at the HS 8-digit level subject to non-automaticimport licensing. China maintains import prohibitions on the following grounds: state security; public morality; human, animal and plant health; environmental protection; balance-of-payments reasons. Prohibited products are listed in the *Catalogue of Commodities Subject to Import Prohibitions*, issued by MOFCOM and other relevant ministries. Currently, 543 tariff lines at the HS 8-digit level were prohibited in 2013. All import prohibitions, restrictions, and licensing comply with prevailing WTO rules and international commitments, except iron ore licensing procedures and tariff-rate quota system for fertilizer and cotton, which the US raised its concerns in the bilateral dialogue[25].

Chinese trade authority conducts trade remedy investigations, including antidumping (AD), countervailing (CA) and safeguard measures, to maintain a fair competitive environment and a normal trade order. The number of anti-dumping measures in China has declined slightly in recent years, and initiations of anti-dumping investigations by China fell from 8 in 2010 to 5 in 2011, but increased to 9 in 2012 and 11 in 2013. China had 113 AD duty orders in effect by the end of 2013, slightly down from the 117 measures reported in 2010. Moreover, during 2011 and 2013, China only initiated three CV investigations, and didn't initiate any safeguard investigations pursuant to the related WTO agreement.[26] Some WTO members pointed out that China still needs to issue additional procedural guidance such as rules governing expiry reviews, and eliminate its apparent use of trade remedy investigations as a retaliatory tool.

<u>Trade Facilitation</u>

As regards custom procedure, in order to facilitate trade, China has launched a series of reforms to make customs procedures more efficient and streamlined both for imports and exports. In 2006 China launched "E-Port" initiative, an electronic platform that operates as a "single window" in 13 major port authorities. Through the "single window", traders can file on-line customs declarations and make payments in foreign exchange of duties. In 2009, China launched a pilot programme on the Reform of Classified Customs Clearance, which aims to classify imports and exports according to risk level of enterprises based, inter alia, on credit rating, and compliance with the law. Enterprises with a higher ranking will benefit from more relaxed customs clearance procedures and can make customs declarations and have goods released at destination. In 2012, China also started implementation of the Reform of Paperless Customs Clearance to cover imports and exports via air, sea and land. [27] However, some trade partners are concerned about inefficient and inconsistent

[25] United States Trade Representative, *Report to Congress on China's WTO Compliance*, 2014.
[26] WTO Secretariat, *Trade Policy Review Report: People's Republic of China*, WT/TPR/S/300, 2014.
[27] Ibid.

issues such as different custom procedures varying from port to port, lengthy delays of clearance, and excessively charged fees. [28]

With regard to standard requirement and product certification, China has made great efforts to bring its standards regime, including technical trade barriers (TBT) and sanitary and phyto-sanitary (SPS) requirements, more in line with international practice after its accession to the WTO. One of its critical steps was to issue rules of reviewing all existing standards and technical regulations and then designed to facilitate China's adoption of international standards. However, major trade partners have expressed their concern that China is allegedly continuing to pursue the development of unique Chinese national standards, apparently as a means for protecting domestic companies from competing foreign technologies and standards.

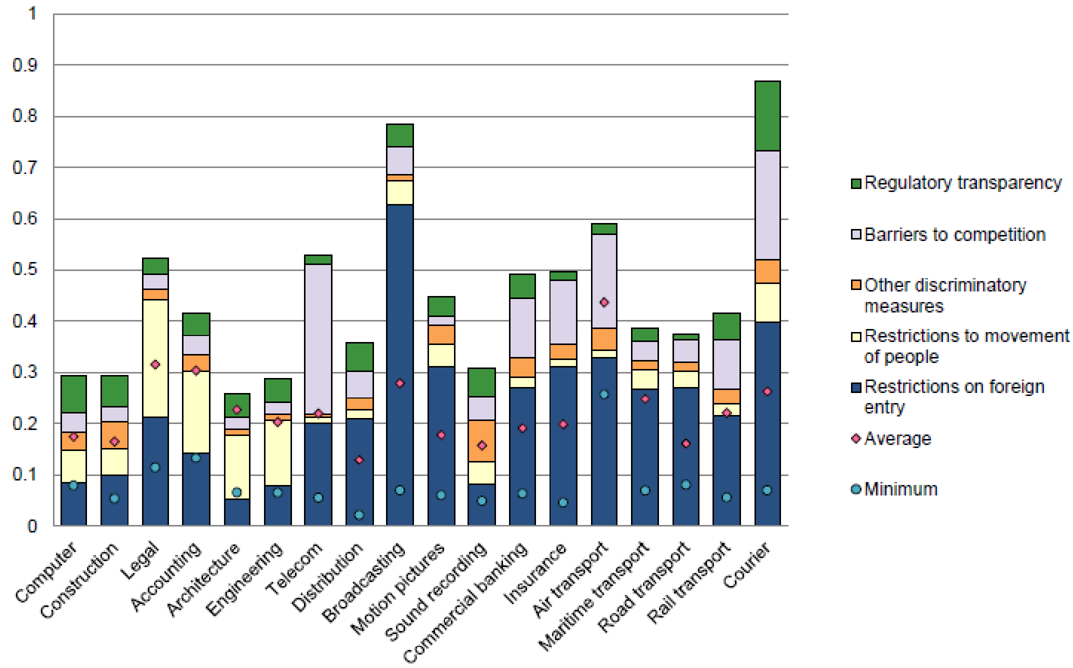
Servics

Given the size of China's huge market and the Chinese leadership's stated intention to promote the growth of China's services sectors, China has consistently pursued the market openings of services by pursuant to its WTO commitments, and deepened regulatory reforms that go beyond the WTO commitments.

We evaluate the degree of China's service liberalization by Services Trade Restrictiveness Index (STRI) developed by OECD[29]. The STRI indices take the value from 0 to 1, where 0 is completely open and 1 is completely closed. They are calculated on the basis of information in the STRI database which reports regulation currently in force. China's score on the STRI index in the 18 sectors is shown in the Chart 1, along with the average and the lowest score among the 40 countries included in the STRI database for each sector. Apparently, China's service trade restrictiveness is higher than global average in all sectors. The least restricted sectors covered by the STRI in China are architecture, engineering and computer services. However, these sectors still score above average. Courier, broadcasting, air transport, telecom and legal service are most protected. In terms of restrictive measures, restriction on foreign entry (FDI) is the most widely-used barriers in service sectors, followed by barriers to competition and regulatory transparency.

Chart 1. Services Trade Restrictiveness Index (STRI) of China by sector and policy area (2012)

[28] United States Trade Representative, *Report to Congress on China's WTO Compliance*, 2014.
[29] The methodology and data explanation of Services Trade Restrictiveness Index (STRI) are referred to http://www.oecd.org/trade/services-trade-restrictiveness-index.htm.



Note: The STRI indices take values between zero and one, one being the most restrictive. They are calculated on the basis of the STRI regulatory database which contains information on regulation for the 34 OECD Members, Brazil, China, India, Indonesia, Russia and South Africa. The STRI database records measures on a Most Favoured Nations basis. Preferential trade agreements are not taken into account. Air transport and road freight cover only commercial establishment (with accompanying movement of people).
Source: OECD

Those restricted service sectors and restrictive measures reflect numerous remaining challenges for China. China has to continue to dismantle discriminatory regulatory measures, informal bans on entry and expansion, various restrictions on the cross-border supply of services, overly burdensome licensing and operating requirements, and other means to frustrate foreign service suppliers of banking, insurance, telecommunications, Internet-related, audiovisual, express delivery, legal and other services to achieve their full market potential in China. In addition, China also has to address trade disputes of some service sectors with other main trade partners, such as electronic payment services and theatrical film distribution, which are subject to the WTO dispute settlement.

Export restraints

The Chinese government may restrict or forbid the exportation of any product to maintain national security and public morality, protect the environment, protect exhaustible natural resources that are in short supply, and organize "export business management". Exports may also be restricted or forbidden in order to comply with international treaties or agreements that China has signed. The special international attention focuses on the trend that China continues to deploy a combination of export restraints, including export quotas, export licensing, minimum export prices, export duties and other restrictions, on a number of raw material inputs. Given the fact that China is the leading world exporter of these certain products, application of export controls could have an impact on world prices of these products. Many countries are concerned that China is able to provide substantial economic advantages to a wide range of downstream producers in China at the expense of foreign downstream producers, while creating incentives for foreign downstream producers to move their operations, technologies and jobs to China. [30] Recently, China removed its export quotas and duties on several raw material inputs of key interest to the U.S. steel, aluminum and chemicals industries after the U.S. won a dispute settlement case against China at the WTO. Besides, China's export restraints on rare earths, tungsten and molybdenum, which are key inputs for a multitude of high technological products, are also under great pressure of some WTO members.[31]

Regulatory reforms and next generation of trade policy measures

With the significant reduction of on-border protection and rising new international production system featured in global value chain, the central piece of trade negotiation has gradually shifted to behind-the-border measures, or so-called "second generation (or next) of trade policy", which focuses on regulatory coherence and structural reforms. Particularly, a couple of mega regional trade negotiation, TPP and TTIP for example, are under the way with an ambition to conclude a brand-new, golden standard, and high-quality FTA agreement covering a variety of emerging trade issues on behind-the-border measures. We use the method developed by Horn, Mavroidis and Sapir[32], which is widely quoted in the literature (including works of the WTO[33]) to classify trade policy measures or areas into two categories, namely, "WTO+" and "WTO-X", based on the legal clauses in FTAs/RTAs that have been signed or in effect. WTO+ includes 14 areas with those provisions which are under the current mandate of the WTO, while WTO-X covers 38 areas that, though beyond the current the WTO legal framework, are intensively adopted and committed at the regional and bilateral level[34].

Following the HMS method, we calculate the percentages of average covered (AC) and legally enforceable (LE)[35] of main WTO-X provisions of China and compare

[30] U.S. Trade Representative, *National Trade Estimate Report on Foreign Trade Barriers: China*, 2014.
[31] WTO Secretariat, *Trade Policy Review Report: People's Republic of China*, WT/TPR/S/300, 2014.
[32] Horn, H., P. C. Mavroidis, and A. Sapir, *Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements*, Bruegel Blueprint Series, Volume VII, 2009.
[33] WTO, *World Trade Report*, 2011.
[34] WTO+ issues include: industrial goods, agricultural goods, customs administration, export taxes, SPS,TBT, state trading, antidumping, countervailing, state aid, public procurement, TRIMS, GATS, TRIPS. WTO-X issues include: competition policy, movement of capital, investment, environmental laws, IPR, labor market regulations, consumer protection, data protection, agriculture, audio visual, mining, anti–corruption, civil protection, cultural cooperation, approximation of legislation, innovation policies, economic policy dialogue, education and training, energy, financial assistance, health, human rights, illegal immigration, illicit drugs, money laundering, nuclear safety, political dialogue, industrial cooperation, information society, public administration, regional cooperation, research and technology, small and medium enterprise, social matters, statistics, taxation, terrorism, visa and asylum. For the detailed descriptions of these areas, please refer to Horn, H., P. C. Mavroidis, and A. Sapir, *Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements*, Bruegel Blueprint Series, Volume VII, 2009.
[35] The percentage of average covered is a ratio of the number of FTAs/RTAs literally covering certain WTO-X provision to the total number of all FTAs/RTAs. The percentage of legally enforceable is a ratio of the number of FTAs/RTAs covering certain legally binding WTO-X provision to the total number of all FTAs/RTAs.

them with those of other major Asia-Pacific economies, on the basis of related clauses in FTAs/RTAs (Table 2). The percentages reflect the quality of trade agreements in terms of second generation of trade policy. The result indicates that the total ratios of both average covered and legally enforceable for China are much lower than those of Asia-Pacific countries in average, particularly of the U.S., Japan and Korea. China's overall commitment to WTO-X provisions is only similar to that of ASEAN countries. As regards specific WTO-X areas, China has only had some progress in investment, IPR, and financial assistance, while there are very low (or even zero) commitments in such areas as competition policy, movement of capital, environmental laws, IPR, labor market, E-commerce, regulations, and consumer protection, which seem to be critical issues of high-quality FTAs in the 21st century.

Table 2. Comparison of WTO-X Provisions Signed by China and other major Asia-Pacific Economies in FTAs/RTAs

	China		U.S.		Japan		Korea		ASEAN		Asia-Pacific	
	AC	LE	AC	LE	AC	LE	AC	LE	AC	LE	AC	LE
Competition	20%	20%	100%	83%	91%	36%	100%	80%	60%	0%	82%	57%
Capital movement	20%	0%	17%	17%	73%	18%	80%	20%	20%	0%	42%	13%
Investment	100%	100%	100%	100%	100%	100%	100%	100%	80%	80%	98%	98%
Environment	20%	0%	100%	83%	82%	0%	100%	40%	40%	0%	58%	20%
IPRs	60%	60%	100%	100%	91%	73%	100%	60%	60%	67%	78%	69%
Labor market	0%	–	100%	83%	36%	0%	40%	40%	0%	–	36%	23%
E-commerce	0%	–	83%	66%	9%	0%	60%	40%	20%	20%	38%	25%
Energy	20%	0%	33%	33%	82%	0%	80%	20%	40%	0%	40%	7%
Regulations	0%	–	100%	83%	91%	46%	100%	100%	60%	40%	76%	58%
Financial assistance	100%	80%	100%	100%	91%	73%	100%	80%	60%	40%	89%	71%
Education	80%	0%	17%	17%	73%	37%	80%	0%	80%	20%	58%	16%
Nuclear	0%	–	33%	0%	55%	0%	60%	0%	40%	0%	27%	0%
Health	0%	–	33%	0%	73%	28%	80%	0%	0%	–	44%	9%
Mining	0%	–	17%	0%	55%	0%	40%	0%	20%	0%	31%	2%
Audio Visual	0%	–	33%	17%	45%	9%	40%	0%	0%	–	29%	7%
Information	60%	0%	67%	34%	82%	27%	80%	80%	20%	0%	64%	38%
R&D	40%	0%	50%	0%	91%	36%	100%	0%	20%	0%	60%	13%
SME	60%	0%	33%	0%	45%	0%	60%	20%	80%	20%	44%	4%
Social matters	0%	–	33%	0%	64%	0%	60%	0%	20%	0%	38%	0%
Visa	20%	20%	0%	–	64%	9%	40%	20%	20%	20%	36%	11%
Consumer protection	20%	0%	50%	34%	0%	–	80%	20%	20%	0%	29%	11%
Total	21%	8%	37%	24%	37%	35%	47%	21%	23%	8%	32%	15%

Note: "AC" as average covered. "LC" as legally enforceable. "-" as not applicable. This table doesn't show the provisions of which the coverage rate is less than 20%, including: legislation, industrial cooperation, fiscal policies, anti-corruption, political dialogue, human rights, taxation, innovation policies, illicit drugs, money laundering, public administration, regional cooperation, data protection, statistics and illegal immigration.

Source: Author's calculation based on WTO RTAs/FTAs database

IV. China’s trade policy decision-making and trade politics

Similar to other countries, the Chinese institutional decision-making process of trade policy is inevitably influenced by a variety of interest groups with Chinese characteristics, namely the central government, local governments, state-owned enterprises, business associations and other stakeholders. In China, though not officially recognized and institutionally legitimated, interest groups have become more active since the outset of economic reform. Notably, central administrative ministries and local governments have been playing as special kinds of pressure groups in China, due to their indispensable status in the delegated bureaucratic hierarchy. State-owned enterprises, private enterprises with government background and military, who are affiliated to governmental entities in various forms, usually lobby, influence, or bargain with the designated authority in an informal, nontransparent and behind-the-scene style. Moreover, with an increasing integration into the world economy, China is confronted with more and more demanding challenges of foreign interests, including a rule-based and institutionalized world trading system, international and regional collective actions, and bilateral economic dialogues and trade negotiations. Therefore, diplomatic strategy of foreign governments, trade politics of parties, commercial interest of multinational corporations and public opinion have imposed a profound impact on China’s trade policy-making process.

Central administrative ministries

The decision-making power of trade policy in China is substantially delegated to administrative body, namely, the State Council, instead of the legislative institution — the National People’s Congress (NPC), though all trade laws and regulations have to be ratified by the NPC. The State Council (the Central People's Government) is the executive body and the highest organ of state administration. It is often subordinated to the Central Finance and Economic Leading Group of the Chinese Communist Party (CCP), a special task force of CCP which is composed of only a few senior party leaders and in charge of all crucial economic issues in China. In the State Council, under the leadership of prime minister, there is generally a vice prime minister delegated to take responsibility of foreign trade, FDI and economic cooperation. The most important administrative organs that are in charge of trade affairs are the National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM). NDRC, which was previously called the State Planning Commission (SPC), is now in charge of devising the overall national economic and social development strategy and setting policies on economic reform and liberalization. MOFCOM, which evolved from the Ministry of Foreign Trade and Economic Co-operation (MOFTEC), has main responsibility for policy coordination and implementation of all trade-related issues, including negotiating international trade treaties on behalf of the Central Government. Other major Ministries involved in trade policy formulation and implementation include: Agriculture; Environmental Protection; Finance; Industry and Information Technology; Land and Resources; and Transportation. [36]

With the lack of a single and integrated system of trade policy-making, the Ministries concerned have to reach a flexible consensus through comprehensive discussion, coordination and bargain. In China, the process is called "guikou" (proper channel) and "zhengchuduomen" (a policy made by several institutions) and, in other words, is defined as "participatory bureaucracy" or "institutional pluralism"[37]. For example, the tariff is set by the Tariff Commission, which is an inter-ministerial body composed of, *inter alia*, officials from the Ministry of Finance, Customs, MOFCOM, the NDRC, and the State Council General Office. Bureaucratic fragment in the overlapping power-sharing systems occasionally result in disputes and conflicts among administrative agencies, and they have to submit problems to senior politicians in a higher hierarchy for final decision. Different ministries attempt to base their positions towards trade policy on the "natural" administrative function, official promotion system, special relation with the regulated business community and and other constituents, and even political corruption. The administrative structure may also pose a coordination problem in regard to the enforcement of trade policy. Therefore, the interagency coordination and consultation remains a major weakness in China's trade policy. Chinese delegation in trade negotiation is often disrupted by the internal bureaucratic infighting and challenging task of aggregating various domestic interests to define a consistent negotiating position.

Local governments

Since the reform, more and more decision-making powers have been decentralized to local authorities. Local governments in different levels also have their own economic and social development plans parallel to the central government. Local officials fully bear in mind the responsibilities for local constituencies and importance of economic performance, which are key to their political promotion. Thus, they are very concerned the effects of economic growth, employment, taxation, external shocks, income distribution and social justice induced by trade and FDI policies.

Owing to the piecemeal approach of open-door policy, eastern and coastal regions have had a dominating impact on China's trade policy formulation in the past three decades, because they account for a majority of foreign trade and FDI. However, with a national strategic shift to inland development, central and western regions, including border areas, are given more special and preferential treatment with regard to trade and FDI policies by the Central Government to achieve a balanced, inclusive and sustainable development. In addition, China Pilot Free Trade Zones (CPFTZs) that

[36] For the detailed description of the structure of administrative institutions related to trade policy, please see the Chart II in Appendix.
[37] Shirk, S. L., *The Political Logic of Economic Reform in China*. Berkley: University of California Press, 1993.

aim to unleash the benefits of reform and opening up through innovation in the governmental administration system have been deliberately established in Shanghai, Guangdong, Tianjin and Fujian. As the new frontier of economic reforms, they re-invigorate the mission of eastern and coastal regions to deepen trade reforms, focusing on the behind-the-border issues, such as trade facilitation, services, investment, financial and capital liberalization, and deregulation.

Business community and association

With the modernization and democratization in China, domestic enterprises witness a historical change of free expression of their commercial interests from an informal, scattered, and implicit style to a formal, organized, and explicit style, though such an expression should always be legitimate, cautious and moderate. Industrial associations and trade chambers, usually led by large state-owned enterprises, collect and share information, convey interests, identify problems, and offer advices of their industries to the designed ministries or local governments. To a large extent, they are still under a tight control and scrutiny of the authority.

There are a few formal venues for enterprises to influence trade policy formation, for instance, policy consultant conferences, hearings, working meetings, etc. However, most trade lobbying activities of business occur behind the scene in an informal, private, and secretive manner. The effect of lobbying or rent-seeking depends on not only the nature and status of individual enterprise and business association, but also its network ("guanxi") with government officials. In specific, there maybe acute differences between public enterprises and private enterprises, between large-size enterprises and small-size enterprises, between profitable enterprises and unprofitable enterprises, between large-tax-remittance enterprises and small-tax-payment enterprises, between coastal enterprises and inland enterprises, between upstream enterprises and downstream enterprises, between high technological enterprises and low technological enterprise, and between domestic enterprises and foreign-funded enterprises.[38]

Among all forms of enterprises, state-owned enterprises (SOEs) have been given special favourable treatment by being protected, subsidized and supported. Although the importance of SOEs in Chinese economy has steadily declined since the reform[39], they are still dominant or key players in some "pillar" industrial and service sectors, for example, iron and steel, coal, oil and petrochemicals, automotive, electric power, defense, banking, insurance, telecommunication, transport, postal service, and public utilities. Notably, after the establishment in 2003 of the State-owned Assets Supervision and Administration Commission (SASAC), which represents the state's

[38] Sheng Bin, Political Economy of China's Trade Policy: The Evidence from Industrial Protection in 1990s. *Frontiers of Economics in China*. Volume 1, No. 3, July, 2006.

[39] According to 2013 Chinese government statistics, the assets of state-owned enterprises account for 41 percent of the total assets of Chinese industrial enterprises, representing a significant decrease from the 1978 figure of 92 percent.

shareholder interests in state-owned enterprises, China has an obvious intent on heavily issuing a series of policies to “enhance the state-owned economy’s controlling power” and “encourage state-owned capital to concentrate in major industries and key fields relating to national security and national economic lifelines”[40]. In recent years, China has also expanded its SOE policy to cover “strategic emerging industries”[41]. Under such circumstances, any package of trade liberalization and regulatory reform has to consider consolidating and strengthening SOEs. It is also not surprising that those large SOEs are main obstacles to pushing radical trade liberalization and reaching international trade agreements.[42]

Another special pressure group of business are foreign-funded enterprises (FFEs) in China. They have long been offered preferential incentives in terms of trading rights, taxation, foreign exchange regulation, capital flow, etc. The Chinese authorities expects inbound FDI to contribute to fostering economic growth, increasing employment, upgrading technology and human resource, and promoting competition in domestic market. In the local level, FDI inflow is one of essential quantitative indicator of evaluating the political performance of leading officials. Hence, foreign investors are usually able to take full advantage of internal competition among regions or cities for better investment treatments that host government could provide. The problems and complaints of FFEs may also be resolved by the authority in priority.

Other stakeholders

Chinese consumers could obviously benefit a lot from trade liberalization by means of lower price, higher quality and more choice. Nevertheless, they have traditionally been very weak in the political process and therefore had little impact on the decision-making of trade policy. Although there exits the Chinese Consumers Association, a semi-official agency, its function has nothing to do with representing and articulating interest of consumers to lobby trade policy. Additionally, the “free-rider dilemma” and psychological ambivalence to import liberalization also nullify the collective force of Chinese consumers.

Unlike the well-organized and strongly influential farm interest groups in Japan, Korea and France, Chinese farmers seem never to play any significant role in trade policy decision-making by their own collective activities, in spite of their huge population approximately accounting for half of the total population in China. They are geographically scattered, socially depressed and hardly organized. However, both Chinese Central Government and local governments have a sharp concern on

[40] State Council, *Guiding Opinions on Promoting the Adjustment of State-owned Assets and the Restructuring of State-owned Enterprises*, December 2006.
[41] They include: new-generation information technology, high-end equipment manufacturing, advanced materials, alternative-fuel cars, energy-saving and environmental protection, alternative energy and biotechnology.
[42] The typical cases of opposing to trade liberalization reforms are PetroChina, Sinopec, ChinaTelcom, China Life Insurance.

accelerating agricultural modernization, promoting rural development, ensuring food security, and improving farmer's well-being. A number of border measures and internal measures have been taken to implement agricultural policy goals. As regards trade policy, the average applied MFN tariff on agricultural products (about 15%) remained relatively higher than non-agricultural products, and tariff rate quotas (TRQs) on some cereals, sugar, mineral, wool and cotton are maintained. Besides, China continues to use state trading to manage trade of some agricultural products. These trade measures serve to protect commercial interests of farmers as well as ensuring an adequate supply of food at stable prices, in coordination with some non-border measures, such as agricultural subsidies, minimum purchase price and farmers' training projects, construction of infrastructure and utilities, preventing epidemics, and agricultural insurance premium subsidy.[43]

V. Addressing the new challenges of China's trade reforms

According to the Chinese "Scientific Outlook on Development", China is now in the critical moment of economic transition from the traditional model of extensive, industry-based, investment and export-driven growth to the new model of intensive, service-based, consumption-driven growth. In terms of trade growth model, China would convert from the traditional pattern dependent on quantitative expansion, price competition, low-skilled processed trade to the new pattern of balanced trade, sustainable development, and benign coordination of internal and external demands.

However, China's economic and trade development transition are confronting some new challenges and constraints. They include: how to address new global trade protectionism that would restrict market access of China's exports and rising outbound FDI; how to address the demanding task of climate change and environmental protection in multilateral framework; how to overcome price volatility of energy and commodities, and the bottleneck of resource supply; how to accommodate domestic rising labour cost in the context of decreasing labour forces, aging, and Chinese newly released regulation on labour market[44]; how to positively contribute to global economic rebalance by further reducing trade surplus.

In 2013, China's new leaders came into power. There have been significant signs of showing a strong commitment and a high-level determination among new leaders to pursue further economic reform, which, if realized, would provide tremendous benefits not only to China but also to its trading partners.

It was a remarkable milestone that the CCP endorsed a number of far-reaching economic reform pronouncements in November 2013, calling for the market to play a "decisive" role in allocating resources, reducing Chinese government intervention in

[43] WTO Secretariat, *Trade Policy Review Report: People's Republic of China*, WT/TPR/S/300, 2014.
[44] *Labor Contract Law of the People's Republic of China*, which was enacted in 2007, was revised in 2012 and came into force in 2013.

the economy, accelerating China's opening up to foreign goods and services, reforming China's state-owned enterprises and improving transparency and the rule of law to allow fair competition in China's market. Some of these important pronouncements have already translated into actions that would significantly change China's trade regime. The broad policy direction is very encouraging.

In terms of trade policy reforms, China also needs a brand-new top-designing to implement the overall reform blueprint and roadmap. China should more focus on behind-the-border measures and regulatory reforms, or "the second generation of trade policies", than of on-border trade measures; on service liberalization than manufacturing sector; on bilateral, regional or plurilateral approaches of trade agreements on multilateral agreements. Meanwhile, China should also shift the focus of its FDI policy from general investment protection and preferential incentives to business facilitation and sustainable development. Finally, as for regional development policies that are closely related to trade development, China needs to stress on assets and business environment competition instead of factor and market competition, and deepening openness by launching new pilot reform areas (such as Shanghai Pilot Free Trade Zone).

Among others, the following trade issues are particular challenges that China has to address in the near future.

First, China needs to seriously reduce or eliminate remaining trade barriers in the existing trade regime. They include: liberalization of distribution restrictions on products like pharmaceuticals, crude oil and refined oil; improvement of the transparency of state trading and tariff quota management (for instance, grains and and fertilizer); conforming domestic technical standards to international criterion; reforming non-transparent and lengthy licensing processes and dismantling informal bans on entry, high capital requirements, branching restrictions in service sectors; phasing out inadequate export restraints; enhancing legal enforcement of IPR; etc. Trade partners have repeatedly reported these specific deficient areas that are believed to be detrimental to their business interests, and many of them have already been brought into the WTO dispute settlement and also raised in bilateral economic and trade dialogues.

Second, China needs to have an objective insight and accurate evaluation on its industry policy that has been questioned and criticized by trade partners for a long time. China is charged of continuing to pursue industrial policies that seek to limit market access for imported goods, foreign manufacturers and foreign service suppliers, while offering substantial government guidance, resources and regulatory support to Chinese industries. Though direct intervention hasn't become the main approach of industrial policy, there has been a shift towards the use of various other new policy tools to channel resources into certain activities that the government believes are imperative for China's growth and development. These tools include:

“guided” credit; various “catalogues” identifying sectors eligible for incentives, as well as restricted or prohibited activities; various forms of "guidance" including section-specific “industrial development policies” (e.g. for steel, automobiles, and cement); price controls; indigenous Innovation; technology transfer; standards; government procurement; etc.[45] The principal beneficiaries of these policies are state-owned enterprises, as well as other favored domestic companies attempting to move up the economic value chain.

Third, China needs to deal with in-depth domestic structural issues with an endeavor of coordinating among legislative and administrative institutions. They include: trade facilitation, investment, competition policy, government procurement, IPRs, environment policy, labour standards, consumer protection, electronic commerce, state-owned enterprises, small and medium enterprises, supply chain connectivity, etc. Meanwhile, China should improve the openness of such service sectors as transportation, health, education, environment, tourism, culture and entertainment that have long been shield from foreign competition. These elements have also been widely discussed and negotiated in some mega FTAs, TPP in particular, and China has to prepare for new rules in a post-TPP world.

Fourth, China could use bilateral, plurilateral and regional tools for deepening domestic institutional reforms and accelerating the new round of China’s economic openness. While WTO is showing its fatigue, the so-called mega-regionalization has being unfolding, exemplified by the Trans Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP) driven by the traditional trade powers, the U. S. and EU. Meanwhile, the Regional Comprehensive Economic Partnership (RCEP) is the Asian-Pacific version driven by the ASEAN. These regional initiatives are aimed at not only promoting regional economic integration, but also leading the updating of international trade and investment rules. China should more actively engaged in the WTO plurilateral trade negotiations, namely, TISA, ITA, EGA and GPA. China could also contribute to the early conclusion of China and Korea FTA, China and Australia FTA, and RCEP negotiations. China should substantially improve the quality of its own FTAs network by gradually accepting and implementing new trade rules with high standards on the basis of global value chain, such as investment, competition, environment, labour, E-commerce, etc.

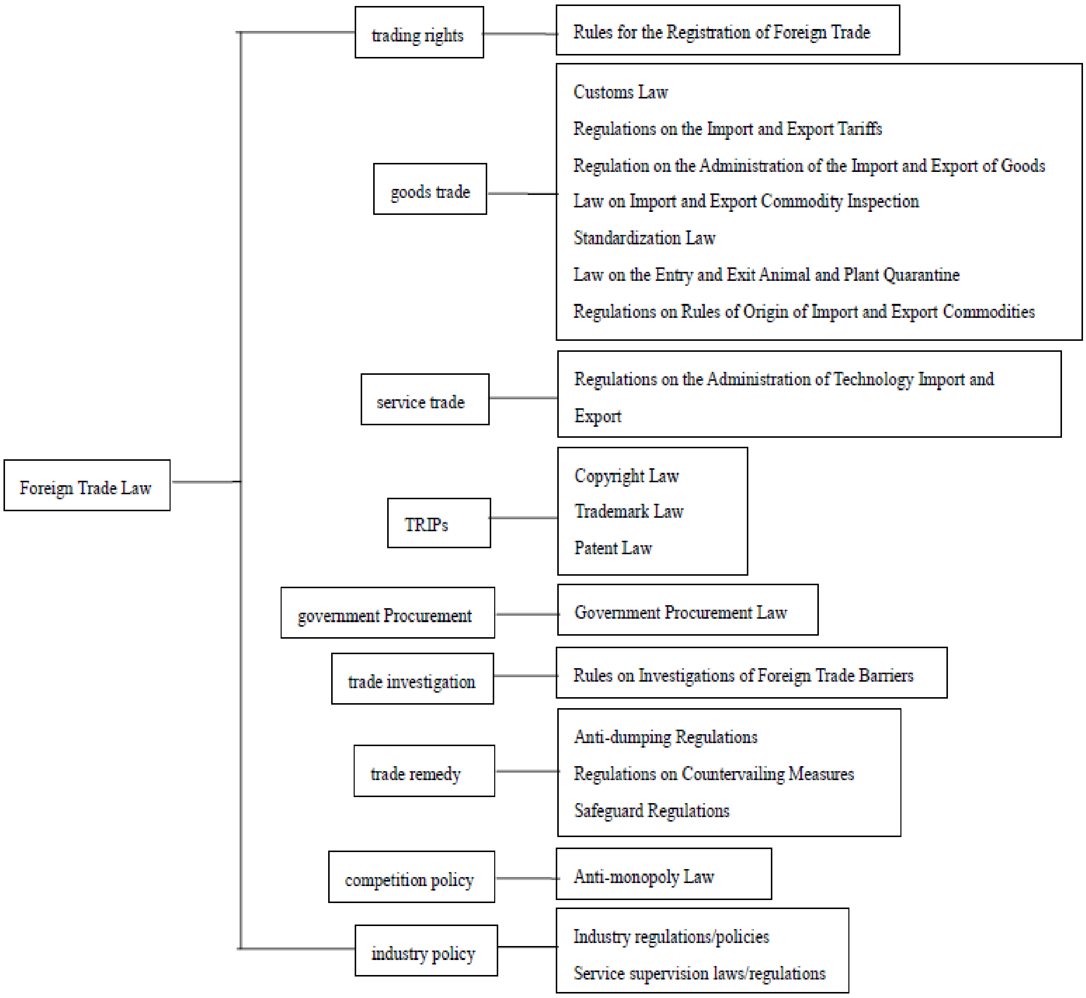
Last but not the least, China still has many detailed issues to tackle after its recent announcement of negotiating a high-standard Bilateral Investment Treaty (BIT) with the U. S. and EU. One of important motivation that China created Shanghai Pilot Free Trade Zone is to serve as a pilot project for significant investment liberalization and facilitation, including establishing registration system for foreign enterprises, providing pre-establishment national treatment, formulating a “negative list”, enhancing market access of service sectors for foreign investors, establishing

[45] United States Trade Representative, *Report to Congress on China’s WTO Compliance*, 2014.

national security review mechanism for FDI. The effect of these pilot reforms needs careful assessment in coming years. Besides, the U.S. is also asking China to accept the clauses of competitive neutrality with regard to state-owned enterprises, social responsibility, and state-investor dispute settlement mechanism. By far it is not clear how China will respond to these tough issues.

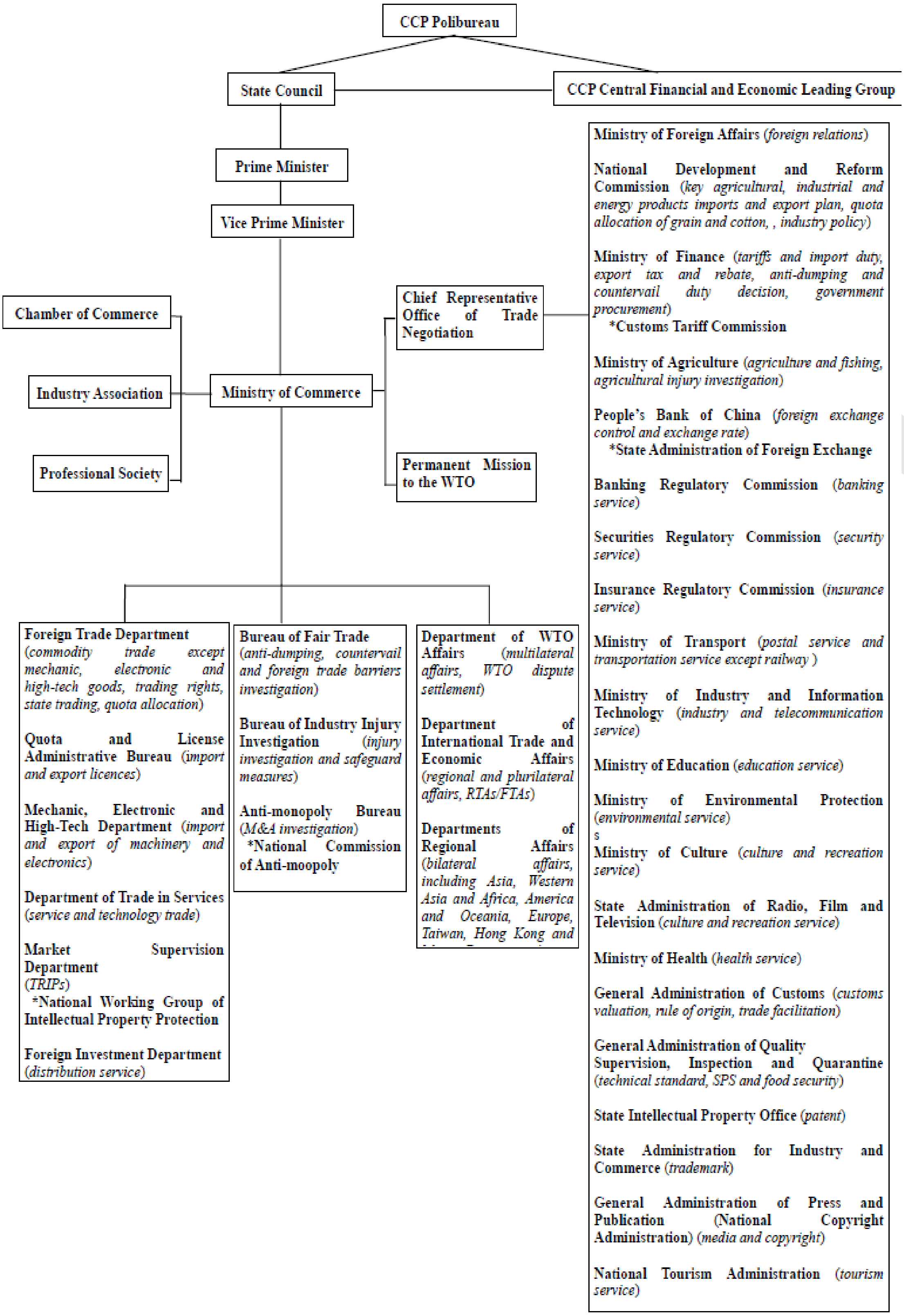
Appendix

Chart I. Legal framework and main laws/regulations of trade in China



Source: Author's compilation based on various information.

Chart II. Structure of administrative institutions related to trade policy



Source: Author's compilation based on various information.

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