China's Involvement in International Trade Governance…

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Abstract: The reform and opening up has helped China achieve great progress in foreign trade. In consideration of better utilization of domestic and foreign markets, and internal and external production factors, China set out to participate in international trade governance, which can be roughly divided into three stages. The first stage focused on bilateral, regional, and multilateral economic and trade cooperation, culminating in China's entry into the World Trade Organization (WTO), which leads to China's improvement of its domestic trade rules and practices and better global economic performance. The second stage focused on signing Free Trade Agreements (FTAs) aimed at promoting regional economic integration and actively engaging in international trade governance. Through the FTAs China began to create more voices and inject more Chinese elements into the formulation of international trade rules. The third stage started with the Belt and Road Initiative. During this period, China's involvement in international trade governance has been integrated into a complete package of international economic governance, which includes policy coordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people bonds. China is now improving and leading in international trade governance with the vision of a community of shared future for mankind.

Keywords: trade governance; WTO; FTA; the Belt and Road Initiative

DOI: http://dx.doi.org/10.19873/j.cnki.2096-0212.2021.01.006

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Little Involvement in International Trade Governance: 1949-1978

The dominant economic system in China from 1949 to 1978 was the planned economy. The planned economic system was an autarkic system which caused the Chinese economy to be relatively closed and there was little trade between China and the world and China had little participation in international trade governance. China did not apply to restore its membership in GATT, nor did it sign many trade agreements with other countries. During this period, China's trade cooperation programs existed largely within the Soviet bloc countries.

China's Planned Economy from 1949-1978 and Its Economic Consequences

China adopted the Soviet Union's economic system from 1949 to 1978, as evidenced by the organizational hierarchy. Organization of decision-making procedures was highly structured. Agriculture was collectivized. Enterprises were all state owned or collectively owned. Most decisions related to production, distribution, and consumption were made by a central planning board. Mechanisms for the provisions of information and for coordination changed. Investment spending was promoted while consumption was restricted. Prices did not reflect demand and supply. Prices were artificially high for industrial goods and low for agricultural goods, and property rights were all state owned or collectively owned. Through the transformation of primary, secondary, and tertiary industries almost all means of production were publicly owned. Mechanisms for setting goals and for inducing people to act were mainly moral incentives with material incentives underutilized. The planned economic system of China led to an economy of shortages and unstable economic growth. (Figures 1 and 2).

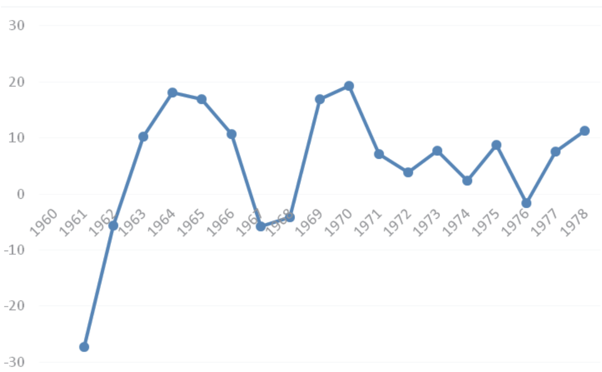

Figure 1. China's real economic growth rate (1960–1978, Annual %)
Source: The World Bank Database

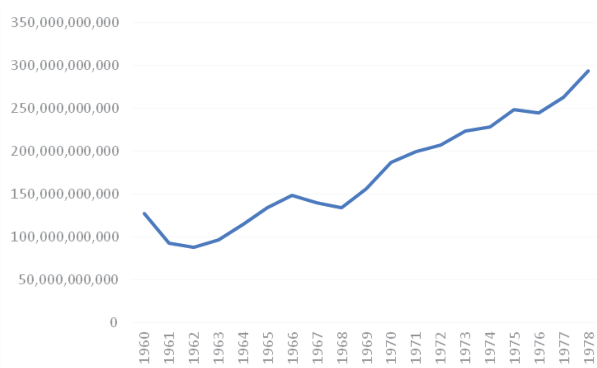

Figure 2. China's economic scale (1960–1978, Constant 2010 US $)
Source: The World Bank Database

China's Foreign Trade in the Planned Economy

In the planned economic system, the decision-making regarding exports and imports was highly centralized. China's foreign trade was governed by mandatory and directive planning. The exchange rate of the renminbi (RMB) with the US dollar was overvalued in order to solve the problem of lack of foreign reserves. There were no private trading enterprises and foreign trade was dominated by state-owned foreign trade enterprises. The state was responsible for both the profits and the losses of state-owned export and import firms.

The planned economic system led to an economy of shortage in China, as it did in the Soviet Union, and in all other countries which adopted the planned economic model. China's economy of shortage dictated that there was little merchandise to export and the poverty embodied by an economy of shortage meant that China could not afford to import much from the international markets. Therefore, before reform and opening up, China conducted minimal trade with the outside world, exporting raw materials and simple manufactured goods to cover payments for imports of strategic minerals and other necessities not available at home. China's imports and exports grew at a slow pace and exports did not contribute much to economic growth. This made it difficult for China to participate in the international division of labor and China's comparative advantage unable to serve the imperative of economic development (Figure 3). During this period, foreign trade was of little significance to China's economic growth. China did not have much of a stake in international trade and therefore did not participate in international trade governance. Even though China was a founding member of the General Agreement on Tariffs and Trade(GATT), it did not take an active part in this multilateral trade governance platform.

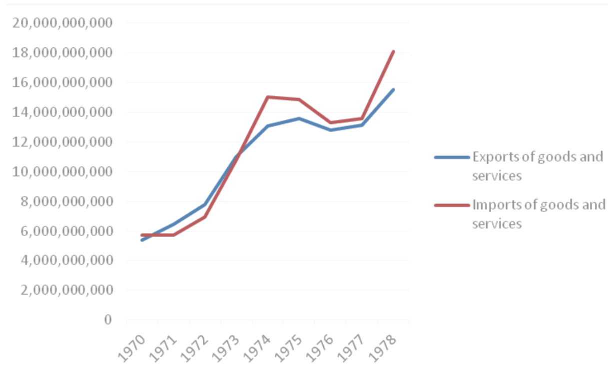

Figure 3. China's imports and exports (1970–1978, Constant 2015 US $)
Source: United Nations Statistics Division, Department of Economic and Social Affairs

Domestic Decision-Making for Involvement in International Trade Governance: China's Economic Structural Reform

China's Planned Economic Structural Reform and the Economic Outcomes

China's reform and opening up included the following measures. First, decentralizing the decision-making arrangements. In agriculture, the de-collectivization started through the introduction of the household contract responsibility system. The legal status of private enterprises and foreign-invested enterprises was restored. Special economic zones were created that permitted foreign investments and encouraged local entrepreneurs to start businesses. After the reform, individual families in agriculture and enterprises (state-owned enterprises, private enterprises, joint ventures,foreign-invested enterprises) are increasingly important economic agents or actors who made decisions about what to produce, how to produce it, and for which target market. Second, markets started to replace commands as information and coordination mechanisms. Farmers were allowed to sell their produce in the local markets. The directive planning was continually reduced. The state became more involved in indirect control of the economy, adopting macroeconomic control measures. Resource allocations became more efficient, both statically and dynamically. The surplus rural labor was gradually absorbed by the cities and the China's production possibility frontier was enlarged. Third, property rights were more clearly delineated. Land ownership rights can be divided into three broad components, the right to disposal, the right to utilization, and the right to gains. Though the land continued to be state owned, the rights to utilization and gains from the land were granted to farmers. Legal private property rights were protected. Material incentives were allowed, and more work equated to more gain. Fourth, the mode of public choice became much more balanced with a series of political reforms.

In 1978, the Third Plenary Session of the 11th Central Committee of the CPC summarized the experience and lessons learned since the founding of the People's Republic of China, and made the historic decision to shift the focus of the Party and the state to economic development and to adopt the policy of reform and opening up stating, "To ensure people's democracy, we must strengthen our socialist legal system, which will enable democracy to be institutionalized and codified, and ensure that such system and laws are stable, continuous and authoritative. All this will ensure that there are laws to go by, that they are observed and strictly enforced, and that violators are brought to book."①

Other laws including the laws of the PRC regarding wholly foreign-owned enterprises, Sino-foreign joint ventures, Sino-foreign cooperative enterprises, and the guiding directory on industries open to foreign investment, preferential policies, and stipulations for special economic zones, were enacted. These reforms helped the Chinese economy to grow and develop to its potential(Figures 4 and 5).

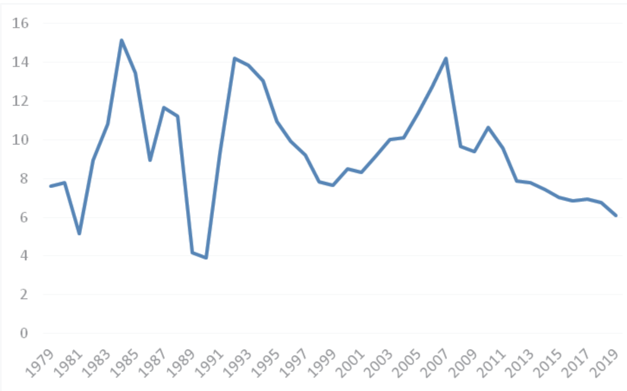

Figure 4. China's real economic growth rate (1979—2019, Annual %)
Source: The World Bank Database

China's Foreign Trade Regime Change after the Economic Structural Reform

During the initial period of reform and opening up, China's foreign trade system reforms

① The Socialist System of Laws with Chinese characteristics, white paper, October 2011, Beijing.

focused on the transformation of its unitary and directive planning, the transfer of management and operational power in foreign trade to lower levels, the implementation of a system allowing enterprises to retain a certain portion of foreign exchange earnings, and the establishment of a foreign exchange coordination market. China absorbed foreign direct investments to introduce foreign-invested enterprises as new business entities in its foreign trade sector, breaking the monopoly of state-owned foreign trade enterprises. After that, China introduced a responsibility system for conducting foreign trade, gradually replacing mandatory planning with guided planning. The state also set up an export tax rebate system in line with the general practice of international trade.

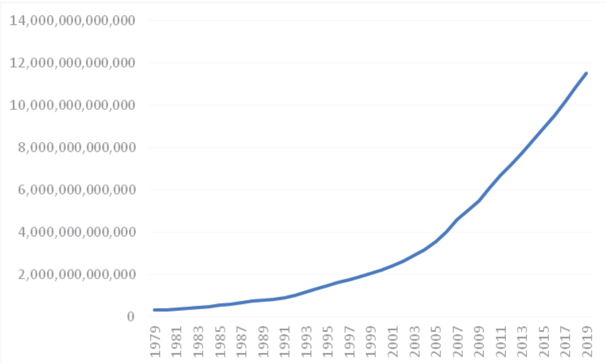

Figure 5. China's economic scale (1979—2019, Constant 2010 US $)
Source: The World Bank Database

In October 1992, China clearly put forward the goal of reform toward a socialist market economy. A comprehensive reform of the systems of finance, taxation, banking, foreign trade, and foreign exchange was implemented. In January 1994, the Chinese government discontinued all export subsidies, making all import and export enterprises fully responsible for their own profits and losses. The official and market-regulated exchange rates of China's currency, the RMB, coexisted in a unitary and managed floating exchange rate system based on market demand and supply. Foreign trade enterprises were incorporated, and pilot programs for the import and export agency system were conducted. In the same year, the Foreign Trade Law of the People's Republic of China was promulgated, establishing principles such as safeguarding a foreign trade order of equity and freedom, and a basic legal system for foreign trade.

In December 1996, China realized current account convertibility for the RMB. Meanwhile, China voluntarily made significant tariff cuts and reduced non-tariff measures such as quotas and licenses. These reforms helped China establish a foreign trade administration and regulation system based on the market economy, giving full play to such economic levers as the exchange rate, taxation, tariffs, and finance.[1] After these reforms, China's foreign trade grew rapidly contributing greatly to economic growth (Figure 6).

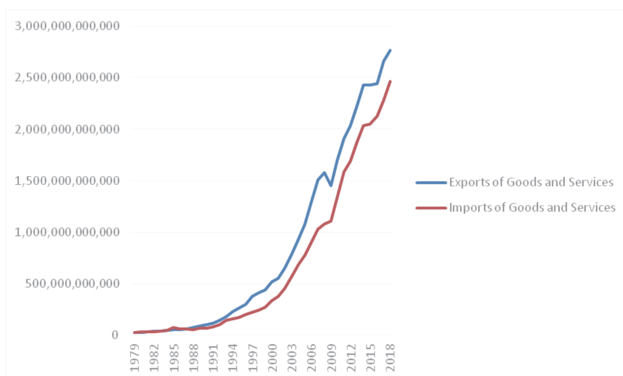

Figure 6. China's imports and exports (1979—2018, Constant 2015 US $)
Source: United Nations Statistics Division, Department of Economic and Social Affairs

China’s Involvement in International Trade Governance

With a growing stake in foreign trade, China started to participate in international trade governance. This participation can be divided into three stages. The first stage focused on bilateral, regional, and multilateral economic and trade cooperation, culminating in China’s entry into the WTO and its active participation in multilateral trade governance. The second stage focused on free trade agreements aimed at promoting regional economic integration. During this period, China introduced proactive initiatives to participate in and promote regional economic integration through FTAs. The third stage started with the Belt and Road Initiative. During this period, trade has been integrated into a package of economic cooperation measures, including policy communications, hard and soft infrastructure connectivity, monetary and financial coordination, and people-to-people exchanges. The rationale behind this is that trade itself cannot promote the full potential of a country’s comparative advantages, and must be combined with economic structural reform, infrastructure connectivity, the flow of foreign direct investment (FDI) and monetary and financial cooperation and with people-to-people exchanges.

First Stage: Focusing on Economic and Trade Cooperation and Entry into the WTO (Starting to Participate in International Trade Governance)

The first stage focused on bilateral, regional, and multilateral economic and trade cooperation, culminating in China’s entry into the WTO.

China attached great importance to the institutional set-up of bilateral and regional economic and trade cooperation. Over 150 countries and regions have signed agreements on bilateral trade or economic cooperation with China. China has established and maintains high-level economic and trade dialogue mechanism with the United States, Europe, Japan, Great Britain, Russia, and other major economies. China applied to restore its founding membership in GATT in 1986 and in 2001 it became a member of the WTO.

Since its accession to the WTO in 2001, China has continuously improved the socialist market economy system, comprehensively strengthened its integration with multilateral trade rules, carefully fulfilled its commitments to opening trade in goods and services, strengthened the protections for intellectual property rights, and made its opening-up policy stable, transparent, and predictable, which significantly improved the performance of the WTO and made positive contributions to the effective operation of the multilateral trade system.

Since its accession to the WTO, China has always firmly supported the multilateral trade system, fully participated in the work of the WTO, promoted the WTO to pay more attention to the concerns of developing members, opposed unilateralism and protectionism, maintained the authority and effectiveness of the multilateral trade system and worked with all members to encourage the WTO to play a greater role in the process of economic globalization.

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① China’s Foreign Trade, White Paper, December 2011, Beijing.

Second Stage: Focusing on FTAs that Promote Regional Economic Integration (Actively Getting Involved in International Trade Governance)

The second stage focused on FTAs that promote regional economic integration. During this period, China took proactive initiatives to participate in and promote regional economic integration through FTAs.

By November 2020, China had signed and implemented the following FTAs, closer economic partnership arrangements, or preferential trade arrangement: Regional Comprehensive Economics Partnership (RCEP), China-Mauritious FTA, China-Georgia FTA, China-South Korea FTA, China-Iceland FTA, China-Peru FTA, China-Singapore FTA, China-Chile FTA, China-Pakistan FTA, China-ASEAN FTA, China-Maudive FTA, China-Australia FTA, China-Switzerland FTA, China- Costa Rica FTA, China-New Zealand FTA, China-Singapore FTA (II), China-Chile FTA (II), China- Pakistan FTA (II), China-ASEAN FTA (II), Closer Economic Partnership Arrangement(CEPA) between China's mailand and Hong Kong and Macao, Economic Cooperation Framework Agreement(ECFA) between China's mailand and the Taiwan region, and the Asia-Pacific Trade Agreement(APTA). There are 13 free trade agreements under negotiation, including RCEP, China and Gulf Cooperation Council FTA, China-Japan-South Korea FTA, China-Sri Lanka FTA, China-Israel FTA, China-Norway FTA, China-New Zealand FTA (II), China-Moldova FTA, China-Panama FTA, China-South Korea FTA (II), China-Palestine FTA, China-Peru FTA (II), China-Cambodia FTA, etc. There are eight FTAs under research, including China-Columbia FTA, China-Fiji FTA, China-Nepal FTA, China-PNG FTA, China-Canada FTA, China-Bangladesh FTA, China-Mongolia FTA and China-Switzerland FTA (II). ①

The FTA strategy reflects China's initiative to promote a higher level of opening up to the outside world and to promote mutual economic development with its trading partners. Speeding up the implementation of the free trade areas strategy is an important step for China to actively participate in the formulation of international economic and trade rules and strive for the institutional capacity of global economic governance. Through the FTAs, China is injecting more Chinese elements into the formulation of international trade rules and sharing its experience for making use of trade to promote economic growth.

Third Stage: Focusing on the Belt and Road Initiative and the Philosophy of A Community with a Shared Future for Mankind (Trying to Improve and Lead International Trade Governance)

China has made a great deal of economic progress through foreign trade and its integration into the global economy and has become a major driving force for the world's economic growth. From its accession into the WTO to the FTAs signed with many countries, China has participated actively in international trade governance.

However, international trade governance is confronted with many challenges. The Doha Round of talks of the WTO stagnated, simple FTAs could not help developing countries make full use of

① Website of China's FTA, http://fta.mofcom.gov.cn/. Accessed on December 10th, 2020.

trade for economic development and trade protectionism is rising. FDI as a major form of economic cooperation is encountering increasing investment protectionism. There is a trend toward de-globalization.

China therefore proposed its own initiative in global trade governance, the Belt and Road Initiative, a comprehensive package which suggests that the free flow of trade should be combined with strengthening institutional capacities through policy communications, facilities connectivity through hard and soft infrastructure upgrades, FDI through eradication of investment barriers, monetary and financial cooperation through better access to finance, and public support through people-to-people exchanges.

The rationale behind the Belt and Road Initiative is that trade itself cannot promote the full potential of a county's comparative advantages. Trade governance itself cannot guarantee trading partners will benefit from trade. Trade must be combined with policy coordination, including sharing experiences in the economic structural reform. Most developing countries along the Belt and Road were planned economies or have partially imitated the Soviet Union's planned economic system and have been locked into the trap of poverty. Without policy coordination and sharing the experiences of economic system reforms, trade will not be helpful to basic economic development. Trade must be combined with facilities connectivity. In many developing countries within the reach of the Belt and Road Initiative, there is a serious shortage of infrastructure. That actually makes private investments very costly, which hinders trade and the division of labor, hence economic development. Trade must be combined with financial integration, with foreign direct investment (FDI) in particular. FDI can help improve the efficiency of resource allocations, can make up for the insufficiency of capital in developing countries and promote trade with appropriate guidance and policy. Trade also must be combined with people-to-people bonds which greatly contribute to removing the barriers to trade. Finally, import substitution policies and practices could be minimized so that China and its trading partners could better benefit from trade.

Specifically, the Belt and Road Initiative is based on the following considerations. First, the world has become a globalized village. Countries are highly interdependent, and the developed world cannot achieve sustainable economic prosperity without the developing countries. Economic development first of all depends on the economic system or the sets of institutions a country adopts. Almost all underdeveloped countries have some form of planned economic system, depending too much on the visible hand, which is the fundamental cause of poverty. Without the right economic institutions, trade will be minimal. The underdeveloped countries cannot be integrated into the world economy and cannot benefit from international trade, just like China's situation before the reform and opening up and that of the existing centrally planned economies; Cuba, North Korea, and many African, Latin American, and South East Asian countries. There are still more than thirty economies that are non-WTO members. These observer countries include Algeria, Andorra, Azerbaijan, Bahamas, Belarus, Bhutan, Bosnia and Herzegovina, Comoros, Equatorial Guinea, Ethiopia, Holy See (Vatican), Iran, Iraq, Lebanese Republic, Libya, Sao Tomé and Principe, Serbia, Sudan, Syrian

Arab Republic, and Uzbekistan. Twelve countries are not members and have not applied to become members. These countries are reluctant to make reforms to their economic systems. They are Eritrea, Kiribati, Marshall Islands, Micronesia, Monaco, Nauru, North Korea, Palau, San Marino, Somalia, South Sudan, Turkmenistan, and Tuvalu. Therefore, it is absolutely necessary to strengthen policy communications, which include experience sharing in economic reforms, in order to enhance the institutional capacity for trade and for economic development.

The second priority of the Belt and Road Initiative is infrastructure building and upgrading. The improvement of infrastructure will facilitate trade and contribute to economic development by connecting facilities of hard and soft infrastructure, which can promote trade and create a sustainable win-win situation. For facilities connectivity through hard and soft infrastructure upgrades, there must be financial resources. The Asian Infrastructure Investment Bank(AIIB) is designed to complement the role of the World Bank, the Asian Development Bank(ADB) and other financial mechanisms.

Third, export itself cannot ensure the full use of the comparative advantages of different countries (for example, location and resource endowments). Exports should be combined with FDI because FDI has become the major form for international economic cooperation and a strong driving force for exports. Capital movement between countries takes three forms: export of goods and services, loans, and FDI. They represent three different stages of economic development. After World War II, capital movement entered its third stage: large scale FDI. However, when the volume of FDI reaches a certain scale, exports are likely to encounter tariff and non-tariff barriers. Large amount of loans may overburden debtor countries, making them unable to repay the debts. Still, in order to make full use of the comparative advantages of different countries, and to circumvent the barriers of market access, FDI is a logical choice. In spite of the seemingly obvious risks and costs arising from political, cultural, legal and language differences, FDI is an irreversible trend for economic cooperation.

Early transnational corporations, based on inter-industry division of labor, produce capital and technology intensive products in developed countries and labor-intensive products in developing countries. Nowadays, parts of the production process of capital and technology intensive products are also being moved to developing countries. The mode of operation of transnational corporations has changed from inter-industry horizontal integrations to intra-industry vertical integrations. The value-added process capital goes beyond specific countries and regions and is spread globally. FDI by transnational corporations surpassed the economic growth rate of a lot of countries, and the average return on capital in transnational corporations is much greater than that of those enterprises operated within national boundaries. The number and scale of transnational corporations has been increasing at an unprecedented rate and the scale of some transnational corporations (TNCs) has surpassed the size of many sovereign states. Trade should be combined with monetary and financial cooperation. As the abrupt fluctuations of exchange rates are obstacles for trade and FDI, it is crucial to increase monetary cooperation.

Fourth, to reform the economic system, infrastructure must be upgraded. For the free flow of trade and the attraction of FDI, it is crucial to gain public support. For these, people-to-people exchanges are a facilitating factor. Deepening people-to-people exchanges is an important way to eliminate barriers and misunderstandings and to promote mutual understanding among people.

Conclusion

China's involvement in international trade governance started with the domestic decision-making of reform and opening up in 1978. China's accession to the WTO in 2001 was the starting point for China's active involvement in international governance. Becoming a member of the WTO gives China the opportunity to directly participate in the formulation of international trade rules and to contribute to global trade governance. The FTA strategy reflects China's determination for higher level of openness on the basis of the multilateral trading system. FTAs are exceptions to the most-favored-nation treatment of the WTO, which reflects the willingness of China and its trading partners to further open markets to each other on the basis of multilateral commitments to achieving trade and investment liberalization. The Belt and Road Initiative indicates China's leading role in international trade governance, promoting well-balanced trade and good international economic governance. Through Five Areas of Connectivity under the Belt and Road Initiative, China, together with the rest of the world, is committed to building a community of shared future for mankind.

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(Editor: Xu Huilan)