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**CHINA AND THE WTO**

**Executive Summary:**

- The WTO is currently in crisis. Two of its core functions – multilateral trade negotiations and dispute settlement – have broken down, primarily due to conflict over China’s trade policies.
- There is widespread concern about China’s heavy subsidies, discrimination against foreign firms, forced technology transfer, violations of intellectual property rules, and weaponization of trade as an instrument of economic coercion.
- While the debate about China’s trade practices has primarily been driven by the US and EU, what has been largely overlooked is that fact that China’s subsidies and other trade policies are having increasingly harmful effects on other developing countries, particularly in areas such as agriculture and fisheries.
- Current efforts to secure a WTO agreement on fisheries subsidies are seen as a critical test of whether the WTO can remain an effective forum for international trade negotiations. But the issue of whether China should have access to special treatment as a developing country may be a key stumbling block.
- The US, EU and Japan have launched a trilateral initiative directed at reforming WTO rules to create stronger disciplines on industrial subsidies, state-owned enterprises, and forced technology transfer. Such efforts have, however, faced significant opposition from China.
- Frustration with the WTO’s inability to curtail China’s trade-distorting practices led the US to impose unilateral tariffs on China, in violation of WTO rules, launching a trade war between the two countries. US-China trade conflict poses a grave threat to the stability of the global trading system, and there are no signs of a resolution on the horizon.

UK-China trade relations are taking place in a context of growing turmoil in the global trading system. The World Trade Organization (WTO) is the primary institution intended to ensure stable and orderly trading relations in the global economy. However, two of the core functions of the WTO – multilateral trade negotiations and dispute settlement – are currently in crisis. The WTO’s negotiation function has broken down, as evident in the collapse of the Doha Round and repeated paralysis in subsequent

multilateral negotiations. The WTO's role in settling trade disputes has been imperilled by the US blockage of Appellate Body appointments. Controversy over China's trade policies has played a significant role in both of these conflicts.

China is a relatively new member of the WTO, having only joined the organization in 2001, at the start of the Doha Round of trade negotiations. WTO membership has been a boon to China's economy. From 2000 to 2008, China's exports grew by 25% per year, with China becoming the world's largest goods exporter in 2009.<sup>1</sup> China's share of total global exports has more than tripled, from 4% to 14% today.<sup>2</sup> While China's export boom was initially fuelled by low-wage, labour-intensive manufacturing, it is increasingly moving up the value-chain into more advanced industries, where it is competing directly with the US, EU, UK, and other advanced-industrialized states.<sup>3</sup>

China's trade policies have come under heightened scrutiny, particularly in the context of the ongoing US-China trade war. Many states have expressed concern about China's trade policies, including its heavy subsidies, import and export restrictions, discrimination against foreign firms, forced technology transfer, and violations of intellectual property rules. Moreover, China has engaged in increasingly aggressive unilateral trade actions, weaponizing trade as an instrument of economic coercion against weaker states, including arbitrarily blocking Canadian imports (and imprisoning two Canadian citizens) in retaliation for extraditing a Huawei executive to face fraud charges in the US, and blocking Australian imports in retaliation for its calls for an independent inquiry into the Covid-19 outbreak. There is widespread concern that the WTO system has proven inadequate to address such trade practices.

## **Multilateral Trade Negotiations at the WTO**

### ***Conflict over Special and Differential Treatment for China***

The question of how China should be treated under global trade rules has become one of the prime sources of conflict in the multilateral trading system. The *China paradox* – the fact that China is simultaneously both a developing country and a major economic heavyweight – has created significant challenges for global trade governance.<sup>4</sup> While China remains a developing country and continues to face significant development challenges, it is now an extremely large and immensely powerful force in

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<sup>1</sup> Congressional Research Service. 2019. *China's Economic Rise: History, Trends, Challenges, and Implications for the United States*. Washington, DC.

<sup>2</sup> WTO data.

<sup>3</sup> Hopewell, K. 2018. "What is 'Made in China 2025' - and why is it a threat to Trump's trade goals?" *Washington Post* (May 3).

<sup>4</sup> Hopewell, K. 2020. *Clash of Powers: US-China Rivalry in Global Trade Governance*. Cambridge: Cambridge University Press.

the global economy and seen by many states as a major competitive threat.

A key principle of the trading system is that developing countries should be granted special and differential treatment (SDT), including certain exemptions from WTO rules and greater scope to use tariffs, subsidies and other protectionist trade measures to foster economic development. China insists that it should be entitled to SDT. However, while China remains a developing country – with a per capita GDP of just \$10,000 compared to \$65,000 in the US, for instance<sup>5</sup> – as the world's biggest trader and second largest economy, its trade policies have profound global implications.

Conflict over the issue of SDT for China, as well as other large emerging economies such as India and Brazil, played a central role in the breakdown of the Doha Round of trade negotiations in 2011. Due to the SDT provisions contained in the proposed agreement, relatively little market opening would be demanded of China and other emerging economies. However, the US refused to extend special treatment to the country that it views as a major economic competitor and hegemonic rival. The US sought to rebalance the deal by demanding additional concessions from China in both agriculture and manufactured goods, but China refused. The result was a stalemate: the US refused to conclude the Doha Round without greater liberalization from China and the other large emerging powers, who continued to insist on their right to SDT.<sup>6</sup> The negotiations became deadlocked and ultimately collapsed.

Since the Doha breakdown, states have attempted to resuscitate the WTO's negotiating function by seeking to reach agreement on narrower, more targeted issues, such as agriculture or fisheries. However, even with a piecemeal approach, there have been few areas of successful agreement. Negotiations have continued to be impeded by persistent conflict over the issue of SDT for China and other large emerging economies.

Although WTO members are currently allowed to self-designate as developing countries, there have been growing calls – particularly from the US and EU – to establish a more restrictive criteria that would exclude China from SDT. China, however, has fiercely resisted such proposals.

### *Implications for Global Development and Environment*

The debate about SDT for China has primarily been driven by major powers such as the US and EU, who strongly object to providing special

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<sup>5</sup> World Bank data, 2019.

<sup>6</sup> Hopewell, K. 2017. "The BRICS – Merely a Fable? Emerging Power Alliances in Global Trade Governance." *International Affairs* 93(6):1377–96.

treatment to a major economic rival. But allowing China to access SDT is also increasingly problematic due to the effects of its trade policies on other developing countries. China is now a major player in global agriculture markets as well as the world's dominant fishing power. It is also the largest subsidizer of both agriculture and fisheries. Consequently, allowing it to exempt its subsidies and other trade policies from WTO disciplines through SDT threatens to undermine important global development and environmental objectives.

### Agriculture

Since the collapse of the Doha Round, WTO members have been seeking to negotiate a standalone agreement to reduce agricultural subsidies. Yet one of the key stumbling blocks has been the issue of SDT for China and other large emerging economies.<sup>7</sup>

Subsidies provided by richer countries give their farmers an unfair advantage in global markets, while depressing global prices and undermining the livelihoods of millions of poor farmers in the developing world. Historically, the US and EU were the principal source of the problem, but the global landscape of agriculture subsidies has changed dramatically. As China has grown richer, it has become the world's largest subsidizer of agriculture. China provided approximately US\$212 billion in support (including both market price support and direct subsidies) to its farmers in 2016, vastly more than the EU (\$100 billion), US (\$33 billion) or any other country.<sup>8</sup>

The US, EU and others have agreed to reduce their subsidies, provided that China does the same, but China has refused, insisting that it should be entitled to SDT as a developing country. China is fiercely resistant to accepting any new disciplines on its agricultural subsidies. In addition to supporting its rural population, China's subsidies are also motivated by the desire to bolster domestic production in order to secure its food supply in the event of a potential future conflict with the US. Efforts to negotiate a WTO agreement on agricultural subsidies have therefore reached an impasse.

Cotton provides a striking illustration of the harmful effects of China's agricultural subsidies for other developing countries. Many developing and least-developed countries depend heavily on cotton exports for employment, government revenue and foreign exchange. Cotton is one of the most important export crops in sub-Saharan Africa, with some 15 million people directly dependent on it for their livelihoods. Burkina Faso, for example, which has an average income of just \$790 per year, relies on cotton for 59% of its export revenues. African cotton producers are

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<sup>7</sup> Hopewell, K. 2019. "US-China Conflict in Global Trade Governance: The New Politics of Agricultural Subsidies at the WTO." *Review of International Political Economy* 26(2):207-31.

<sup>8</sup> OECD. 2017. *Agricultural Policy Monitoring and Evaluation*. Paris: OECD.

among the world's most competitive, but they face lower prices and unfair competition due to heavy subsidies in richer countries. Cutting subsidies would boost cotton prices and incomes for poor farmers, and lead to a significant shift in production to African countries.

While the US was once the chief source of the cotton subsidy problem, China has now surpassed the US as world's largest cotton subsidizer. Over the past decade, China provided a massive \$41 billion in cotton subsidies – almost six times more than the \$7 billion provided by the US.<sup>9</sup> China alone accounts for nearly three-quarters of all cotton subsidies worldwide. Like the US, China is a relatively inefficient cotton producer, with production costs roughly four times those of some African countries.<sup>10</sup> But subsidies and other trade measures have made China one of the world's largest cotton producers. China's subsidies artificially increase its own cotton production, displacing imports and depressing global prices, reducing the incomes of farmers globally. In addition, China also imposes tariffs as high as 40% on cotton imports. China's heavy subsidies and import barriers cause significant hardship to poorer and weaker countries.

China's cotton subsidies are specifically targeted at encouraging cotton production in Xinjiang, where more than 85% of China's cotton is grown, primarily under the control of large, government-owned or operated cotton farms. China's cotton subsidies are part of the government's efforts to exert internal control over the region, home to China's Uighur minority, which also has strategic significance as a key hub of China's Belt and Road Initiative, intended to create trade and infrastructure links to Central Asia, the Middle East and Europe.

Developing countries have been actively pushing for a WTO agreement to eliminate global cotton subsidies. But China has refused to accept any new WTO disciplines on its subsidies. China insists that, as a developing country, it should be entitled to SDT and exempt from any requirement to reduce its subsidies. The reality, however, is that China is now the primary source of the cotton problem. Exempting China's subsidies from WTO disciplines by granting it SDT would severely undermine the efficacy of any new disciplines. It is impossible to address the cotton problem without tackling China's subsidies.

### Fisheries Subsidies

Fisheries subsidies is one of the sole active areas of multilateral negotiations at the WTO, and achieving a successful agreement is seen as essential to demonstrating the continued relevance of the institution and its system of global trade rules. The UN Sustainable Development Goals

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<sup>9</sup> International Cotton Advisory Committee (ICAC) data.

<sup>10</sup> ICAC. 2016. "Production and Trade Policies Affecting the Cotton Industry." International Cotton Advisory Committee, Washington, DC.

identified the need for a WTO agreement to eliminate harmful fisheries subsidies as a urgent international priority. The goal is to achieve a “triple win” – an outcome that is positive for trade, development and the environment.

Subsidies have contributed to a global fisheries crisis by fuelling overcapacity and overfishing (“too many vessels chasing too few fish”). The UN Food and Agriculture Organization estimates that 90% of global fish stocks are already fully exploited and almost a third are being fished at a biologically unsustainable level. Approximately \$35 billion in fisheries subsidies are provided annually, with the vast majority going to large-scale, industrial fishing operations.<sup>11</sup>

Overfishing causes severe damage to fragile marine ecosystems and undermines the sustainability of global fisheries. But this is not just an environmental issue. Many developing countries depend on fisheries for food security and livelihoods, and are acutely vulnerable to plummeting fish harvests. Subsidies have enabled countries with large industrial fishing fleets to exploit resources far beyond their own waters. Although West Africa, for instance, has some of the world’s richest fishing grounds, its fish stocks are rapidly being depleted by heavily-subsidized foreign ships. Declining fish stocks have resulted in falling incomes for local fisherfolk – many of whom live in conditions of poverty and severe hardship – along with reduced domestic food supply.

In the past, the primary source of the problem lay with developed countries like the EU and Japan. But China now dominates the global fishing industry: it has the world’s largest and furthest-ranging industrial fishing fleet, which accounts for an astonishing 42% of global fishing activity – outstripping the next 10 biggest countries combined.<sup>12</sup> And China is also now the world’s biggest fisheries subsidizer.<sup>13</sup> China’s subsidies are driven by both economic and security motives, with Beijing using its heavily-subsidized fishing fleet to bolster its claims in the East and South China Seas, as well as to advance its objective of becoming a dominant maritime power.

As the dominant player in this sector, with a heavily subsidized fleet, a meaningful fisheries agreement is simply not possible unless China is willing to reign in its subsidies. Yet China has been seeking to avoid disciplines on its subsidies by insisting on access to SDT. This would contravene the purpose of constructing disciplines and have severely

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<sup>11</sup> Sumaila, U. R., N. Ebrahim, A. Schuhbauer, D. Skerritt, Y. Li, H. S. Kim, T. G. Mallory, V. W. L. Lam, and D. Pauly. 2019. "Updated estimates and analysis of global fisheries subsidies." *Marine Policy* 109:103695.

<sup>12</sup> Kroodsma, D. A., J. Mayorga, T. Hochberg, N. A. Miller, K. Boerder, F. Ferretti, A. Wilson, B. Bergman, T. D. White, B. A. Block, P. Woods, B. Sullivan, C. Costello, and B. Worm. 2018. "Tracking the global footprint of fisheries." *Science* 359(6378):904-08.

<sup>13</sup> Sumaila, et al. "Updated estimates and analysis of global fisheries subsidies."

negative implications for the many developing countries that rely on global fisheries resources for their economic welfare.

States are seeking to secure a WTO agreement on fisheries subsidies by the end of this year. The ability to reach such an agreement is seen as a crucial test case for the WTO and an indicator of whether it will be possible to resuscitate its negotiating function. Addressing the issue of SDT for China will be critical to constructing an effective agreement.

### ***Trilateral Initiative***

Beyond the debate about SDT for China, many states have expressed concerns that existing WTO rules have proven insufficient to address China's model of heavy state intervention in its economy and discipline its trade-distorting policies.

The US, EU and Japan have launched a trilateral initiative directed at reforming WTO rules to create stronger disciplines on industrial subsidies, state-owned enterprises, and forced technology transfer. The EU, US and Japan have proposed changes to the WTO's Agreement on Subsidies and Countervailing Measures (ASCM) to expand the list of prohibited industrial subsidies and establish rules to address subsidies that cause overcapacity. The trilateral group has also proposed shifting the burden of proof by requiring states to demonstrate that their subsidy programs are not distorting trade or contributing to overcapacity, as well as advocating more stringent notification standards for industrial subsidies. It has also called for an expanded definition of "public body," maintaining that the Appellate Body's excessively narrow interpretation of the term has undermined the effectiveness of WTO subsidy rules vis-à-vis China.

The trilateral initiative has, however, faced significant opposition from China, which has indicated that it is not open to considering changes to the ASCM. Under the WTO's consensus-based decision making system, such reforms would require the agreement of the entire WTO membership.

## **WTO Dispute Settlement System**

### ***Appellate Body Crisis***

The US has blocked appointments to the Appellate Body – which acts effectively as a supreme court for global trade – throwing the WTO's dispute settlement mechanism (DSM) into jeopardy. The WTO's DSM is a fundamental pillar of the rules-based multilateral trading system: it is essential to enforcing global trade rules and providing a peaceful means of resolving trade disputes among states. The Appellate Body hears

appeals of decisions by WTO dispute settlement panels, and as such is a crucial part of the dispute settlement system.

Under the Trump administration, the US began blocking all appointments to the Appellate Body as the terms of its judges expired. There are a total of seven seats on the Appellate Body, and it requires a minimum of three judges to form a panel to adjudicate a dispute. Since December 2019, with six of its seven seats vacant, the Appellate Body has not had enough judges to adjudicate disputes. Since December 2020, all seven of its seats have been vacant.

By blocking Appellate Body appointments, the US has imperilled the WTO's entire mechanism for settling disputes: if appealed, a dispute settlement panel decision is blocked – and will not become legally binding – until a decision of the Appellate Body. Consequently, without a functioning Appellate Body to hear the case, the country ruled against in a dispute can block adoption of the panel decision simply by filing an appeal. This has come to be known as appealing “into the void.”

The US has articulated a lengthy list of procedural complaints about the Appellate Body. More fundamentally, however, the US accuses the Appellate Body of judicial overreach and complains that it has interpreted WTO rules in ways that run counter to American interests. The US is particularly dissatisfied with several Appellate Body rulings that concern China's trade policies and the US's ability to use trade defence measures to restrict imports. The US criticizes the Appellate Body for prohibiting its use of “zeroing” in calculating antidumping duties and prohibiting “double remedies” (simultaneously imposing both antidumping and countervailing duties). The US also criticizes the Appellate Body for interpreting the definition of “public body” in an excessively narrow manner that limits the application of WTO subsidy rules to China's state-owned enterprises. The deeper issue is that the US is dissatisfied not simply with the Appellate Body but with the WTO's failure to adequately address China's model of state capitalism and rein in its allegedly “unfair” trading practices.<sup>14</sup>

The US has signalled that it has little interest in reform of the Appellate Body until its systemic concerns regarding China's trade policies are addressed. Without a functional Appellate Body, the US can simply block rulings against it by appealing into the void – as it did in October 2020 when a WTO panel determined that its Section 301 tariffs on China violate WTO rules. Despite the election of President Biden, there are still no signs of a resolution to the Appellate Body impasse on the horizon. Without a functional dispute settlement system to ensure the WTO's rules are enforced, the entire system of multilateral trade rules is in danger of unravelling.

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<sup>14</sup> US, “2017 Report to Congress on China's WTO compliance”, WTO General Council, 16 July 2018, WT/GC/W/746, p. 3.

## ***Multi-Party Interim Appeal Arbitration Arrangement (MPIA)***

In response to the Appellate Body crisis, the EU has led a group of states in creating a Multi-Party Interim Appeal Arbitration Arrangement (MPIA). The MPIA provides a means for appeals to be heard while the WTO's formal appeals process is unable to function, allowing the essential features of WTO appellate review to be preserved. It is intended to broadly replicate the practices and procedures of the Appellate Body, and it will remain in place until a permanent solution to the Appellate Body is found. The MPIA has established a pool of 10 arbitrators to hear appeals of WTO dispute settlement panel reports. As with the Appellate Body, each appeal will be heard by three arbitrators, whose decision will be binding on states.

The interim appeals arrangement applies only to participating states but is open to all WTO members to join. At present, over 50 countries have agreed to participate.<sup>15</sup> The MPIA encompasses most major non-US users of the WTO dispute settlement system, including the EU, China, Canada, Australia, Mexico, and Brazil. Although spearheaded by the EU, China's economic weight has made it an important partner in the MPIA, which encompasses two of the world's three largest economies.

## **US-China Trade War**

The crisis in the multilateral trading system has been further exacerbated by growing trade conflict between the US and China. Frustrated with the inability of the WTO to tackle China's protectionist trade practices, the US turned to aggressive unilateral trade measures.<sup>16</sup> Under President Trump, the US ignited a trade war with China by imposing tariffs on \$360 billion of goods imported from China and threatening to impose further tariffs on all \$520 billion of Chinese imports. China responded by imposing tariffs on \$110 billion of US imports in retaliation.

The American tariffs were imposed under Section 301 of the US Trade Act, which enables the US to unilaterally take retaliatory action against countries deemed to "unjustifiably" restrict or burden US commerce. The sweeping, unilateral nature of Section 301 means it can be used as a blunt instrument of economic coercion. Part of the motivation for creating the WTO's binding dispute settlement mechanism was specifically to curtail the US's use of Section 301.

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<sup>15</sup> The EU and its member states, as well as Australia, Benin, Brazil, Canada, China, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Hong Kong, Iceland, Macao, Mexico, Montenegro, New Zealand, Nicaragua, Norway, Pakistan, Peru, Singapore, Switzerland, Ukraine, and Uruguay.

<sup>16</sup> Hopewell, K. 2021. "Trump & Trade: The Crisis in the Multilateral Trading System." *New Political Economy* 26(2):271-82.

Despite the Phase 1 deal signed in January 2020 and heralded as a ceasefire in the US-China trade war, most of the tariffs imposed by the two countries remain in effect. Even this temporary trade truce is highly fragile, as it is unlikely that China will be able to meet its stated commitment of increasing its imports from the US by \$200 billion, which would require China to nearly double its imports from the US. The prospects of a Phase 2 agreement – with the US seeking deeper structural changes in the Chinese economy and significant reforms of China’s industrial policy – are dim. Although the WTO has ruled that the US’s Section 301 tariffs on China are in violation of international trade law, they nevertheless still remain in place. And the Biden administration has not yet shown any intention of rescinding the tariffs.

## **Conclusion**

The rules-based multilateral trading system has played a key role in fostering increasing economic integration and creating stable conditions for the functioning of global markets. But this system has increasingly come under threat. Amid the breakdown of the WTO’s negotiation function, the Appellate Body crisis, as well as growing trade conflict between the world’s two largest economies, the US and China, this is widely considered the most perilous moment for the multilateral trading system since its creation after World War II. States are engaged in various efforts to save the WTO, such as the Ottawa Group led by Canada which is pursuing institutional reforms to strengthen the WTO, the EU-led MPIA, and the trilateral initiative. The goal is to maintain the liberal trading order, in order to ensure stability in the global economy and ensure that trade is based on the rule of law, rather than simply raw power. Although the future of the WTO is highly uncertain, the UK, as a major trading country and the world’s fifth largest economy, has the potential to play an important role in efforts to preserve the rules-based multilateral trading system.

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*April 24, 2021*

**Received 4 May 2021**