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WTO Accession, Financial Reform and the Rule of Law in China

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Abstract

Developing the rule of law in China has become a goal of highest priority for the Chinese government and the Chinese Communist Party (CCP) in recent years. This article examines the reasons for China's high level of concern with the rule of law, and focuses on its role in financial and economic developments and the relationship to WTO accession. The article argues that the concern over the development of the rule of law in China is driven by the country's rapid economic development and the need to strengthen the government's and the CCP's positions at the centre of power in the country.

1. Introduction

A key goal of the 11th Five-Year Plan (2006–10) of the People's Republic of China (PRC) is to fully develop a system of the rule of law in China.¹ Clearly, developing the rule of law in China has therefore become a goal of

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highest priority for the Chinese government and the Chinese Communist Party (CCP). Why does this rise to new heights of significance and why now? While books have been written on the rule of law in China,² the purpose of this article is only to highlight the reasons for China's high level concern with the rule of law, focusing on its role in financial and economic developments and the relationship to WTO accession.

Specifically, this article argues that the PRC government and the CCP are concerned with developing the rule of law in the PRC as both a means to support economic development in China and to strengthen their own position at the centre of power in the country. In supporting this proposition, the article begins with a discussion of the rule of law and its relationship to governance and to financial and economic developments. It then applies this analytical framework to the role of the CCP and the PRC Government in China. The article concludes by arguing that just as WTO accession was a means to lock in economic reform necessary to support ongoing economic development and enhance China's role on the world stage, development of the rule of law is a necessary next step in addressing the twin goals of improving the CCP/PRC governance nexus and its economic justification. At the same time, the impact of the return to focus on Marxist ideology in the CCP remains to be seen.

From the perspectives of international trade, this article explores whether China is developing a legal system that is supreme over the state and the CCP. In its efforts to implement the various international conventions and commitments relating to international trade, China is progressing towards greater public input, transparency and accountability of the bureaucracy, as well as undertaking administrative law reform. Its accession to the World Trade Organization (WTO) demonstrates the transformation of China from a planned economy to an economy integrated into the global market system. The odyssey in achieving this objective indicates the commitment of its political leadership in reforming China's legal landscape. Inevitably, China's domestic laws and principles have to harmonise with international standards. Ostensibly, the implementation of international laws in liberalising trade and regulating financial institutions is *de facto* depriving the leadership of the CCP.

2. Governance, the Rule of Law and Economic Development

Issues of governance and appropriate political structure have been of interest since the development of the first stationary agricultural

settlements with specialised human activity over ten thousand years ago and the consequent development of writing systems appropriate to their administrative and governance structures. Building the “perfect” society and the necessary governance systems to move towards it has been a focus of many writers, including Plato, Confucius, Aquinas, Locke and Marx. The political system and the economic system function in close parallel, even though the connection is not always acknowledged by political theorists. Certainly, the relationship between politics (or governance) and the economy has been a key interest of Adam Smith, as well as Marx, and more recently Keynes, Hayek and Milton Friedman. Although politics and economics became distinct disciplines over the twentieth century, by the end of the millennium the interaction between governance and economics was again being addressed, at least partially as a result of lessons learnt through the process of transition from centrally planned to market economies, as well as from failures of development models focusing largely on economic policy.

The role and development of financial institutions have become a focus of attention relatively recently in law, financial policy and economics, although each discipline is directly concerned with important issues forming both the problem and its explanations. Since the late 1980s, finance has become recognised as being vital to many aspects of economic development, and what determines the nature of financial institutions and infrastructure is susceptible to both quantitative analysis and the qualitative tools of legal and economic theory.

By the beginning of the 1990s, the two essential alternatives of central planning and state ownership and control and *laissez-faire* had merged into an apparent consensus as to the superiority of a market economy, but one that would function under the framework of an appropriate and transparent regulatory system. This would address the interests of society as a whole through the provision of public goods, systems to prevent or ameliorate market failure, and sanctions to penalise market abuse, whether arising from monopoly or the occurrence of asymmetric information available to privileged participants. Nonetheless, as Shleifer and others have recognised, many differences exist between extant economic and governance models around the world.³ The ensuing question arises as to what may represent the best choices among all available options, and to what extent those choices lead to the disadvantage of certain individuals or interests.

For new institutional economists such as North and many writers in the

law and economics school, governance systems must provide for two fundamental features to support a market economy, regardless of its ideological basis and consequent form. First, the governance system needs to provide for clear and usable property rights. Second, it must provide for a usable and fair system for contract enforcement. Both sets of literature agree that these conditions are essential in the context of imperfect markets where there exist accepted transaction costs. While there appears to be agreement as to the need to satisfy these basic points, the type of governance structure that best provides these two foundations for a market economy is less apparent.

Many scholars have argued that democratic models of governance are also optimal for protecting property rights and the enforcement of contracts, albeit this was the result they sought most often to prove. However, Olson has presented a convincing argument that a variety of governance structures can provide each of these necessary features.⁴ Specifically, he maintains that an autocrat with a sufficiently long-term time horizon will have strong incentives to support both property rights and contract enforcement from economic self-interest, chiefly to maximise revenue from taxation and other formal revenue sources. Likewise, he argues that any democracy, while also potentially providing for property rights and the enforcement of contracts, may nevertheless become subject to inefficient outcomes due to the presence and success of interest groups within the society. As a result, neither autocracy nor democracy is necessarily a superior political system from the standpoint of providing the most beneficial support for a market economy: what is necessary is a “market-augmenting government”.⁵ Recent empirical research has begun to test these ideas and also appears to be supportive.⁶

The result is that a national governance structure is important in that it must provide for property rights and enforcement of contracts, as well as human capital development. However, at this point, while some governance structures are clearly not conducive (for example, those run by short-term autocrats who behave essentially as stationary bandits), there is no clearly preferable model at present. Both autocratic and democratic governance systems can support a market economy. Likewise, both can also provide for institutional choices that do not result in efficient, wealth-maximising outcomes for a given economy.

We would suggest that these ideas are at the heart of the recent importance being placed on the rule of law by the PRC government and the CCP.

What then is the rule of law? The rule of law may be defined in many ways. There is no consensual definition as it may mean different things for different people depending on their cultures, societies and political systems. Western constitutional theorists often associate democracy and judicial review with democracy and the rule of law respectively.⁷ It also has been considered as one of the cardinal features of the common law judicial system, demanding general acceptance of law by the government. Albert Venn Dicey (1835–1922), an English jurist, outlined this doctrine by stating the predominance of law over the exercise of arbitrary power, equality before the law, and the derivation of law from individuals' rights as decided by the courts.⁸

Using these criteria to evaluate the rule of law in China would no doubt draw a negative conclusion, as neither Western democracy nor judicial review is entrenched in China's constitutional framework. Likewise, we would argue that at least democracy is not a necessary component of the rule of law.

There are numerous theoretical notions of the rule of law. Formulating these notions depends on the ideologies of the theorists. At minimum, the core meaning of the rule of law is that the law must impose meaningful limits on the state and every member of the ruling elite.⁹ The different notions of the rule of law can be classified into "thin" and "thick" types depending on the requirements.¹⁰

The "thin" type focuses on the formal or instrumental aspects of the rule of law. These are the features necessary and essential for the effective operation of a legal system regardless of the nature of the governance and implementing legal system. This formal theory of law has three basic components, i.e. conceptual, instrumental and axiological.¹¹ The ideal rule of law governing the relationship between the state and its citizens is that the rules should not only be publicly known, but must be congruently interpreted and applied.¹² Any deviation from the rules by the state or the citizens should be adjudicated only by independent tribunals after due process.¹³ These conceptualised attributes are then institutionalised in rules through legislatures, administrative bodies and courts.¹⁴ The common ground built upon the thin notion requires the laws to be general, public, prospective, clear, consistent, capable of being followed, stable and enforced.¹⁵ The formal theory of law serves *inter alia* the values of legitimate government, certainty of the law and freedom from arbitrary power.¹⁶ The thin type shuns the relationship with substantive aspects of law, e.g. human rights and Western democracy.¹⁷ Insofar as the formal criteria of the law are fulfilled, then there is rule of law.¹⁸

Supporters of the “thick” type argue that a formal theory is nevertheless an obstacle to laws with bad content, as these laws are often manifestations of substantive arbitrariness.¹⁹ The thick type stresses the substantive aspects of the rule of law, which goes beyond the thin type.²⁰ It incorporates into the fundamental elements of the thin notion elements of economics, politics and morality, e.g. free-market capitalism versus central planning, democracy versus one party dictatorship, and human rights versus Asian values.²¹ It goes beyond the legality of the law by requiring it to be just in certain fundamental elements. The thick type of the rule of law can be further subdivided in accordance to the substantive elements.²² The general liberal democratic version of the rule of law espouses free market capitalism and liberal interpretation of human rights.²³

We suggest that the thin type is the version being advocated by the PRC and the CCP. In the PRC, the leadership of the CCP and the socialist road are stipulated in the preamble of its Constitution of the PRC (Chinese Constitution). Its socialist economic system now is market orientated with the increasingly diminishing role of public ownership, although this remains a dominant element. It emphasises stability over human and individual rights and the minimum necessities of life over civil and political rights.²⁴ Thus, the fundamental legal instruments highlight the PRC/CCP governance nexus. The next section discusses why the governance structure would seek to limit its own freedom of action through the development of the rule of law: the role of continued economic development in securing the continuing relevance of the PRC/CCP governance nexus.

As noted above, the PRC and CCP have determined that developing the rule of law (a thin version, we suggest) is of highest significance. We argue that the reason for this is a pragmatic approach to the role of the CCP and the necessity of continued economic development in the PRC in order to retain this role. Economic development beyond a certain basic level increasingly is seen as dependent upon the development of an effective system for contract enforcement and dispute resolution, and that a rule of law system is important in supporting the development of long term arms length commercial and financial transactions.

At a general level, the earliest modern studies of the determinants of economic growth identified a strong correlation between the “rule of law” and per capita growth.²⁵ These analyses were weak in terms of identifying with any practical precision the ways in which legal reform might be affected, given that the measures used to identify “rule of law” variables

were basic and included subjective components such as commercial indexes of sovereign risk.

The law and finance school asserts that there exist significant causal links between the origins of law or the means by which a national system of law has been acquired, and the nature of financial system development.²⁶ Certain scholars further suggest a causal relationship that flows from financial development to economic performance, although most accept that such links are unlikely to be unicausal.²⁷ While not unanimous, these studies generally suggest that finance often has a positive effect on growth, although (contrary to popular belief) there is no accepted theoretical school that asserts the contrary, that the primary causal flow is from economic growth to financial development.

According to the World Bank, the rule of law is the pillar for sustainable and equitable economic growth.²⁸ The Asian financial crisis in the late 1990s illustrated that economic development is not sustainable without an effective rule of law.²⁹ In achieving sustainable economic development, legal and judicial reforms are critical components of the process.³⁰ In attracting investors, the stability of the political system should be supported by the certainty of law in protecting property rights.

Based on this analysis, one can conclude that the rule of law is significant for economic growth, which is vital to the continuation of the role of the CCP in the PRC, and that this interaction is one of the key factors underlying the rationale for the high focus now being placed on the development of a rule of law system of governance in China.

3. Using Law: The Law-Governance Nexus in China

One of the most important rationales for legal reform in China is to facilitate its transition from a centrally planned economy to a socialist market economy,³¹ an objective which is generally agreed to be the result of the CCP's determination that the previous system of central planning was not effective and therefore detrimental both to China and the long-term role of the CCP. In devolving the economic authority from a small number of central planning agencies to a broader array of economic actors, it has to implement laws and structures as prudential governance.³² Without long experience of market forces, China has referred to laws from liberal democratic jurisdictions, e.g. Germany, Japan, the United Kingdom and the U.S.A.³³

In every society, customary law is a natural product of its civilisation.

A legal system that is based on the needs of a society under its cultural conditions is more acceptable to the population than a legal system dictated by the ideals of a few individuals. If the law is not in accord with the culture, law can hardly survive on its own, nor can law meet the needs of the people. The reception of common law in conquered colonies of the former British Empire did not completely contradict the idea that the nature of a legal system is a reflection of the culture of the population, as local culture was preserved to a certain extent through the retention of customary law by the authorities in these colonies.³⁴ The rule of law, as a concept derived from Western civilisation, is no exception. Likewise, traditional China has its own version of the rule of law, e.g. the legalist school, with which some scholars attempt to draw a parallel to the Western concept.³⁵ The absorption of the rule of law in contemporary China has to be considered in a Chinese context. In China, democracy and judicial independence have their own vernacular. However, China has entered into a number of international commitments which require it to observe the rule of law as understood by the international community, e.g. transparency, independent adjudication process and legal reasoning. The incorporation of these concepts into the Chinese legal system has to be examined.

The rule of law itself is a Western political theory restricting governmental powers. It is an ideal whose existence in each country is subject to debates, e.g. written constitution versus supremacy of parliament, and civil law versus common law. The transplant of the rule of law from one culture to another is a tedious and difficult task. It is more so when the rule of law is transplanted from one political culture to another radically different political culture, e.g. Western democracy versus communism. Each individual political system has its own unique legal infrastructure. Although the World Bank claims that studies have shown a strong correlation between the rule of law and development indicators, e.g. gross national income and infant mortality,³⁶ its definitions of the rule of law simplistically fit into the thin type.³⁷ Some critiques argue that they hide a fundamental conceptual vagueness, as the rule of law has different meanings in different contexts.³⁸ Whether China is considered to have rule of law or rule by law is an issue of definition and degree.³⁹ China takes a pragmatic approach in its concept of human rights, with a narrow view considering human rights as the rights of the people not to live in poverty.⁴⁰ This may well be a national priority in its economic development. It does not have universal suffrage as in Western democracies.

Rather, it has implemented a system of indirect election up to the municipal level with direct elections at the local level under the scrutiny of the CCP.⁴¹

Legal reform in China is a challenging task. The present legal system in China is a transplanted legal system based primarily on the civil law system. It adopted the civil codes of Germany and to a considerable extent the socialist legal system of the former Soviet Union and its own traditional law and customs.⁴² Reforming any legal system would take time and require the patience of the people to adapt. The present laws in China are considered vague, lacking transparency, conflicting and inconsistent in their interpretation, unfairly administered, and unevenly and ineffectively enforced.⁴³ Assessing China's legal development without considering its cultural, economic, historical and political aspects lacks sophistication. There are many defects in its effort to build a contemporary legal system, as well as many challenges confronting its future development. An example is China's corporate and financial law reform. It has to strike a balance between market reform and maintaining social stability. Therefore, state ownership and control of companies are still essential in providing a social security net for the mass of workers. On the other hand, privatisation would result in less reliance of the people on the government, and this might foster democracy in the long run. The real issue is whether or not there is evidence of a genuine undertaking by its ruling elite in developing a legal system that fits modern China. The efforts of China in building its legal system cannot be discredited⁴⁴ and are considered as extensive by a number of academics.⁴⁵ As Professor Alford, a Harvard jurist, has written:

... China's post-Cultural Revolution project of legal development is an event of epic historical proportions. No other major modern society has endeavored in so short a time to reconstruct its legal system in so extensive and novel a fashion. Indeed, one might say that in its magnitude, this undertaking offers something of a contemporary societal analogue to another unparalleled China construction project ... of the Great Wall. As with the Great Wall, ... law reform has the potential to recast China's internal dynamic, even as it seeks to shape China's interaction with the world beyond its borders.⁴⁶

One overreaching question is the harmonisation of the leadership of the CCP with the supremacy of the law under the thin type. After a period of lawless turmoil during the Cultural Revolution (1966–76), Deng Xiaoping (1902–97), China's paramount leader, stated in 1978 that

democracy should be provided by law in ensuring that the change of leadership would not result in change of law and institutions.⁴⁷ A survey of U.S. businesses by the General Accounting Office of the U.S. Congress (GAO) has shown that they believe the Chinese leadership is strongly committed to reform.⁴⁸ In its transformation to a market economy, China has to protect the property and contractual rights of its citizens. Chinese jurists have begun to argue that law is the prerequisite to economic reform. Accordingly a number of pieces of legislation have been enacted in fostering international trade, protecting intellectual property rights, regulating business association, etc.⁴⁹ As China has entered into the international community, it has also revised its laws in response to pressure from foreign countries.⁵⁰ It recognised that foreign interests in China have to be protected by law in ensuring continuous foreign investment and trade. By 1986, China had already enacted more than 300 pieces of legislation on economic reform notwithstanding there was widespread defiance against them.⁵¹ Even the Tiananmen incident in 1989 did not stop China's progress in developing its legal system. A 1999 amendment of the Chinese Constitution incorporated an element of the thin type notion of the rule of law by requiring the state to be ruled in accordance with the law and building a socialist country of law.⁵² This was implemented by a document of the State Council.⁵³ In the same year, the Supreme People's Court issued a directive requiring all future judicial appointments to be made competitively based on merit rather than party loyalty.

Legal reform in China is to provide a supporting infrastructure for its economic reform in meeting the challenges of participation in global markets. This would require importing legal concepts with an accountable government.⁵⁴ Economic reform requires the implementation of the rule of law with minimal state intervention in maximising individual rights and autonomy.⁵⁵ As its legal culture has a tendency to rely on political authority, this inevitably creates a conflict.⁵⁶ The ambiguity between the leadership of the CCP and supremacy of the law under the Chinese Constitution nevertheless requires authoritative reconciliation. Notwithstanding the Chinese Constitution expressly stipulates that it is the supreme law of the land, it is uncertain whether this provision overrides the leadership of the CCP in its preamble.⁵⁷ Arguably, the preamble of the Chinese Constitution may be construed as an interpretation guide providing the historical development of its main text. Although the CCP continues to exert its influence on the legislative functions of the NPC and the judicial functions of the courts,⁵⁸ one cannot ignore the fact that the

legal system in China is in transition. After the Cultural Revolution (1966–76), there was virtually no law in China. Those which survived were hard to find or simply regarded as “confidential law”.⁵⁹ Rather than surmising what the formal law should be, it is the attitude of the governing elite, the awareness of the general population and the appropriate legal infrastructure that count. The success of legal reform in China very much depends on whether or not new laws would respond effectively to its new economic order. In reality, advancing the rule of law in China depends more on its legal infrastructure than on the laws on the book.⁶⁰ It has to train more lawyers and judges than economists in supporting the legal framework, e.g. an independent judiciary.⁶¹

In progressing towards the thick notion of the rule of law, a 2004 amendment of the Chinese Constitution entrenches human rights in its equality provision.⁶² This amendment also protects private property and provides compensation for property expropriated or requisitioned.⁶³ In implementing these amendments to the Chinese Constitution, the State Council published *A National Implementation Program to Promote Administration of the Country in Accordance with the Law*.⁶⁴ This document aims at building a governmental system which operates under the rule of law in 10 years’ time.⁶⁵ This document serves as internal guidelines for officials. Its publication indicates transparency and greater public participation in the policy making process. In April 2004, the State Council issued a set of rules requiring CCP and government officials to resign for blunders and dereliction of duty.⁶⁶ This is a step forward towards transparency and accountability of the governing elites. In the past, the bureaucrats had been pursuing rapid economic growth at the expense of occupational safety and a sustainable environment.⁶⁷ These rules set out clear criteria in regulating these officials.

The effort in developing the rule of law in China is evidenced from its effort in training more lawyers and enhancing the standards of judicial officers.⁶⁸ China has sent thousands of promising personnel to study law overseas and has received thousands of overseas judges, academics and lawyers for legal consultations.⁶⁹ Departing from its socialist past, foreign law is part of the curriculum not only for undergraduate law students, but also for judges, prosecutors and lawyers.⁷⁰ China’s efforts in introducing a sound legal system are considered impressive.⁷¹ A report of the Asia-Pacific Economic Cooperation Forum (APEC) released in June 2004 commended the highest political leadership of China for clearly committing to reform its economy based on WTO and APEC

commitments.⁷² Another report by the U.S. GAO states clearly that China has shown considerable determination in revising its laws, regulations and measures in ensuring its legal system are WTO compatible on paper.⁷³ Notwithstanding the constant criticism of China's human rights records by the U.S. Congress, this report describes China's legal reform, which has been ongoing for more than twenty years, as substantial legal developments that are rule of law related.⁷⁴

4. The Rule of Law and China's WTO Accession

China's accession to the WTO in December 2001 marks the beginning of a new era in its development of the rule of law. It has been described as part of a larger strategy of massive and fundamental economic reform by the CCP.⁷⁵ As a member of a number of international organisations and a signatory state to a number of international conventions, including human rights conventions, e.g. the *International Covenant on Economic, Social and Cultural Rights*, and environmental protection convention, e.g. the *Montreal Protocol on Substances that Deplete the Ozone Layer*, China has already committed to adopt international best practices. Its WTO accession integrates China with the global community through trade in goods and services. It has also accelerated the space of market liberalisation in China amidst its transformation from a socialist economy to a market economy.⁷⁶ There is very little doubt that China's WTO accession will accelerate its economic, financial and legal reforms. It provides grounds for the reformers to overcome resistance to structural and policy reforms.⁷⁷ International influence is necessary in reforming its state-owned enterprises (SOEs), breaking up monopolies and streamlining its financial institutions. China's WTO accession is a significant assurance in pursuing domestic reform. The WTO commitments bind all successors of China's ruling elite and the entire bureaucracy and enhance the incentives to all Chinese people to adapt to the changes accordingly.⁷⁸ When China's bureaucrats and local officials realise that its WTO commitments are meant to be serious, they will modify their plans and actions accordingly, making the commitments more expensive to violate.⁷⁹ This is one step forward in establishing a market oriented economy. Upon its WTO accession, China committed to implement a legal system which is adaptable to the influx of international competitors in its domestic markets. The extent of compliance by China towards its WTO agreements indicates its state behaviour induced by international law.⁸⁰

4.1 The long march to WTO membership

The transaction costs for China are quite high in its WTO accession. It entered into a very complicated process in negotiating and drafting the WTO agreements. Domestically, it had to contend with the bureaucracy and local authorities who do not wish to give up their vested interests as a result of its WTO commitments. Internationally, as a requirement to becoming a member of WTO, China entered into bilateral agreements with 37 requested WTO members.⁸¹ These bilateral agreements addressed each requested member's individual concerns with China's accession. These agreements were then codified and synthesised into China's *Protocol of Accession (Protocol)*. Upon accession to the WTO, China has to eliminate all forms of prohibited subsidy.⁸² China has committed to revise all its legal documents to meet its WTO obligations.⁸³ The *Protocol* provides that "China's local regulations, rules and other measures of local governments at the sub-national level shall conform to" its WTO commitments.⁸⁴ This addresses the concerns expressed by some members of a Working Party established by the Council of the WTO (the WTO Working Party) that local governments in China might not cooperate with implementing China's WTO commitments.⁸⁵ This provision reinforces the WTO Agreement which requires each member to ensure its domestic laws conform to it.⁸⁶ In monitoring China's compliance with its WTO commitments, a Transitional Review Mechanism was established.⁸⁷ This mechanism provides that each subsidiary body, e.g. Council for Trade in Services and Subsidies and Countervailing Measures, and the General Council, etc., should review the implementation by China of the WTO Agreement and the related provisions of the *Protocol*.⁸⁸

In October 2001, the WTO Working Party submitted its report on the accession of China to the WTO,⁸⁹ which has been in line with China's objective of economic reform in establishing a socialist market economy and its basic national policy of opening to the outside world.⁹⁰ Like any other socialist state, state subsidies to all major sectors of the economy are an integral part of a planned economy. The Working Party was concerned about trade-distorting subsidies, which may violate the *SCM Agreement*.⁹¹ There were concerns that when state-owned commercial banks (SOCBs) provided financial contributions, they might be acting on behalf of the government.⁹²

The *Protocol* stipulates that China has to notify the WTO of any subsidy within the *SCM Agreement*, and specifically prohibited

subsidies.⁹³ The information provided should be as specific as possible in conformity with the requirements of the *SCM Agreement*.⁹⁴ The *Protocol* makes it expressly clear that subsidies provided to SOCBs are considered as specific, as defined by Article 2 of the *SCM Agreement*, if state-owned enterprises are the predominant recipients of such subsidies, or they receive disproportionately large amounts of such subsidies.⁹⁵ This provision in the *Protocol* in effect avoids any doubt as to whether or not subsidies apply to state-owned enterprises. As China embarks in restructuring its SOEs, reforming its financial sector and seeking direct foreign investment, it has also learnt that it has to reform its financial architecture in line with international standards. China has to take account of the WTO Agreement in formulating its reform in the financial sector. The liberalisation of the financial sector in China and state subsidies were one of the most important hurdles to entry into the WTO.⁹⁶

The *Protocol* provides that all the commitments referred to in the *Working Party Report* are an integral part of the WTO Agreement for China.⁹⁷ This would include China's commitment that its objective is that SOCBs are run on a commercial basis and responsible for their own profits and losses.⁹⁸ This commitment was made as a result of concerns expressed by some members of the Working Party that SOCBs might grant subsidies as government actors by providing financial contributions.⁹⁹ China stated that such financial contributions would not necessarily confer a benefit under the *SCM Agreement*.¹⁰⁰ As required by the notification mechanism under the *SCM Agreement*, China has committed to provide subsidy notifications in respect to subsidies from the central budget provided to certain SOEs which are running at a loss.¹⁰¹ The notification would include subsidies in promoting restructuring of SOEs which are running at a loss, while keeping employment by means of promoting rationalisation and maintaining stable production and safety of the society, e.g. compensation for the lack of a social security system.¹⁰² This covers SOCBs which receive government subsidies in granting loans to SOEs which are running at a loss for keeping employment.

There are numerous studies which support the assumption that the rule of law is positively correlated with economic development.¹⁰³ However, whether economic development depends on the rule of law is debatable.¹⁰⁴ Nevertheless, the Asian financial crisis in the late 1990s was a result of inadequate economic planning, weak regulatory mechanisms, lack of enforcement of prudential rules and poor transparency.¹⁰⁵ Empirical research has shown that economic development depends on meeting the

threshold of the thin type of the rule of law.¹⁰⁶ This conclusion may not be universally true as China has sustained high economic growth since 1978 notwithstanding its rudimentary rule of law.¹⁰⁷ There are many explanations for this phenomenon, including irrational investor choice, willingness to bear higher risks for prospective profits and informal investments from overseas Chinese.¹⁰⁸ One cannot ignore the reality that the high growth rates in China's economic development are correlated to the progression in its legal development.¹⁰⁹ Such progression is not difficult to measure, as the concept of law was virtually non-existent during the Cultural Revolution. A jurisdiction governed by the rule of law and judicial independence is more likely to comply with its international obligations.¹¹⁰ The likelihood of China's compliance to the WTO agreements may accordingly be correlated to its progression in its legal development.

4.2 Legal reform

One of China's WTO commitments is to revise its laws and enact new ones to comply with the WTO Agreement.¹¹¹ It would be in China's national interest to comply with the WTO agreements. The legalisation of the WTO Agreement by China enhances the credibility of its commitment to economic reform in the global arena.¹¹² In the late 1970s China began to reform its legal system.¹¹³ The reform can be classified into five main categories, i.e. business entities, establishing "rights in rem" in protecting property rights, enacting new contract legislation in accord with a market economy and establishing the legal framework for the macro-economy.¹¹⁴ Their major accomplishments are governance according to the law, establishment of a legal framework for a market economy and constructing a judicial system.¹¹⁵ In ensuring compliance with international commitments, in adjudicating cases involving foreigners, the courts must give preference to these commitments over conflicting domestic laws.¹¹⁶ Notwithstanding mediation continues to be a traditional preference in settling disputes, the number of civil and economic proceedings commenced in Chinese courts has risen from 2.4 million to 6 million cases in a seven year period.¹¹⁷ During the Cultural Revolution, law schools were closed.¹¹⁸ Thereafter, the few lawyers were inadequately trained and most judges were laymen. By 2000, China had over 150,000 lawyers and 8,000 law firms.¹¹⁹ Now, all judges must pass the legal practitioner examination. In the 1990s, China established legal institutions which are intended to limit bureaucratic arbitrariness by enacting the *Law on Administrative*

Procedures and the Law on Administrative Review in 1990 and 1999 respectively. The *Regulations of Administrative Review*, however, had been promulgated by the State Council in 1990 as an administrative order. According to an official report in 2001, the President of the Supreme People's Court, Xiao Yang, stated that all courts must be able to apply WTO agreements in domestic law properly in upholding China's judicial sovereignty.¹²⁰

In implementing its WTO obligations, China has revised more than 1,413 separate legal documents, including laws, regulations and directives.¹²¹ In line with this, the Supreme People's Court by 2002 had reviewed and cleared over 2,600 judicial interpretations and annulled 177 of them.¹²² Like other member states, China's commitments under international trade obligations would inevitably weaken its absolute sovereignty. Legal scholars posit that when international commitments are incorporated into domestic law, it raises concern over national sovereignty.¹²³ The competency of its CCP, NPC and the State Council is inevitably limited by honouring China's WTO commitments. China's constitutional framework assures the supremacy of the CCP and this has to be reconciled with its WTO commitments. Nevertheless, under the doctrine of legislative interpretation, the Standing Committee of the NPC has the final adjudication power in interpreting the Chinese Constitution, which may be vetoed by the full NPC.¹²⁴ Therefore, it is very unlikely that the NPC would consider any legislative provisions it enacted in implementing China's WTO commitments as *ultra vires* to the Chinese Constitution. The supremacy of the CCP is a guiding principle under the Chinese Constitution, which may be construed as a directive and not mandatory provision. The entire preface of the Chinese Constitution may be considered more of a background chapter than anything else, as the Chinese Constitution also asserts the supremacy of the law.¹²⁵ Ironically, it may well be the absence of the doctrine of separation of powers in the Chinese Constitution which legitimises China's WTO commitments.

The *General Agreement on Tariffs and Trade (GATT)* and the *General Agreement on Trade in Services (GATS)* provide that each member state shall establish judicial, arbitral or administrative tribunals or procedures to review administrative actions relating to customs matters and trade in services respectively.¹²⁶ They require that the final adjudication process must be handled by an independent tribunal.¹²⁷ The WTO Agreement also provides that a member state shall provide the right of appeal without penalty to the judiciary.¹²⁸ There are similar provisions under the

Agreement on Subsidies and Countervailing Measures (SCM Agreement) and anti-dumping agreement regulating a member state which has countervailing and anti-dumping laws.¹²⁹ The *Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)* also provides for a judicial review mechanism.¹³⁰ The consequence of China's WTO accession goes beyond its legislative reform. The liberalisation of its markets with the influx of foreign enterprises would have a profound influence in its status quo.¹³¹ These WTO agreements set up minimum standards for the rights to judicial review with formal procedures to an independent, fair, and impartial tribunal.¹³² The Chinese administrative laws, mentioned above, essentially meet the threshold of these WTO agreements on judicial review.¹³³ Facing external competition, China has already embarked on economic and financial reforms. The business and commercial sector of China will be more pluralistic. Consequently, the attitude of its population would be more cosmopolitan.¹³⁴ This monopoly of information by the state is diminishing, as foreign media enter China's market. This inevitably would raise the political consciousness of the population. One direct consequence of China's WTO accession is that it has reformed its legal system in protecting investor rights and its judicial review system in providing a channel for grievances against administrative actions.

China's WTO accession will open up its legal services market by 2007. It is committed to liberalise the cross-border supply of professional services, which is unprecedented.¹³⁵ Although foreign law firms are restricted to provide services in respect to their home jurisdictions, this will have a profound influence in enhancing China's legal standards and jurisprudence. It is inevitable that the lawyers in China will have to compete for lucrative referrals from foreign law firms. In doing so, they have to conform to the requirements of multi-national law firms. In the long term this will have a profound influence on China's legal development. As China engages in liberalising its domestic markets through economic and legal reforms, the legitimacy of the CCP will transform from socialism and class struggle to economic reform and socialist legalism.¹³⁶ As economic growth depends very much on stability and predictability through formal legal process in protecting rights, informal governance is inevitably challenged.¹³⁷ The ideological approach of state planners would be contested in response to the economic reality, which is changing rapidly.¹³⁸ In ensuring predictability of market regulation, state intervention must be curtailed in providing economic autonomy.¹³⁹ The enactment of new legislation would diminish the role of

the CCP as the legislative and legal processes are in the reign of legal experts than party officials.¹⁴⁰ The CCP may retain control through party discipline and appointments. However, legal experts will pose a real challenge to the CCP over the legal reform, as market regulation relies on legal expertise rather than on party ideology.¹⁴¹

China has paid transaction costs in gaining its accession to the WTO from negotiation, legislative reform and political adaptation. It has made its best efforts to enhance the credibility of its commitments towards market liberalisation to international investors. Historically, China has been very mindful of giving up its sovereign autonomy. Sovereignty costs are the highest when international commitments alter the relationships between a state and its citizens.¹⁴² The prevalence of its WTO commitments over the leadership of the CCP is a very high political cost for its ruling elite. This can be shown from its swift legal reform to conform to its WTO commitments. Legal scholars have suggested that when commitments are legalised by a country state, it demonstrates the desire of the state to be a reliable member of the international community.¹⁴³ It has been observed that legal commitments are credible because other aggrieved countries can enforce the domestic law.¹⁴⁴ China has to conform to the rules of the international trading community in benefiting from its WTO accession and in enhancing its status in future rounds of WTO negotiations. The reputational costs of violating the WTO agreements would strengthen China's commitments to them.¹⁴⁵ The compliance of China with its WTO commitments is a measurement of its state behaviour. With legal reform, China's WTO commitments can be adjudicated by its judiciary and lawyers are more inclined to apply the law accordingly. Although China's legal system may not be perfect to enforce its domestic law in enforcing violations of its WTO commitments, the last thing the ruling elite would want to see is the imposition of countervailing measures against its domestic economy by the WTO.

5. Financial Services Liberalisation and the Rule of Law

China's economic growth is supported by its financial sector, which is most affected by its WTO accession. Therefore, financial reform is inevitable in order to meet competition from international financial services providers. However, financial reform is a politically sensitive area. In China, its leadership has been steering the economy through control over its financial system.¹⁴⁶ The liberalisation of China's financial

markets is a major concession made in its WTO accession. Empirical studies have shown that a sound legal and regulatory environment is required for financial development.¹⁴⁷ Countries with better legal and regulatory systems have better functioning financial intermediaries.¹⁴⁸ Research has shown that legal and regulatory changes that enhanced financial intermediary development are positively correlated with economic growth.¹⁴⁹ However, studies have also shown that China is a counterexample in that its legal and financial systems both lag behind its very fast growing economy.¹⁵⁰ One explanation of this phenomenon is the important role of informal mechanisms, e.g. financial channels, based on reputation and institutions, rely upon implicit contractual agreements for alternative corporate governance mechanisms.¹⁵¹

In China where the legal and institutional preconditions have yet to be fully developed, its economy should fare better by strengthening its financial sector.¹⁵² Now, China's WTO accession should accelerate the pace of financial reform through its commitments to liberalise its domestic financial markets.

5.1 Commitments to liberalise banking services

China's commitments to liberalise its financial markets consist of horizontal and specific commitments. Under the horizontal commitments, foreign invested enterprises, including foreign capital enterprises (wholly foreign-owned enterprises) and joint venture enterprises are allowed to have commercial presence in China.¹⁵³ Branches of foreign enterprises may be established subject to specific restrictions.¹⁵⁴ These commitments are applicable to all sectors, including financial services.¹⁵⁵

One of the free trade principles is to trade without discrimination. Accordingly, financial services provided by foreign and domestic institutions should be treated equally in the domestic market. This is called "national treatment" and is applied once the financial services providers have entered the domestic market. The GATS is an integral part of the WTO Agreement.¹⁵⁶ Its Annexes on Financial Services applies to measures affecting the provision of financial services.¹⁵⁷ A member state has to comply with this principle only if it has made a specific commitment for foreign access to its banking market.¹⁵⁸ Under the *Protocol*, China is committed to allow foreign access to its financial markets through a scheduled process.¹⁵⁹ Accordingly, when the foreign access of a specific financial service to China's markets is in force, it has to apply the principle

of national treatment. The GATS provides that a member state shall accord to services and service suppliers of another member state, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own similar services and services suppliers.¹⁶⁰

5.2 Commitments to eliminate trade barriers

Crucial to a competitive environment for financial services upon China's WTO accession are the specific commitments providing that the criteria for authorisation to deal in China's financial services sector are solely prudential.¹⁶¹ The criteria contain no economic needs test or quantitative limits on licenses.¹⁶² By December 2001, any existing non-prudential measures restricting ownership, operation and juridical form of foreign financial institutions, including on internal branching and licenses, shall be eliminated.¹⁶³ The commitments made by China to liberalise its financial markets upon its WTO accession are considered as the most radical change in its economic and political developments. As a socialist state, financial resources have always been a means for the central authority to exercise its control nationally. Its banking sector has been a state organisation to allocate resources in implementing governmental policies. Consequently, profit making has not been high in its agenda. Upon accession to the WTO, its financial institutions are facing competition from foreign institutions. In preparation for this, China has embarked on reforming its financial sector.

6. Conclusion

As China is still a developing socialist market economy, its efforts to comply with the WTO commitments could hardly be perfect. Its legal documents, as well as its judicial process, have yet to be proven to be consistent with its WTO obligations. Nevertheless, the above discussions have shown the sincere efforts of China to fully implement its WTO commitments. China is exploiting WTO commitments to enhance its legal infrastructure and eliminate the protectionism of vested interest groups. According to the public choice theory, China's ruling elite could use its WTO accession to accelerate domestic reforms, as people who act in self-interest have no motivation to support the reforms. We have argued in this article that this is in fact exactly what is taking place, not only with WTO accession but also with the CCP/PRC focus on developing the rule of law.

In any event, China's WTO commitments nevertheless would result in

giving up its sovereignty power in policy-making, as it can no longer restrict access to its domestic markets and foreign ownership. In using international commitments as a reform mechanism, the ultimate consequence would limit state intervention in the markets and enhance transparency in governance. As a result, developing a rule of law system is both necessary to implement international commitments made to support economic development as well as to support continued economic development, regarded as necessary in order to maintain the governance objectives of the CCP in the context of the PRC. At the same time however, one cannot lose sight of the fact that implementation of a thin rule of law system is also aimed at increasing central government control over local and provincial officials, the idea that a rule of law system, as well as providing major economic benefits, may at the same time serve as an administrative means to address China's age-old conflict between central and dispersed power.

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