

## HOW MAY CHINA RESPOND TO THE U.S. TRADE APPROACH? RETALIATORY, INCLUSIVE AND REGULATORY RESPONSES

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*This paper endeavours to conceptualize and provide an analytical framework for China's response to U.S. trade policy. It analyses the following questions: what is the new U.S. trade approach? How might China respond to the United States' trade approach? What are the trend and implications of China's response to the U.S. trade approach? It argues, first, that the U.S. trade approach has not changed regarding most of the U.S.-style regulatory disciplines. However, it has changed in terms of the shift toward managed trade, unilateralism and trade enforcement. Second, China will likely adopt a three-track approach: consisting of retaliatory, inclusive and regulatory responses. Third, these responses exist on a political-legal spectrum that spans from a more political retaliatory response through to an inclusive one, or a more legalized approach (regulatory response). The inclusive response is likely to be given primacy by China over the other two responses, and China's responses carry profound implications.*

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## I. INTRODUCTION

The bilateral relationship between the US and China is crucial, since they are the two biggest economies and most consequential strategic actors in the world.<sup>1</sup> U.S. trade policy often targets China, including in domestic measures (e.g., trade remedies measures and President Trump's order of a Section 301 of the 1974 Trade Act investigation into China's intellectual property practices<sup>2</sup>), the United States-China bilateral investment treaty (BIT) negotiations, and disputes at the World Trade Organization (WTO). The United States is deemed to be the only country that has the power to force China to make systemic concessions regarding trade policy,<sup>3</sup> and the European Union can do the same at least to a lesser degree. More broadly, the United States plays "an oversized role in the Chinese legal imagination and legal politics today."<sup>4</sup>

There is substantial China-United States disagreement on trade. The volume, gravity and urgency of the issue deserve attention, including President Trump's likely aggressive trade policies toward China, and the inadequacy of existing dispute settlement mechanisms. Historically, China's WTO accession is arguably a response to the requirements regarding the MFN treatment in the United States. Nowadays China has quickened the pace in its Belt and Road initiative (BRI), preferential trade and investment agreements (PTIAs), and free trade zones (FTZs), among others. Given its economic clout, China's reaction to the U.S. trade approach may affect not only the countries' bilateral relationship (e.g., the possible trade

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<sup>1</sup> Mark Beeson & Fujian Li, *What consensus? Geopolitics and Policy Paradigms in China and the United States*, 91 INTERNATIONAL AFFAIRS 93, 93 (2015).

<sup>2</sup> *Presidential Memorandum for the United States Trade Representative* (Aug. 14, 2017), available at <https://www.whitehouse.gov/the-press-office/2017/08/14/presidential-memorandum-united-states-trade-representative>.

<sup>3</sup> *Trump's Deficit Crusade Overshadows Xi's Investment Treaty Pitch*, BLOOMBERG NEWS, Apr. 19, 2017, <https://www.bloomberg.com/politics/articles/2017-04-19/trump-s-deficit-crusade-overshadows-xi-s-investment-treaty-pitch>.

<sup>4</sup> TEEMU RUSKOLA, *LEGAL ORIENTALISM: CHINA, THE UNITED STATES AND MODERN LAW 202* (Harvard Univ. Press. 2013).

war<sup>5</sup>), but also other countries and even global economic governance (e.g., possible retaliation bringing uncertainties in the world trading system and increasing protectionism). Although China's interaction with the United States regarding trade has received much attention,<sup>6</sup> there is insufficient research on the analytical framework of China's responses to the United States on trade, which will be explored here.

As a work of primary original analysis, the paper discusses several questions: what is the new U.S. trade approach? What are the possible responses of China to U.S. trade policy? What are the trend and implications of China's response to the U.S. trade approach? The aim of the paper is to develop a conceptual framework that could inform debate over China's possible trade strategies and pathways. The paper proceeds as follows: Part II critically reviews the U.S. trade approach, arguing that the U.S. trade approach remains largely unchanged regarding U.S.-style regulatory disciplines but has changed in respect of the shift toward managed trade, unilateralism and trade enforcement. According to the major functions of different responses, the paper argues that China will likely adopt a multipronged approach: comprising retaliatory (Part III), inclusive (Part IV) and regulatory responses (Part V). Retaliation deters or stops the measures of the other party. An inclusive response engages with partners to liberalize trade without imposing deep regulatory disciplines. Meanwhile, a regulatory response promotes regulatory protection. Part VI analyses the profound implications raised by the responses. Importantly, these responses exist on a political-legal spectrum that spans from a more political retaliatory response through to the inclusive one and to a more legalized end (a regulatory response). Part VII provides short concluding remarks, reflecting on the essence of China's response and open issues.

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<sup>5</sup> The U.S. actions and China's reaction will decide whether a trade war between the two states will eventually materialize. Marianne Schneider-Petsinger, *Trade Policy Under President Trump: Implications for the US and the World*, <https://www.chathamhouse.org/sites/files/chathamhouse/publications/research/2017-11-03-trade-policy-trump-schneider-petsinger-final.pdf>.

<sup>6</sup> See, e.g., Ming Du, *Explaining China's Tripartite Strategy Toward the Trans-Pacific Partnership Agreement*, 18 JOURNAL OF INTERNATIONAL ECONOMIC LAW 407, 407-432 (2015).

Before commencing, one point needs to be clarified. It is difficult, if not impossible, to separate China's response to the U.S. trade approach (particularly inclusive and regulatory responses) from China's efforts to pursue its autonomous trade policies that take into account a wide range of domestic and international considerations. Therefore, China's measures discussed below are largely, but not necessarily fully, attributable to the U.S. trade approach.

## II. THE NEW U.S. TRADE APPROACH

First it is helpful to sketch the U.S. trade<sup>7</sup> approach to consider how this interacts with China. The U.S. response to the rise of China<sup>8</sup> has long been to engage and hedge – to draw China into a rules-based system while refurbishing old alliances as an insurance policy.<sup>9</sup> The major concerns of the United States regarding its trade with China include trade deficit, RMB exchange rate, excess capacity, market access (e.g., regarding finance, culture, and manufacturing), and the protection of intellectual property.<sup>10</sup> Although these are not new issues, the U.S. trade approach has changed and affected China.

It should be noted that the changed facets of the U.S. trade approach cannot be segmented from its unchanged aspects. In various aspects, the former develops from the latter. Therefore, an overview of the unchanged U.S. trade approach will be useful. Essentially, the U.S. unchanged trade approach is to push for strong U.S.-style regulatory disciplines bolstered by the enforcement of these rules in trade pacts.<sup>11</sup> These disciplines may shape new generation trade norms, and may affect China indirectly. An example of potential indirect effect is China's PTIA negotiation with partners that have concluded Free Trade Agreements

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<sup>7</sup> As trade pacts conclude by the United States cover WTO-extra issues such as investment and social issues, trade is understood in the broad sense here unless otherwise stated.

<sup>8</sup> For the analysis of China's rise, see, e.g., DAVID C. KANG, *CHINA RISING: PEACE, POWER, AND ORDER IN EAST ASIA 1-203* (Columbia University Press, 2007).

<sup>9</sup> Daniel S. Hamilton & Steven Blockmans, *TTIP's Broader Geostrategic Implications*, in *RULE-MAKERS OR RULE-TAKERS? EXPLORING THE TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP* 245, (Daniel S. Hamilton & Jacques Pelkmans eds., 2015).

<sup>10</sup> Research Report on China-US Economic and Trade Relations (2017).

<sup>11</sup> Trading Up: U.S. Trade and Investment Policy (2016).

(“FTAs”) with the United States, such as Australia, Korea, and possibly Canada. More broadly, the PTIAs negotiated by the United States could gradually shape new international rules that will affect China.

The United States is not likely to radically deviate from its previous deep FTAs in terms of highlighted regulatory requirements on non-tariff measures, and its previous positions such as the Bipartisan Trade Deal,<sup>12</sup> and the Bipartisan Congressional Trade Priorities and Accountability Act.<sup>13</sup> Under the Trump Administration’s NAFTA negotiation objectives, “the new NAFTA may look very similar to” the Trans-Pacific Partnership (TPP) despite some differences.<sup>14</sup> As recently indicated by the US government, its PTIAs “must adhere to high standards in intellectual property, digital trade, agriculture, labor, and the environment.”<sup>15</sup> The US trade agreements adopt a “‘conditional’ or ‘hard’” template on labor provisions.<sup>16</sup> The recent US approach in all of its trade pacts is to link social issues (such as workers’ rights) to trade.<sup>17</sup> Following the same path, the Trump Administration has further proposed moving labour rights and environmental standards<sup>18</sup> into ‘the core’ of the NAFTA rather than in a side agreement and highlighting their enforcement (i.e. enforcement of domestic labour law in NAFTA parties and enforcement of environment obligations under NAFTA dispute settlement system).<sup>19</sup> Overall, the United States will probably maintain its current position on many of key issues including intellectual property, e-commerce and state-owned enterprises (SOEs), which are largely based on the U.S. domestic law.

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<sup>12</sup> Office of the United States Trade Representative, *Bipartisan Trade Deal* (2007).

<sup>13</sup> Bipartisan Congressional Trade Priorities and Accountability Act of 2015, S. 995, 114th Cong. (2015).

<sup>14</sup> Simon Lester, *The Trump Administration’s NAFTA Negotiating Objectives*, INTERNATIONAL ECONOMIC LAW AND POLICY BLOG (July 17, 2017).

<sup>15</sup> *National Security Strategy of the United States of America*, at 20, (Dec. 2017).

<sup>16</sup> Ferdi De Ville, et al., *Sustainable Development in TTIP: A Highest Common Denominator Compromise?*, 7 EUROPEAN JOURNAL OF RISK REGULATION 290, 291 (2016).

<sup>17</sup> Daniel C.K. Chow, *How the United States Uses the Trans-Pacific Partnership to Contain China in International Trade*, 17 CHICAGO JOURNAL OF INTERNATIONAL LAW 370, 400 (2016).

<sup>18</sup> Trump Administration seems to roll back environment protection particularly in terms of the renunciation of the Paris Agreement. That said climate change is usually not addressed under the previous U.S. FTAs such as the TPP.

<sup>19</sup> Office of the United States Trade Representative, *Summary of Objectives for the NAFTA Renegotiation*(Jul. 17, 2017), available at <https://ustr.gov/sites/default/files/files/Press/Releases/NAFTAObjectives.pdf>.

For the new U.S. trade policy, its overarching objective is “to expand trade in a way that is freer and fairer for all Americans.”<sup>20</sup> In particular, the U.S. government tends to address unfair foreign trade practices through unilateral policies, renegotiation or withdrawal from pacts, and threats of import protection.<sup>21</sup> As discussed below, the changed aspects of the U.S. trade approach may develop from the previous one (such as the enforcement of trade rules). However, with the U.S. trade approach in flux, it is difficult to accurately review its features. The following part focuses on the most salient aspects of the paradigm shift of the U.S. trade approach, particularly those related to Sino-US trade relations.

### A. Managed Trade

The United States shifts from trade liberalisation to managed trade, and in particular further highlights its trade deficit with China.<sup>22</sup> As the most noticeable difference from previous trade practices, the Trump Administration adopts a mercantilist approach anchored in economic nationalism<sup>23</sup> under the new “America First” trade policy.<sup>24</sup> Reducing the US trade deficit is a key pillar of Trump’s policy.<sup>25</sup> This explains why there is considerable rhetoric on bilateral trade relations with China,<sup>26</sup> which attracts more attention than before. Trade pacts pursued by the US are also “‘trade balance agreements’ or ‘trade deficit agreements’ rather than free trade agreements.”<sup>27</sup> This new approach differs from the United States’ leading role in institutionalizing and advancing the liberalization of trade and flows of

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<sup>20</sup> Office of the United States Trade Representative, *2017 Trade Policy Agenda and 2016 Annual Report of the President of the United States on the Trade Agreements Program* (2017), available at <https://ustr.gov/sites/default/files/files/reports/2017/AnnualReport/AnnualReport2017.pdf>.

<sup>21</sup> Kyle Handley & Limão Nuno, *Trade under T.R.U.M.P. policies*, in *ECONOMICS AND POLICY IN THE AGE OF TRUMP* 141, (Chad P. Bown ed. 2017).

<sup>22</sup> Ministry of Commerce of the People’s Republic of China, 64. 2017.

<sup>23</sup> David P. Fidler, *President Trump, Trade Policy, and American Grand Strategy: From Common Advantage to Collective Carnage*, 12 *ASIAN JOURNAL OF WTO & INTERNATIONAL HEALTH LAW AND POLICY* 1, 1, 7 (2017).

<sup>24</sup> *America First Foreign Policy* (Dec. 2, 2017), available at <https://www.whitehouse.gov/america-first-foreign-policy>. (The US will “put American workers and businesses first when it comes to trade”); Schneider-Petsinger, 3. 2017.

<sup>25</sup> Schneider-Petsinger, 2, 2017.

<sup>26</sup> Bridges Negotiation Briefing: A Guide to the WTO’s Eleventh Ministerial Conference 4 (2017).

<sup>27</sup> C. Fred Bergsten, *The US Agenda: Trade Balances and the NAFTA Renegotiation*, A PATH FORWARD FOR NAFTA 17, (C. Fred Bergsten & Monica de Bolle eds., 2017).

investment since World War II.<sup>28</sup> The primary reasons for the waned support for trade liberalization are, inter alia, the serious employment and income pressures by affected sectors.<sup>29</sup> It drives the US trade policy from the support to ambivalence and then to the doubts of trade liberalization.

On a related note, the United States appears to start managing the outflow of its investment. As reflected in the remarks of the United States Trade Representative (USTR),<sup>30</sup> it is suggested that the U.S. government is no longer responsible for guaranteeing legal protections for American businesses investing in NAFTA countries.<sup>31</sup> This is probably the reason why USTR's NAFTA renegotiation position is to subject new investment provisions to opt-in provisions: countries would have to "opt-in" to participate in ISDS.<sup>32</sup> This arguably makes ISDS largely ineffective.<sup>33</sup> If this is the case, the managed outflow of investment could partially explain why there is lack of incentives to promote the United States-China BIT negotiations recently.

## B. Unilateralism

The Trump Administration shifts its trade approach toward unilateralism and probably bilateralism<sup>34</sup> and away from multilateralism and mega-regionalism (e.g. the TPP). In particular, the shift away from multilateralism toward unilateralism directly affects China at

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<sup>28</sup> Fidler, *ASIAN JOURNAL OF WTO & INTERNATIONAL HEALTH LAW AND POLICY*, 6 (2017).

<sup>29</sup> U.S. Trade and Investment Policy. (2011).

<sup>30</sup> *Closing Statement of USTR Robert Lighthizer at the Fourth Round of NAFTA Renegotiations* (2017), available at <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/october/closing-statement-ustr-robert>. (The US government may not continue to "encourage and guarantee U.S. companies to invest in Mexico and Canada primarily for export to the United States.")

<sup>31</sup> Chad P. Bown, et al., *US Trade Representative "Surprised and Disappointed" Statement from Latest NAFTA Talks—Annotated and Explained* (Nov. 1, 2017), available at <https://piie.com/blogs/trade-investment-policy-watch/us-trade-representative-surprised-and-disappointed-statement>.

<sup>32</sup> *Id.*

<sup>33</sup> Jenny Leonard, *Sources: USTR considering ISDS proposal that would require NAFTA countries to opt in*, Inside US Trade (Aug. 19, 2017), available at <https://insidetrade.com/daily-news/sources-ustr-considering-isds-proposal-would-require-nafta-countries-opt>.

<sup>34</sup> Bilateralism brings less effect on China compared with unilateralism. The U.S. does not have bilateral FTA negotiations with China. Its current bilateral negotiations partners have not proceeded smoothly or are suspended (such as the United State-China BIT negotiations).



the level of the WTO and U.S. domestic law. The United States has historically preferred multilateral liberalisation over regional and bilateral initiatives.<sup>35</sup> Currently the U.S. government has not lent much support to the WTO negotiations and dispute settlement. The U.S. refused to continue talks on global trade reforms in the WTO negotiation.<sup>36</sup> For dispute settlement, the United States may neglect or derogate from the ruling of multilateral trading system if such neglect or derogation is in its national interest,<sup>37</sup> and has recently held up the filling of two Appellate Body vacancies at a time when a heavy case backlog has accumulated.<sup>38</sup>

Notably the Trump Administration increasingly relies on unilateral sanctions, which were adopted by the U.S. government during the pre-WTO era of the 1970s and 1980s and are of uncertain legality under WTO norms.<sup>39</sup> A hallmark of the Trump Administration's trade policy statements is its willingness to use trade sanctions and restrictions based on unilateral determinations of harm to the United States.<sup>40</sup> As discussed below, there are the initiation of high-profile trade remedy and intellectual property investigations by domestic authorities.<sup>41</sup>

That said two points deserve attention here. One is that the United States still intends to play a leading role in multilateral institutions such as the WTO, but will call for their reforms such as making the WTO "a more effective forum to adjudicate unfair trade practices".<sup>42</sup> The other is that stringent U.S.-style regulatory norms are likely to remain under the NAFTA or

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<sup>35</sup> U.S. Trade and Investment Policy 35. 2011.

<sup>36</sup> Tom Miles, *U.S. Gives Davos Trade Meeting No Clues on Ending WTO Crisis* (Jan. 26, 2018), available at <https://money.usnews.com/investing/news/articles/2018-01-26/us-gives-davos-trade-meeting-no-clues-on-ending-wto-crisis>.

<sup>37</sup> Handley & Nuno, 145. 2017.

<sup>38</sup> Rosalind Mathieson, *U.S. Block of WTO Appeals Body Compromises System, Director Says* (Nov. 9, 2017), available at <https://www.bloomberg.com/news/articles/2017-11-08/u-s-block-of-wto-appeals-body-compromises-system-azevedo-says>; China Inc. in the WTO Dock: Tales from a System under Fire. (2017).

<sup>39</sup> Blustein, 16. 2017.

<sup>40</sup> Fidler, *ASIAN JOURNAL OF WTO & INTERNATIONAL HEALTH LAW AND POLICY*, VOL. 12, NO. 1, PP. 1-31, MARCH 2017, 12 (2017).

<sup>41</sup> ICTSD, 4. 2017.

<sup>42</sup> National Security Strategy of the United States of America 40-41. 2017.

future U.S. bilateral pacts. As discussed above, the NAFTA renegotiation does not vastly change the TPP rules.

### C. Trade enforcement

The United States shifts from trade liberalisation to trade enforcement,<sup>43</sup> and adopts a confrontational trade approach. It highlights the enforcement of trade law, including its domestic law and WTO norms. The strong tactic could involve more frequent use of domestic measures or unilateral policy against China,<sup>44</sup> and is likely to continue in view of the recent National Security Strategy of the United States under which China is regarded as a competitor.<sup>45</sup> On the one hand, it reflects a wave of populist and nationalist sentiment,<sup>46</sup> and overlaps with the shift toward unilateralism. On the other hand, the U.S. government claims that there are unfair trade practices conducted by China that need to be addressed,<sup>47</sup> including dumped or subsidized imports, the improper handling of intellectual property rights, and currency manipulation.<sup>48</sup>

The focus on trade enforcement involves various tools, grounds and processes. Regarding the tools, they range from contingency protection to possible border taxes<sup>49</sup> and investment review. Among them, making more aggressive use of trade remedies is to be a key pillar of Trump's policy.<sup>50</sup> The United States may impose further restrictions on SOE investments from China.<sup>51</sup> Regarding the grounds, national security is often invoked as a

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<sup>43</sup> Schneider-Petsinger, 25. 2017.

<sup>44</sup> For instance, the US has initiated many more trade remedy measures against China's iron and steel exports to the US although the export has declined year by year since 2014. Ministry of Commerce of the People's Republic of China, 97. 2017.

<sup>45</sup> National Security Strategy of the United States of America 21. 2017.

<sup>46</sup> Handley & Nuno, 142. 2017.

<sup>47</sup> *Id.*

<sup>48</sup> Schneider-Petsinger, 24. 2017.

<sup>49</sup> Caroline Freund, *Trump's Confrontational Trade Policy*, 52 INTERECONOMICS 63(2017).

<sup>50</sup> Schneider-Petsinger, 2. 2017.

<sup>51</sup> David Dollar, *The Future of U.S.-China Economic Relations*, in BROOKINGS BIG IDEAS FOR AMERICA 133-134, (Michael E. O'Hanlon ed. 2017).

major reason for these measures. The U.S. government self-initiated investigations of steel and aluminum imports under Section 232 of the Trade Expansion Act of 1962 on national security grounds.<sup>52</sup> The Trump Administration has also raised investment restrictions in the United States by legislation introduced to update the Committee on Foreign Investment in the United States (CFIUS) to address national security concerns.<sup>53</sup> Regarding the processes, the Trump Administration has been more active in self-initiating investigations than before. The United States has initiated a number of investigations, including the aforementioned Section 232 investigations and an investigation under Section 301 of the 1974 Trade Act that target China's handling of technology transfer and intellectual property. Notably the United States self-initiated antidumping and countervailing duty investigations against China in aluminium, which is used by the US Department of Commerce for the first time in 20 years.<sup>54</sup>

#### D. Summary

To sum up, the changed facets of U.S. trade approach directly affect China through managed trade (particularly the pressure to reduce bilateral deficit), the shift away from multilateralism toward unilateralism, and trade enforcement. To a large extent, the unchanged facets of the U.S. trade approach also indirectly affect China through strong regulatory disciplines. These facets are often interrelated with or overlap each other (such as trade enforcement and the shift toward unilateralism). The changed facets may build on or develop the unchanged ones. Essentially, the emphasis of the U.S. approach to China is probably

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<sup>52</sup> U.S. Department of Commerce, *Section 232 Investigation on the Effect of Imports of Aluminum on U.S. National Security*, available at <https://www.commerce.gov/page/section-232-investigation-effect-imports-aluminum-us-national-security>.

<sup>53</sup> William Reinsch, *What is President Trump Thinking on Trade?* (Jan. 11, 2018), available at [https://travevistas.csis.org/president-trump-thinking-trade/?utm\\_source=Members&utm\\_campaign=eb9b0a139b-EMAIL\\_CAMPAIGN\\_2018\\_01\\_12&utm\\_medium=email&utm\\_term=0\\_e842221dc2-eb9b0a139b-188595225](https://travevistas.csis.org/president-trump-thinking-trade/?utm_source=Members&utm_campaign=eb9b0a139b-EMAIL_CAMPAIGN_2018_01_12&utm_medium=email&utm_term=0_e842221dc2-eb9b0a139b-188595225).

<sup>54</sup> Lori Ann LaRocco, *US launches anti-dumping case against Chinese aluminum producers using rare aggressive tactic* (Nov. 28, 2017), available at <https://www.cnbc.com/2017/11/28/us-launches-antidumping-case-against-chinese-aluminum-sheet.html>. (The self-initiated case was reportedly to shield the businesses from possible retaliation)

more on hedging. That said, the United States also adopts a ‘pragmatic and realistic’ approach,<sup>55</sup> with engagement as an important part of U.S. policy toward China to promote China’s economic reforms and opening up.<sup>56</sup>

### III. THE RETALIATORY RESPONSE

#### A. The Forms

First, retaliation<sup>57</sup> can take a wide range of forms. Retaliation and counter retaliation are not new, and may be reflected in legislation or other measures. Retaliatory legislation includes discretionary or mandatory retaliatory stipulations. Meanwhile, retaliation usually does not need to change the law. It often occurs in the enforcement of law and involves the discretion of various administrative agencies, including customs or financial regulators, quality inspectors or economic planning bodies.<sup>58</sup> China has enacted wide-ranging trade laws and regulations, such as those enabling the use of trade remedies.

Retaliation may involve tariff and non-tariff barriers. Other than duties on imports (often arising from trade remedy investigations), retaliation includes the restriction of imports and exports,<sup>59</sup> the change of import source,<sup>60</sup> antitrust investigations, currency devaluation,<sup>61</sup> actions based on national security concerns (e.g., cyber security), and foreign investment

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<sup>55</sup> Stephan W. Schill, *Authority, Legitimacy, and Fragmentation in the (Envisaged) Dispute Settlement Disciplines in Mega-Regionals* 37 (2017).

<sup>56</sup> Ricardo Meléndez-Ortiz, *Order or Disorder: The Future of Global Economic Integration and China's Role* (2017), at [http://cdf-en.cdrf.org.cn/jjh/pdf/en11\\_1.pdf](http://cdf-en.cdrf.org.cn/jjh/pdf/en11_1.pdf) (last visited Oct. 4, 2017).

<sup>57</sup> Here the term ‘retaliation’ is probably more accurate than ‘countermeasure’, since the response targets measures that are not necessarily illegal. *Responsibility of States for Internationally Wrongful Acts* 2001 Article 49.1 (Countermeasures targets internationally wrongful act) (2001).

<sup>58</sup> Bloomberg News, *China Elevates ‘Good Cop’ on Trade to Counter Trump Barbs* (Apr. 12, 2017), available at <https://www.bloomberg.com/politics/articles/2017-04-11/the-most-important-chinese-trade-official-you-ve-never-heard-of>.

<sup>59</sup> Tom Phillips, *China Threatens to Cut Sales of iPhones and US Cars If ‘Naive’ Trump Pursues Trade War*, *The Guardian* (Nov. 14, 2016), available at <https://www.theguardian.com/world/2016/nov/14/china-threatens-to-cut-sales-of-iphones-and-us-cars-if-naive-trump-pursues-trade-war>. (The U.S. soybean and maize imports could be halted, and China may limit the number of Chinese students studying in the United States if Chinese countermeasures are triggered by the U.S. aggressive trade measures)

<sup>60</sup> *Id.*

<sup>61</sup> Seema Mody, *Three Ways Beijing Could Retaliate Against Trump's Get-Tough Trade Policies* (Jan. 10, 2017), <http://www.cnbc.com/2017/01/10/three-ways-beijing-could-retaliate-against-trumps-trade-policies.html>.

regulation.<sup>62</sup> Taking the United States as an example, U.S. non-tariff barriers against its largest trading partners before 1994 were significantly retaliatory.<sup>63</sup> Less formal measures could be applied (e.g., imposing delays at the border and additional health and safety inspections).<sup>64</sup> New retaliation may involve a slowdown in diplomatic and security cooperation (e.g., linkages between trade disputes and Sino-United States interaction on North Korea policy).<sup>65</sup>

Direct and indirect retaliation are possible. Most of the above measures fall within the former. In terms of indirect retaliation, states can adopt “breach-for-breach” measures without drawing a specific link to the target country’s policy (e.g., carbon tariffs of one country against that of another country).<sup>66</sup>

Second, trade remedies are probably the most common form of retaliation. As a source of the United States-China trade tension, they include antidumping measures,<sup>67</sup> safeguard investigations.<sup>68</sup> As a strategic motive, retaliation is a significant incentive behind antidumping filings.<sup>69</sup>

Third, in most if not all cases, retaliatory response does not include the WTO dispute settlement mechanism (DSM), even if recourse to the DSM may trigger retaliation.<sup>70</sup> Within the multilateral system agreed by WTO membership, the DSM is essentially inclusive rather

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<sup>62</sup> Many of which are not necessary retaliatory, but (within limits) proactive trade policy and/or justified on other bases.

<sup>63</sup> Kishore Gawande, *Are U.S. Nontariff Barriers Retaliatory? An Application of Extreme Bounds Analysis in the Tobit Model*, 77 THE REV. OF ECON. AND STAT. 677, 677 (1995).

<sup>64</sup> Rachel Brewster, *The Remedy Gap: Institutional Design, Retaliation, and Trade Law Enforcement*, 80 GEO. WASH. LAW REV. 102, 136 (2011).

<sup>65</sup> Fan Zhai, *Trade Cooperation and Conflicts between the United States and China: Risks and Realities*, in US-CHINA COOPERATION IN A CHANGING GLOBAL ECONOMY 153, 153 (Adam S. Posen & Ha Jiming eds., 2017).

<sup>66</sup> Brewster, *supra* note 64.

<sup>67</sup> William Clinton, et al., *Possible Unilateral Actions under US Law* (Jan. 13, 2017). (‘China initiated retaliatory AD investigations of imports of U.S. cars and poultry in response to President Obama’s imposition of new duties on imports of Chinese tires under Section 421 of the Trade Act of 1974’).

<sup>68</sup> *Id.*

<sup>69</sup> See, e.g., Robert M. Feinberg & Kara M. Reynolds, *The Spread of Antidumping Regimes and the Role of Retaliation in Filing*, 72 S. ECON. J. 877, 877 (2006) (retaliation was a significant motive in explaining the rise of antidumping filings over the 1995-2003 period).

<sup>70</sup> Jennifer M. Freedman, *China Floods the WTO With Tit-for-Tat* (Jun. 8, 2012), at <https://www.bloomberg.com/news/articles/2012-06-07/china-floods-the-wto-with-tit-for-tat>.

than retaliatory. It provides predictability from a legal perspective, contrasting with the oft-politicized and unpredictable retaliatory response. It arguably enables one party to engage with rather than confront the other. Essentially judicial in nature, the disputes usually enable consultations, presentation of arguments by parties, and responses to the other side's views. The DSM may authorize suspension of concessions if there is a violation of WTO rules,<sup>71</sup> which reflects the consensus of the WTO membership. The suspension of concessions is used in a regulated manner, and limits are set on the extent of allowed retaliation.<sup>72</sup> Moreover, the DSM performs an important function in restricting threats of counter-retaliation.<sup>73</sup> More broadly, the WTO disputes are arguably a unifying force that helps fortify the trade community and supports the governance project.<sup>74</sup>

## B. The Features

### 1. *Deterrence against specific measures*

Retaliation seeks to change the target country's position, which often means to stop current measures and deter future measures. Accordingly, it may offset the benefits arising from the target state's policies. Retaliation or its threat may be used in situations under which the DSM is lacking or inefficient and other options (e.g., PTIA negotiations) are not easily available.<sup>75</sup>

As a typical example, antidumping action is adopted to deter further use of antidumping measures and/or to punish trading partners that have used antidumping cases.<sup>76</sup> Therefore, the

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<sup>71</sup> Understanding on Rules and Procedures Governing the Settlement of Disputes art. 22.1., Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401.

<sup>72</sup> E.g., *id.*, Article 22.1, 22.3, 22.6, 23.2(c).

<sup>73</sup> Rachel Brewster, *Rule-Based Dispute Resolution in International Trade Law*, 92 VA. L. REV. 251, 258 (2006).

<sup>74</sup> Monica Hakimi, *Constructing an International Community*, 111 AM. J. OF INT'L L., 317, 347 (2017).

<sup>75</sup> For related research, see Alan O Sykes, *Constructive Unilateral Threats in International Commercial Relations: The Limited Case for Section 301*, 23 L. AND POL'Y IN INT'L BUS. 263, 266-267 (1991-1992).

<sup>76</sup> Thomas J. Prusa & Skeath Susan, *Modern Commercial Policy: Managed Trade or Retaliation?*, in HANDBOOK OF INTERNATIONAL TRADE: ECONOMIC AND LEGAL ANALYSES OF TRADE POLICY AND INSTITUTIONS 358, (E. Kwan Choi & James C. Hartigan eds., 2004).

theoretical motivations for retaliation are the need to maintain credibility in attempting to deter future antidumping or part of a disequilibrium movement to the prisoner's dilemma outcome.<sup>77</sup>

### 2. *Passive, acute but short-term response*

Retaliation is provoked by the target country's measure (e.g., increased tariffs) or position (e.g., disregard of WTO rules). Retaliation is essentially a passive response and serves as a strategic option. Even if antidumping measures are an active action, they are at least a reactive response in the sense that they are triggered by the target country's prior act (e.g., trade enforcement). It is a country-specific and measure-specific response. On the flip side, retaliation is often a prompt and acute reaction. Retaliation can be threatened quickly,<sup>78</sup> incentivizing the target country to amend its policies or settle the dispute earlier.<sup>79</sup> Retaliation may involve strong measures, since it usually aims to maximise political costs on the target country by mobilizing powerful export groups in that state against the disputed measure or policy.<sup>80</sup> Not surprisingly, retaliation is often adopted as a temporary response given its strong negative effect on trade. Having said that, retaliatory measures may become part of the trade policy. The United States' previous retaliatory measures, for instance, are an increasing part of the current U.S. approach (e.g., recent Section 301 investigation).

### 3. *Possible lose-lose outcome*

The outcome of retaliation very much depends on the political economy in which the measures are taken. For the retaliating country, retaliation and its threat may deter measures

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<sup>77</sup> Feinberg & Reynolds, *supra* note 69.

<sup>78</sup> See Phillips, *supra* note 64 (stating that it is claimed that 45% tariffs on Chinese imports imposed by the United States would trigger "immediate" retaliation from Beijing).

<sup>79</sup> Brewster, *supra* note 64, at 106.

<sup>80</sup> Jide Nzelibe, *The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization's Dispute Resolution Mechanism*, 6 THEORETICAL INQUIRIES IN LAW 215 (2005).

of the target country, pry open foreign markets,<sup>81</sup> and have other ancillary benefits (e.g., a publicity effect and a valve for letting out domestic interest group pressure,<sup>82</sup> possible support for sectors negatively affected by trade liberalisation). That said these benefits do not always eventuate. Unilateral action may fail to secure concessions,<sup>83</sup> and trigger counter retaliation that affect other sectors. Retaliation does not necessarily lead to negotiations, and could entail significant disruption to economic relations.

From the perspective of global trade, retaliation is a lose-lose situation in most situations and could bring enormous costs to both sides. It will hurt the target country. Retaliation by China would create an uncertain global economic environment that would slow the growth of the United States even if it were presumed that retaliation would not have much direct effect on the U.S. economy.<sup>84</sup> The target country is left with few options except for counter retaliation. As a highly adversarial approach, it escalates protection and creates a vicious circle of retaliatory protectionism. For the retaliating country, retaliation could also incur actual and reputational costs, as well as counter retaliation, particularly if a significant trading partner is implicated.<sup>85</sup>

A tit-for-tat response is a double-edged sword even if retaliation does not involve protectionism. The reduction of holdings of American bonds would harm China as American bonds are deemed to be stable.<sup>86</sup> Even if protectionism is not involved, indirect retaliation by

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<sup>81</sup> Thomas O. Bayard, *Comment on Alan Sykes' "Mandatory Retaliation for Breach of Trade Agreements: Some Thoughts on the Strategic Design of Section 301"*, 8 B. U. INT'L L. J. 325, 326 (1990).

<sup>82</sup> Holger Spamann, *The Myth of 'Rebalancing' Retaliation in WTO Dispute Settlement Practice*, 9 J. OF INT'L ECON. L. 31, 79 (2006).

<sup>83</sup> Krzysztof J. Pelc, *Will Trump's Unilateral Trade Approach Work? History Says No.* (Mar. 7, 2017), [https://www.washingtonpost.com/news/monkey-cage/wp/2017/03/07/will-trumps-unilateral-trade-approach-work-history-says-no/?utm\\_term=.542cf814df14](https://www.washingtonpost.com/news/monkey-cage/wp/2017/03/07/will-trumps-unilateral-trade-approach-work-history-says-no/?utm_term=.542cf814df14) ('[D]espite a far more potent threat of retaliation, the U.S. was 34 percent less likely to secure concessions in the targeted countries when it opted for the unilateral route').

<sup>84</sup> David Dollar, *The Future of U.S.-China Economic Ties*, BROOKINGS (Oct. 4, 2016), at <https://www.brookings.edu/research/the-future-of-u-s-china-trade-ties/>.

<sup>85</sup> Jared R. Silverman, *Multilateral Resolution Over Unilateral Retaliation: Adjudicating the Use of Section 301 before the WTO*, 17 U. OF PA J. OF INT'L ECON. L. 233, 285–287 (1996).

<sup>86</sup> Kirsty Needham, *What a Trump v China Trade War Looks Like from Australia*, The Sydney Morning Herald (Jan. 27, 2017), <http://www.smh.com.au/federal-politics/political-news/what-a-trump-v-china-trade-war-looks-like-from-australia-20170127-gtztpx.html>.



reduced holdings of American bonds may negatively affect the position of the U.S. dollar as the international reserve currency.

Retaliation could complicate rather than solve the problem, and may be counterproductive. It is potentially arbitrary, discriminatory and excessive. Therefore, the possibility of retaliation is put into doubt by the success of the GATT, the limitations on retaliation in the WTO, and observed behavior of state actors.<sup>87</sup> Retaliation could occur in areas where the WTO norms are vague and insufficient (e.g., investigations based on national security concerns), or lacking (e.g., competition law). To sum up, retaliation produces negative and unpredictable interactions as in the case of beggar-thy-neighbour policies and previous measures (e.g., Smoot-Hawley Tariff Act of 1930).

### C. The Future

#### 1. *Will China adopt a retaliatory response?*

Retaliation will probably be used only in exceptional circumstances. Due to geopolitical, economic and legal considerations, China is cautious about retaliation and is unlikely to instantiate a trade conflict. China's willingness to strike the 100-day deal is illustrative of its reluctance to adopt retaliation. From the geopolitical perspective, retaliation will harm the United States-China relationship in a way that will be costly and time-consuming to recover. Notably, its relationship with the United States is of great significance to China. Support can be found in Chinese President Xi's statement that there are 'a thousand reasons to make the China-US relationship a success' and there is 'not a single reason to break it'.<sup>88</sup>

From an economic perspective, retaliation would affect the bilateral relationship and increase protectionism, working against China's export of trade and investment. Sino-United States economic ties are emphasized by China as 'ballast' and a 'propeller' in bilateral

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<sup>87</sup> Spamann, *supra* note 82, at 78.

<sup>88</sup> *Meeting Builds on a Thousand Reasons to Be Good Partners*, CHINA DAILY (Apr. 15, 2017), [http://www.chinadaily.com.cn/opinion/2017-04/08/content\\_28841782.htm](http://www.chinadaily.com.cn/opinion/2017-04/08/content_28841782.htm).

relations.<sup>89</sup> This helps explain why China reportedly offered concessions (such as ending the beef import ban, raising the investment ceiling in BIT negotiations) to avert a trade conflict.<sup>90</sup> It is the same with the United States, since retaliation often leads to a lose-lose situation. Both sides will probably endeavour to avoid retaliation, and use the threat of retaliation as a negotiation tactic.

From a legal perspective, retaliation does not bring predictability. Retaliation is a largely political rather than legal response, since the concept often defies legal definition,<sup>91</sup> and retaliation is largely based on the retaliating country's own subjective criteria of fairness.

However, the possibility of retaliation cannot be excluded. It is observed that China's trade tactics may include 'a big stick' that seldom makes it to the negotiating table.<sup>92</sup> Certain punitive actions of the United States against China will probably invite retaliation.<sup>93</sup> These punitive actions could deal with trade imbalances (e.g., border adjustment tax,<sup>94</sup> and the declaration of China as a currency manipulator), intellectual property, investment (e.g., a ban on Chinese SOE investments in the United States<sup>95</sup>), or other issues (e.g., disregard for WTO rulings that it sees as an affront to U.S. sovereignty,<sup>96</sup> sanctions involving the alleged 'cyber theft' of business trade secrets<sup>97</sup>). As an example, non-market economy (NME) status and intellectual property are two of the mostly likely areas for major trade friction. The Trump

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<sup>89</sup> *Economic Watch: Economic Ties Serve as Ballast in China-U.S. Relations*, XINHUANET (Mar. 19, 2017), [http://news.xinhuanet.com/english/2017-03/19/c\\_136140566.htm](http://news.xinhuanet.com/english/2017-03/19/c_136140566.htm).

<sup>90</sup> *China to Offer Concessions to Avert US Trade War: Report*, THE STRAITS TIMES (Apr. 11, 2017), <http://www.straitstimes.com/world/united-states/china-to-offer-concessions-to-avert-us-trade-war-report>.

<sup>91</sup> Thomas J. Schoenbaum, *Trade Friction with Japan and the American Policy Response*, 82 MICH. L. REV. 1647, 1656 n.35 (1984).

<sup>92</sup> Bloomberg News, *China Elevates 'Good Cop' on Trade to Counter Trump Barbs*, Apr. 12, 2017.

<sup>93</sup> David Lawder, *Trump Packs Trade Team with Veterans of Steel Wars with China* (Dec. 13, 2016), at <http://www.reuters.com/article/us-usa-trump-china-trade-analysis-idUSKBN13Y2FI>; China Daily, *Move to Protect US Steelmakers Is Against Norms of World Trade* (Apr. 24, 2017), available at [http://www.chinadaily.com.cn/opinion/2017-04/24/content\\_29051319.htm](http://www.chinadaily.com.cn/opinion/2017-04/24/content_29051319.htm).

<sup>94</sup> Xinhua, *China to Respond If U.S. Introduces Border Tax: Minister* (Feb. 21, 2017), available at [http://news.xinhuanet.com/english/2017-02/21/c\\_136074442.htm](http://news.xinhuanet.com/english/2017-02/21/c_136074442.htm).

<sup>95</sup> David Lawder & Thomas Denny, *U.S. Panel Urges Ban on China State Firms Buying U.S. Companies* (Nov. 17, 2016), at <http://www.reuters.com/article/us-usa-china-idUSKBN13B1WO>.

<sup>96</sup> Eric Beech, *Trump Administration Would Ignore WTO Rulings It Sees as Anti-U.S.: FT* (Mar. 1, 2017), available at <http://www.reuters.com/article/us-usa-trump-wto-idUSKBN16832U>.

<sup>97</sup> Wayne M. Morrison, *China-U.S. Trade Issues* 54 (2017).

administration's disregard of WTO rules could trigger a trade conflict with China<sup>98</sup> if the WTO ruling deals with China's major concerns such as NME status. The recent Section 301 probe into China's intellectual property practices also arguably circumvents the WTO.

## 2. *How may China adopt a retaliatory response?*

If China adopts retaliation, it will be taken in a restrained way. First, China may adopt retaliatory measures equivalent to the United States' measures. Generally, China's stance on U.S. trade is illustrated as 'an equal and opposite reaction' to U.S. action.<sup>99</sup> Specifically, a wide range of measures may be taken, such as: (i) imposing same duties, quotas or other restrictions on U.S. exports in goods (e.g., aircrafts, oilseeds, soybeans, pulp and wood products, and passenger motor vehicles) and services (e.g., tourism, education, and business services) in which China runs large deficits with the United States, (ii) banning the export of strategic goods (e.g., rare earth metals as it did for Japan in 2010), (iii) depreciating Renminbi,<sup>100</sup> or (iv) the change of import source. Taking the change of import source as an example, it is reported that retaliation may include reducing imports of American aircraft and agricultural products, targeting U.S. companies with tax investigations and anti-competition probes, or reducing the holdings of American bonds.<sup>101</sup> China may shift to alternate nations for products and services. As discussed above, other forms of retaliation could also be adopted. Retaliation may involve U.S. companies that have an advantage over other countries (e.g., finance and high-tech).<sup>102</sup>

Second, China, as a quick learner, will probably follow and develop on the U.S. practice. It is observed that the United States has inadvertently taught China how to conduct facial

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<sup>98</sup> DW.com, *China Warns of Trade War, Urges US to Abide by WTO Rules* (Mar. 9, 2017), available at <http://www.dw.com/en/china-warns-of-trade-war-urges-us-to-abide-by-wto-rules/a-37876534>.

<sup>99</sup> Bloomberg News, *When the U.S. Moves on Trade, China Hits Back Fast* (Nov. 18, 2016), available at <https://www.bloomberg.com/news/articles/2016-11-17/china-hits-back-fast-on-perceived-u-s-trade-slights-past-shows>.

<sup>100</sup> Zhai, 151.

<sup>101</sup> Needham, Jan. 27, 2017.

<sup>102</sup> China Daily, Apr. 24, 2017.

implementation without concrete results in the DSM.<sup>103</sup> China may learn from the United States regarding retaliation. As an example, the Trump Administration has initiated the rarely used Section 232 investigations twice in a single week.<sup>104</sup> They focus on the vague concept of a national security threat. Such investigations have raised the concerns of China, and involve the WTO consistency issue.<sup>105</sup> China (and other WTO members) may take similar measures if the United States actually imposes trade sanctions based on Section 232. Theoretically, China may even retaliate against U.S. exporters or investors, using the similar justifications regarding WTO applicability that the Trump administration applied in its Section 301 actions.<sup>106</sup>

Third, China would likely take measured retaliation as a temporary tool due to the potential lose-lose outcome. China will probably confine its retaliation to trade to avoid endangering the overall bilateral relationship.<sup>107</sup> One may argue that it is possible for China to adopt similar rules, such as mandatory retaliation provisions in Sections 301-310 of the Trade Act of 1974 that are deemed by the United States to represent a sensible strategic response to ‘cheating’ under trade pacts.<sup>108</sup> However, retaliatory legislation is unlikely to happen in the short term as it may increase tensions. China may respond with focused displays of retaliatory capacity.<sup>109</sup>

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<sup>103</sup> Gregory Shaffer & Gao Henry, *China's Rise: How it Took On the U.S. at the WTO*, 45-46 (2017).

<sup>104</sup> *Trump Administration's Second Section 232 Investigation in a Week Focuses on National Security Threat of Aluminum Imports* (May 1, 2017), available at <http://www.thompsonhine.com/publications/trump-administrations-second-section-232-investigation-in-a-week-focuses-on-national-security-threat-of-aluminum-imports>.

<sup>105</sup> Simon Lester, *Would Section 232 Duties on Steel Violate the AD Agreement?* (Apr. 21, 2017), available at <http://worldtradelaw.typepad.com/ielpblog/2017/04/would-section-232-duties-on-steel-violate-the-ad-agreement.html>.

<sup>106</sup> Clinton, et al. Jan. 13, 2017.

<sup>107</sup> Zhai, 151-152.

<sup>108</sup> Alan O. Sykes, “Mandatory” Retaliation for Breach of Trade Agreements: Some Thoughts on the Strategic Design of Section 301, 8 BOSTON UNIVERSITY INTERNATIONAL LAW JOURNAL 301, 303 (1990).

<sup>109</sup> *A US China Trade War?* (Feb. 2017), available at <https://www.controlrisks.com/en/our-thinking/analysis/a-us-china-trade-war>.

#### IV. THE INCLUSIVE RESPONSE

##### A. The Forms

An inclusive response aims to engage with partners tactfully to liberalize trade without imposing stringent regulatory disciplines. It consists of the utilization of the multilateral trade system, and exploration of PTIAs and other initiatives. It counterbalances or engages with the United States either in a direct and indirect manner. This echoes with China's position on economic globalization that highlights inclusiveness,<sup>110</sup> with regional trade arrangements<sup>111</sup> and BRI<sup>112</sup> being inclusive.

##### 1. Multilateral trade system

China heavily relies on the WTO system and particularly its DSM. Emphasizing inclusivity,<sup>113</sup> the WTO negotiations could arguably reduce the impacts of the U.S. FTAs and strengthen the multilateral system that supports an open world market. China is negotiating the Environmental Goods Agreement (EGA), and is in the process of acceding to the Agreement on Government Procurement (GPA). The United States is a party to both agreements. However, for the beleaguered Doha Round negotiations, China has taken a backseat, not least because of the difficulties in brokering between developed and developing countries.<sup>114</sup> Other reasons include that negotiations among WTO members are complex, and China neither wants to demand nor offer substantial concessions in the WTO negotiations. In

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<sup>110</sup> Jinping Xi, *President Xi's Speech to Davos in Full* (Jan. 17, 2017), available at <https://www.weforum.org/agenda/2017/01/full-text-of-xi-jinping-keynote-at-the-world-economic-forum>.

<sup>111</sup> Wang Yi: *China Will Promote the APEC Meeting to Maintain Free Trade System* (Oct. 6, 2016), available at [http://www.fmprc.gov.cn/mfa\\_eng/zxxx\\_662805/t1404248.shtml](http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1404248.shtml).

<sup>112</sup> Chinese National Development and Reform Commission, et al., *Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road* (Mar. 28, 2015), available at [http://en.ndrc.gov.cn/newsrelease/201503/t20150330\\_669367.html](http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html).

<sup>113</sup> *General Council: Appointment of the Director-General (Presentation by DG Azevêdo)* (Feb. 28, 2017), available at [https://www.wto.org/english/news\\_e/spra\\_e/spra158\\_e.htm](https://www.wto.org/english/news_e/spra_e/spra158_e.htm).

<sup>114</sup> Gisela Grieger, *China's WTO Accession: 15 Years on Taking, Shaking or Shaping WTO Rules?* (Dec. 2016), available at [http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/593570/EPRS\\_BRI\(2016\)593570\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/593570/EPRS_BRI(2016)593570_EN.pdf).

contrast, China is one of the most active members in the DSM. Ten out of 15 cases initiated by China are raised against the United States.<sup>115</sup>

## 2. PTIAs and other initiatives

Given the United States' shift away from multilateralism, China may actively seek non-WTO responses that will be discussed here. PTIAs involving China fall within the category of inclusive response, except for China's BIT negotiations with the United States and European Union that will probably impose new regulatory requirements. China's plan for FTAs appears to emphasize inclusiveness. Through July 2017, China has concluded 15 FTAs with 23 countries or regions, including the recent China-Korea FTA and China-Australia FTA (ChAFTA). In the short term, China is committed to speeding up FTAs negotiations including the Regional Comprehensive Economic Partnership (RCEP).<sup>116</sup> In the long term, it aims to establish a global free trade zones network 'reaching the important countries in five continents' and 'realizing the liberalization and facilitation' of trade and two-way investment.<sup>117</sup> China's strategy starts with FTAs with neighbouring countries, and then with BRI countries and the rest of the world.<sup>118</sup>

Other initiatives consist of two categories. One category has until now little involvement of the United States. The typical example is BRI. BRI targets a large number of countries and regions,<sup>119</sup> with unimpeded trade as a cooperation priority.<sup>120</sup> The other category involves direct engagement with the United States, particularly government-to-government dialogues.

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<sup>115</sup> World Trade Organization, *Disputes by Member*, available at [https://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_by\\_country\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm). (last visited Aug. 13, 2017)

<sup>116</sup> Chinese Ministry of Commerce, *Official of the Department of International Trade and Economic Affairs of the Ministry of Commerce Interprets the Opinions of the State Council on Speeding up Implementation of Free Trade Zone Strategy* (Dec. 21, 2015), available at <http://english.mofcom.gov.cn/article/newsrelease/policyreleasing/201601/20160101228504.shtml>.

<sup>117</sup> *Id.*

<sup>118</sup> State Council, *Opinions on Speeding up the Implementation of Free Trade Area Strategy* paragraph 1.3 (2015).

<sup>119</sup> Xinhua, *Belt and Road Initiative Makes Fruitful Progress* (Dec. 28, 2015), available at [http://www.chinadailyasia.com/chinafocus/2015-12/28/content\\_15364435.html](http://www.chinadailyasia.com/chinafocus/2015-12/28/content_15364435.html).

<sup>120</sup> Chinese National Development and Reform Commission, et al. Mar. 28, 2015.

The United States and China have a deep comprehensive economic dialogue mechanism consisting of a large number of committees with a high degree of mutual collaboration. They include the United States-China Comprehensive Economic Dialogue (CED), the United States-China Joint Commission on Commerce and Trade (JCCT), and the 100-day plan for United States-China trade in 2017. The mechanism serves the interests of both nations. The United States-China Strategic and Economic Dialogue (S&ED) is not only efficient for the United States to achieve its goals particularly regarding soft issues, but also accords China 'big state status' on par with the United States.<sup>121</sup> Replacing the S&ED, the CED was established as a new high-level framework for negotiations.<sup>122</sup> The JCCT focuses on bilateral trade and investment rules.<sup>123</sup> Both sides have reached agreement on various occasions, including an agreement imposing quotas on Chinese textile exports to the United States.<sup>124</sup> Responding to U.S. concerns, China agreed to eliminate its indigenous innovation products catalogues under S&ED and then announced in the 2011 JCCT that the State Council issued a measure requiring governments at the provincial level to eliminate catalogues or other measures linking innovation policies to government procurement preferences.<sup>125</sup> Through S&ED, China has committed to developing new legislation and improving the enforcement of existing laws regarding intellectual property.<sup>126</sup> Recently, a cyber agreement has been signed to avoid supporting or conducting cyber theft of intellectual property, trade secrets, or other commercial information, after which there have reportedly been positive changes.<sup>127</sup> After the upgrade of the JCCT, there is bilateral policy communications that seem to cover

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<sup>121</sup> Hsieh, *ASIAN JOURNAL OF WTO & INTERNATIONAL HEALTH LAW & POLICY*, 382-383 (2009).

<sup>122</sup> *Briefing by Secretary Tillerson, Secretary Mnuchin, and Secretary Ross on President Trump's Meetings with President Xi of China* (Apr. 7, 2017), available at <https://www.whitehouse.gov/the-press-office/2017/04/07/briefing-secretary-tillerson-secretary-mnuchin-and-secretary-ross>.

<sup>123</sup> Morrison, 53. 2017.

<sup>124</sup> *United States and China Agree on Textile Quotas*, 100 *THE AMERICAN JOURNAL OF INTERNATIONAL LAW* 472, 472-473 (2006).

<sup>125</sup> *Id.*

<sup>126</sup> Simon Lester & Zhu Huan, *It's Time to Negotiate a New Economic Relationship with China* 3 (2017).

<sup>127</sup> *Id.*

many issues, ranging from antitrust law enforcement procedures, to approval of drugs and medical equipment, and to the access to China Compulsory Certification (3C) services of foreign-funded enterprises.<sup>128</sup> However, there is also concern. For instance, it was observed that the S&ED has become ‘too big and formal to be of much use’.<sup>129</sup>

## B. The Features

### 1. *Focus on engagement with partners*

An inclusive response often serves two major functions here: (i) engaging with the United States through WTO institutions (in particular DSM) and other initiatives directly and indirectly; (ii) increasing China’s trade network to offset the lack of PTIA benefits with the United States. An inclusive response does not focus on creating substantial regulatory disciplines.

For multilateral trade system, China has not advocated for strong regulatory disciplines in Doha Round, under which the WTO develops few new stringent regulatory rules. Concerning the PTIAs and other initiatives, China does not prioritize deep regulatory disciplines, given the implementation difficulties for China and these disciplines’ possible effect of slowing down the inclusive process (particularly with developing countries). It is observed that imposing domestic reforms is usually not the starting point or the motivation for China’s pursuit of FTAs, and China takes a cautious approach to domestic reform under a FTA due to the government’s view of economic security and stability that have assumed priority in its opening up strategy.<sup>130</sup> As a clear illustration, China appealed for economic unity and an all-inclusive Free Trade Area of the Asia-Pacific (FTAAP) rather than the ‘high

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<sup>128</sup> Ministry of Commerce of the People’s Republic of China, 99. 2017.

<sup>129</sup> Dollar. Oct. 4, 2016.

<sup>130</sup> Razeen Sappideen & He Ling Ling, *Observations on the Australia-China Free Trade Agreement Negotiation Process*, 38 AUSTRALIAN BUSINESS LAW REVIEW 257, 262 (2010).



standards' argued by the United States.<sup>131</sup> Not surprisingly, China's PTIAs and other initiatives do not feature new and stringent regulatory requirements. Instead, they often focus on the improvement of political relationships, market liberalization, and investment protection. For instance, investment and trade cooperation is 'a major task' in building BRI.<sup>132</sup> In the same vein, the thrust of the United States-China 100-day trade talk is to engage both sides at the negotiation table.<sup>133</sup>

## 2. *A full-range of tools*

Inclusive response is a multifaceted category, ranging from short (e.g., 100-day plan for United States-China trade) to medium (e.g., BRI projects) to long term (e.g., PTIAs) options. Based on whether China directly interacts with the United States, direct and indirect responses are possible. Direct responses include interaction in the WTO (i.e. negotiations and dispute settlement) and other initiatives between the United States and China (e.g., the United States-China trade talks). Indirect responses include PTIAs, other initiatives with non-U.S. partners, and China's unilateral measures to liberalize trade. For instance, it is observed that China 'has no choice but to accelerate the pace of inking FTAs with more trading partners'<sup>134</sup> given the possible substantial market change initially thought likely to result from the TPP. The TPP negotiation has been 'a major driver' in accelerating the China-Korea FTA

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<sup>131</sup> Shannon Tiezzi, *As TPP Leaders Celebrate, China Urges Creation of Asia-Pacific Free Trade Area* (Nov. 19, 2015), available at <http://thediplomat.com/2015/11/as-tpp-leaders-celebrate-china-urges-creation-of-asia-pacific-free-trade-area/>.

<sup>132</sup> Chinese National Development and Reform Commission, et al. Mar. 28, 2015.

<sup>133</sup> Bloomberg News, *China-U.S. Trade Talks Near 100 Days Jarred by North Korean Test*, Bloomberg (Jul. 7, 2017), available at <https://www.bloombergquint.com/global-economics/2017/07/06/china-trapping-u-s-at-trade-table-with-100-day-sweetener-talks>.

<sup>134</sup> Zhong Nan, *China Will Speed up Free Trade Talks This Year* (Jan. 15, 2015), available at [http://usa.chinadaily.com.cn/business/2015-01/15/content\\_19326150.htm](http://usa.chinadaily.com.cn/business/2015-01/15/content_19326150.htm).

negotiation.<sup>135</sup> It is the same with other PTIAs, including the RCEP, the China-Japan-Korea FTA, the FTAAP, the United States-China BIT,<sup>136</sup> and the European Union-China BIT.

### 3. Flexibility

Among the features of an inclusive response (including conveying soft power and a long-term commitment), flexibility is a major one. Flexibility is reflected in the choice of respondents and the pace of WTO dispute settlement. China has never sued developing countries, probably due to the negative effect on bilateral relationships and the capacity limit. The United States and European Union are the two members that have been respondents in WTO disputes with China as the claimants, and the United States has been the respondent in many more cases than the European Union. For the pace of dispute settlement, China recently requested the establishment of a WTO panel regarding EU antidumping duty methodology,<sup>137</sup> but not on a similar complaint against the United States that was initiated on the same day.<sup>138</sup>

China's PTIAs and other initiatives also vary with partners. China's FTAs feature malleable rules. It is observed that China prefers to work off the draft FTA provisions of partners including Peru or Pakistan.<sup>139</sup> Responding to partners' demands to a certain extent, China has, for instance, accepted comprehensive investment rules.<sup>140</sup> Given the differences among partners and the (non-) existence of PTIAs, BRI will probably utilize soft law to engage more parties. In contrast, the government-to-government dialogues between China and the United States may aspire for binding commitments.

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<sup>135</sup> Dukgeun Ahn, *Systemic Issues for the Post MC-9 WTO System*, 9 ASIAN JOURNAL OF WTO & INTERNATIONAL HEALTH LAW & POLICY 367, 374 (2014).

<sup>136</sup> Mercurio. Nov. 17, 2016.

<sup>137</sup> European Union — Measures Related to Price Comparison Methodologies, DS516, [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds516\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds516_e.htm).

<sup>138</sup> United States — Measures Related to Price Comparison Methodologies, DS515, [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds515\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds515_e.htm).

<sup>139</sup> Nargiza Salidjanova, *China's Trade Ambitions: Strategy and Objectives behind China's Pursuit of Free Trade Agreements*, U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION STAFF RESEARCH REPORT 22 (2015).

<sup>140</sup> Axel Berger, *Investment Rules in Chinese Preferential Trade and Investment Agreements: Is China Following the Global Trend Towards Comprehensive Agreements?*, available at [https://www.die-gdi.de/uploads/media/DP\\_7.2013.pdf](https://www.die-gdi.de/uploads/media/DP_7.2013.pdf). (visited Oct. 2, 2017)

### C. The Future

#### 1. Will China adopt an inclusive response?

China will likely promote an inclusive response given its geopolitical, economic and legal implications. Regarding geopolitical implications, PTIAs help to ‘lock up’ trading partners in a close relationship. Economic considerations (e.g., enhancing market access) have taken a back seat to political considerations in shaping China’s FTA calculations.<sup>141</sup> BRI also involves geopolitical considerations.<sup>142</sup>

Concerning economic implications, an inclusive response may increase market opening. China’s FTA partners account for around one-third of China’s total exports.<sup>143</sup> The potential of its FTA coverage could be explored, which fits with China’s aim of generating ‘greater FTA-driven prosperity’.<sup>144</sup> BRI may help to address, among other aspects, overproduction in China.<sup>145</sup>

Concerning legal implications, China supports the development and clarification of WTO rules through adjudication and negotiations. The development of WTO rules, such as the Agreement on Trade Facilitation, provides more predictability in a rule-based system. It may partly explain why China has compromised in the Information Technology Agreement and EGA.<sup>146</sup> The recourse to the DSM could help line up with other economies to jointly rebuff the Trump administration for violating multilateral norms.<sup>147</sup> Dispute resolution

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<sup>141</sup> Ka Zeng, *China’s Free Trade Agreement Diplomacy*, 9 CHINESE JOURNAL OF INTERNATIONAL POLITICS 277, 279 (2016).

<sup>142</sup> Jiayi Zhou, et al., *The Trouble With China’s ‘One Belt One Road’ Strategy* (Jun. 26, 2015), available at <http://thediplomat.com/2015/06/the-trouble-with-the-chinese-marshall-plan-strategy/>.

<sup>143</sup> Salidjanova, U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION STAFF RESEARCH REPORT, 13 (2015).

<sup>144</sup> Keqiang Li, *WE WANT TO WORK WITH YOU FOR PROGRESS AND PEACE*, THE AUSTRALIAN, Mar 22, 2017.

<sup>145</sup> Zhou, et al. Jun. 26, 2015.

<sup>146</sup> Sean Miner, *US Should Support China’s Inclusion in the Trade in Services Agreement* (Nov. 3, 2016), available at <https://piie.com/blogs/trade-investment-policy-watch/us-should-support-chinas-inclusion-trade-services-agreement>.

<sup>147</sup> Jiming Ha & Posen Adam S., *Creating a Basis for China-US Economic Cooperation under the New US Administration*, in US-CHINA COOPERATION IN A CHANGING GLOBAL ECONOMY 8, (Adam S. Posen & Ha Jiming eds., 2017).

through a legal mechanism lowers political costs compared with retaliation. Even if China loses a dispute, conceding to legitimate multilateral challenges reveals China to be a good global citizen.<sup>148</sup> However, there is a limit on the utilization of the DSM due to the coverage of WTO law (e.g., difficulties in addressing WTO-extra issues such as competition and cyber issues), the capacity of China (e.g., increasingly complex and resource-demanding WTO cases), and the limits of the WTO dispute settlement body ('no spare capacity [of the WTO system] to respond to any future rise in cases'<sup>149</sup>).

## 2. *How may China adopt an inclusive response?*

China will likely utilize its expertise and enormous economic clout to foster an inclusive response. First, an inclusive response will build on norms that China is familiar with (in particular, WTO law and investment rules). China will bring WTO cases against the United States regarding its unilateral measures, since it is one of the very few legal means for addressing Sino-United States trade disputes. It will arguably move toward Asian aggressive legalism.<sup>150</sup> These cases would often target trade remedies. For instance, China will likely have recourse to the DSM if the United States applies a 'particular market situation' as justification for ratcheting up duties and disregarding home market prices or costs of production when calculating dumping margins.<sup>151</sup> These disputes may involve other measures (e.g., Section 337 actions,<sup>152</sup> and even the WTO-consistency of a specific measure under an FTA). However, the WTO negotiations will remain difficult for China as discussed above.

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<sup>148</sup> Krzysztof J. Pelc, *Will Trump's Unilateral Trade Approach Work? History Says No.* (Mar. 7, 2017), at [https://www.washingtonpost.com/news/monkey-cage/wp/2017/03/07/will-trumps-unilateral-trade-approach-work-history-says-no/?utm\\_term=.542cf814df14](https://www.washingtonpost.com/news/monkey-cage/wp/2017/03/07/will-trumps-unilateral-trade-approach-work-history-says-no/?utm_term=.542cf814df14).

<sup>149</sup> General Council: Appointment of the Director-General (Presentation by DG Azevêdo). Feb. 28, 2017.

<sup>150</sup> Saadia M. Pekkanen, *Aggressive Legalism: The Rules of the WTO and Japan's Emerging Trade Strategy*, 24 *WORLD ECONOMY* 707, 707-737 (2001).

<sup>151</sup> Adam Behsudi, *Commerce Takes 'Unprecedented' Step in Trade Case* (Apr. 12, 2017), available at <http://www.politico.com/tipsheets/morning-trade/2017/04/commerce-takes-unprecedented-step-in-trade-case-219738>.

<sup>152</sup> William Clinton, et al., *Implications of th*

China will use its experience to pursue FTA upgrades and larger FTAs besides negotiating bilateral FTAs. China's FTAs will probably be modeled on the WTO norms, but will make limited effort to establish advanced rules beyond these norms. FTA upgrades deepen China's engagement with partners. Larger FTAs help China to expand inclusiveness and shape future trade rules. The RCEP negotiations could show China's capacity to ensure the conclusion of a mega FTA, which may improve China's negotiation position with the United States. This helps to explain why China highlights the importance of concluding the negotiations of the RCEP and China-Japan-Korea FTA,<sup>153</sup> endeavors to press the FTAAP,<sup>154</sup> and join the Trade in Services Agreement (TiSA). However, the prospect of many of these FTAs (e.g., the FTAAP) remains unclear. BRI and other initiatives may rely on trade rules to the extent possible.

Second, China's inclusive response outside the WTO may attach more importance to developed countries including the United States. China will probably seek to upgrade or negotiate PTIAs to recalibrate its trade approach without unintended regulatory outcomes. This finds support from the fact that China is pursuing FTA upgrading with nearly all of its developed-country FTA parties (e.g., New Zealand, Singapore, Australia, and Switzerland), although these agreements were concluded not long ago. China also engages with developed countries through negotiating (e.g., Japan, Israel, and Norway) or exploring (i.e. Canada and potentially the UK<sup>155</sup>) FTAs.

Why would China likely engage more with developed countries? From a geopolitical perspective, interaction with developed countries reduces confrontation and improves political relationships. Moreover, China seeks to demonstrate its capacity to conclude pacts

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*e 2016 US Presidential Election for Trade Policy*, White & Case LLP (Jan. 2017), available at <https://www.whitecase.com/sites/whitecase/files/files/download/publications/2016-us-presidential-election-implications-on-trade-policy-updated.pdf>.

<sup>153</sup> Tiezzi. Nov. 19, 2015.

<sup>154</sup> *Id.*

<sup>155</sup> Kamal Ahmed, *UK Explores Multi-Billion Pound Free Trade Deal with China* (Jul. 24, 2016), available at <http://www.bbc.com/news/business-36877573>.

with developed countries and to strengthen cooperation. Meanwhile, the FTAs with some developing countries (e.g., India) will not be easy partly due to concerns over the impact of China's exports.<sup>156</sup>

From an economic perspective, engagement with developed countries could bring economic benefits if properly managed. For instance, China could reduce the impact of the U.S. PTIAs by receiving preferential treatment in other developed countries that may have PTIAs with the United States. Importantly, these countries are usually among China's major economic partners, and are likely to bring more effects in terms of trade volume.

From a legal perspective, this engagement may avoid or delay the imposition of stringent regulatory disciplines. In China's view, the 100-day plan for the United States-China trade will focus initially on 'easy issues while making continued efforts on the harder issues'.<sup>157</sup> The focus appears to be enhanced market access rather than strict regulatory standards. China is also working to engage with the United States in BRI.<sup>158</sup> These initiatives mainly address trade imbalance or expand investment rather than set high regulatory requirements in the short term.

## V. THE REGULATORY RESPONSE

### A. The Forms

A regulatory response deals with regulatory improvement and protection, which largely responds to the U.S. approach to behind-the-border regulatory issues. It aligns China more closely with developed countries, especially the United States. FTAs are a typical example here. Legally enforceable WTO-extra provisions of U.S. FTAs all deal with regulatory issues

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<sup>156</sup> Iain Marlow & Srivastava Shruti, *India May Water Down China-Championed Asia Trade Pact* (Apr. 3, 2017), available at <https://www.bloomberg.com/politics/articles/2017-04-02/go-slow-india-may-water-down-china-championed-asia-trade-pact>. (India hesitates to expose its manufacturers to competition from China, which runs a \$52 billion surplus with India.)

<sup>157</sup> Bloomberg News, *Trump's Deficit Crusade Overshadows Xi's Investment Treaty Pitch*, Apr. 19, 2017.

<sup>158</sup> Bloomberg News, *China Says Trump Open to Cooperating on Silk Road Projects* (Jun. 23, 2017), available at <https://www.bloomberg.com/news/articles/2017-06-23/china-says-u-s-is-willing-to-work-on-belt-and-road-initiative>.

(including those concerning environment and labour standards) and recent FTAs often involve the treatment of regulatory measures.<sup>159</sup> The FTAs of the United States stimulate deep integration beyond WTO norms, which target regulatory impediments to trade (e.g., regulation of services production, product standards, customs procedures, regulation of investment, competition, intellectual property, and government procurement).<sup>160</sup> For BITs, strengthened protection of its investors largely through BIT negotiations is important part of the U.S. trade approach.<sup>161</sup>

Moreover, the United States highlights an increasingly high level of regulatory protection, including regulators' ability to protect their citizens<sup>162</sup> and the removal of regulatory barriers.<sup>163</sup> For instance, the U.S. FTA approach to regulatory coherence is developing from WTO-based one with a number of transparency and cooperation mechanisms, to an increasing focus on regulatory good practice, particularly on pushing adoption and recognition of international standards.<sup>164</sup> More broadly, FTAs have undergone 'legalisation': moving from agreements that mainly dealt with tariffs and related restrictive regulations (such as origin rules) to pacts that cover a wide range of regulatory policies.<sup>165</sup> These regulatory disciplines affect China directly (through the United States-China BIT negotiations) and indirectly in the race to shape new generation trade norms.

### 1. Domestic reform

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<sup>159</sup> Henrik Horn, et al., *Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements*, 33 WORLD ECONOMY, 1587, 1570ff (2010).

<sup>160</sup> David Evans, et al., *Assessing Preferential Trading Agreements Using the Sussex Framework* (March 2007), available at <https://www.sussex.ac.uk/webteam/gateway/file.php?name=cariswp01.pdf&site=261>.

<sup>161</sup> Trading Up: U.S. Trade and Investment Policy 16. 2016.

<sup>162</sup> Peter Chase & Jacques Pelkmans, *This Time It's Different: Turbo-Charging Regulatory Cooperation, in RULE-MAKERS OR RULE-TAKERS? EXPLORING THE TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP 17*, (Daniel S. Hamilton & Pelkmans Jacques eds., 2015).

<sup>163</sup> Lester & Huan, 2.

<sup>164</sup> Phoenix X. F. Cai, *Regulatory Coherence and Standardization Mechanisms in the Trans-Pacific Partnership*, 5 BRITISH JOURNAL OF AMERICAN LEGAL STUDIES 505, 515 (2016).

<sup>165</sup> Bernard M. Hoekman & Petros C. Mavroidis, *WTO 'à la carte' or 'menu du jour'? Assessing the Case for More Plurilateral Agreements*, 26 EUROPEAN JOURNAL OF INTERNATIONAL LAW 324 (2015).

Domestic reform could produce regulatory improvements. Examples include establishing FTZs, reforming the forex settlement of foreign-invested enterprises (FIEs), allowing multinational companies to set up cash pooling in RMB and foreign currency, and revising the Foreign Investment Catalogue to reduce the number of restrictive measures, and issuing documents to promote opening-up,<sup>166</sup> many of which aim to enhance the utilisation of foreign investment.<sup>167</sup> A number of these measures are also regarded by the Chinese Ministry of Commerce as a kind of response to the United States' concerns over market access.<sup>168</sup>

Domestic reform can be made nationwide (including law amendment such as the recent reform of investment law) or within a region (including FTZs). It may lead to the amendment of national law when needed. Given the difficulties with regulatory improvements, major domestic reform often takes a top-down approach.

## 2. *High-level PTIAs*

China could negotiate or join deep PTIAs that set stringent WTO-plus and WTO-extra regulatory obligations, which contrast with China's existing FTAs that largely follow WTO norms with few developments in regulatory disciplines. One option is 'regulatory' PTIAs with non-U.S. partners (e.g., the European Union-China BIT). The RCEP is probably not a regulatory response, since it can hardly impose stringent regulatory requirements due to the different positions and development level of parties. The other option is PTIAs involving the United States, either involving only the United States and China (the United States-China BIT), or involving the United States and other parties (e.g., the TiSA). The TiSA is a typical example. Concerning regulatory issues such as data flows and new services,<sup>169</sup> the TiSA may

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<sup>166</sup> For instance, the State Council of China has issued the Circular of Several Measures for the Expansion of Opening-up and the Active Use of Foreign Investments in 2017. Ministry of Commerce of the People's Republic of China, 81-82 2017.

<sup>167</sup> PwC, *China Unveils 20 Measures to Further Open up the Economy to Foreign Investment* (Feb. 2017), available at <https://www.pwc.com/au/tax/taxtalk/assets/alerts/china-measures-economy-feb17.pdf>.

<sup>168</sup> Ministry of Commerce of the People's Republic of China, 81-82 2017.

<sup>169</sup> Miner. Nov. 3, 2016.



impose regulatory disciplines resembling the FTAs that the United States and European Union negotiated (e.g., the TPP, the Korea-United States FTA, and CETA).<sup>170</sup> China's entry to the TiSA was blocked by the United States as it thought China might 'drag its feet' in the negotiations.<sup>171</sup> China has not concluded high-level PTIAs, and it is negotiating BITs with the United States and European Union respectively.

## B. The Features

### 1. *A dichotomy between minor and major regulatory responses*

There is a distinction between minor and major regulatory responses. Minor regulatory responses (i) often deal with specific issues (e.g., the application processing time under regulatory transparency); (ii) can be implemented by administrative agencies without changing domestic law; and (iii) are more likely to involve WTO-plus obligations.

China's regulatory response is often a minor one. China's PTIAs contain few new regulatory obligations, and usually do not need the amendment or enactment of national law. China prefers a soft law approach in new regulatory requirements. Even when regulatory obligations are imposed, they can be addressed by administrative agencies. For instance, regulatory transparency in the ChAFTA requires regulators to make administrative decisions on a completed application of a financial service provider within 180 days, and to notify the decision to the applicant.<sup>172</sup>

Domestic reform progresses more on market opening and trade facilitation,<sup>173</sup> rather than stringent regulatory requirements. Experiments in intellectual property and social issues are

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<sup>170</sup> Sherry Stephenson, et al., *Implications of the Trade in Services Agreement (TiSA) for Developing Countries* 37 (2016).

<sup>171</sup> Miner, Nov. 3, 2016.

<sup>172</sup> ChAFTA Annex 8-B, Article 5 (2015).

<sup>173</sup> Dong Liu, *Xiao Lin: Substantial Difference Between the Innovation of Free Trade Zones and International Rules*(Oct. 15, 2016), available at <http://m.21jingji.com/article/20161015/herald/0c380e7a68d915a732b80adc1547e3dc.html>.(Obvious progress has been made in FTZs concerning trade facilitation in which there is competition)

weak in the FTZs,<sup>174</sup> and domestic reform has been slow in thorny regulatory issues such as reducing the role of SOEs.<sup>175</sup> The innovations in FTZs are mainly procedural (e.g., simplified procedure, reduced processing time) instead of policy or systematic ones.<sup>176</sup>

Major regulatory responses have several features. First, they often deal with deep and systematic issues. The negative list is an example of a systematic issue. To prepare the negative list for United States-China investment treaty talks, China established an inter-ministerial mechanism in the State Council and ‘reviewed tens of thousands of’ rules governing foreign investment in China.<sup>177</sup> Second, they require legal modification or enactment by the national legislature to bring systemic regulatory changes. The oft-required amendment of domestic law is the hallmark of major regulatory response. The legal amendment could indicate the depth of regulatory requirements, although not every legal modification means a major regulatory response. Third, they often involve WTO-extra obligations (e.g., investment, and environment) and require more regulatory efforts.

Major regulatory responses occur mainly in investment, and are slow or lacking in other areas such as social issues (e.g., labour and environment), intellectual property, and SOEs. China’s regulatory improvements in investment appear to relate to China’s BIT negotiations with the United States and European Union. China and the United States agreed to conduct negotiations on the basis of pre-establishment national treatment with a negative list approach.<sup>178</sup> This negative list approach is to be adopted nationwide in China from 2018,<sup>179</sup> and therefore four laws are to be modified to adopt the record-filing regime for the

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<sup>174</sup> *Id.*

<sup>175</sup> Bloomberg News, *Trump's Deficit Crusade Overshadows Xi's Investment Treaty Pitch* (Apr. 19, 2017).

<sup>176</sup> Bin Sheng, *How to Develop the Upgraded Free Trade Zones?*, Shanghai Securities News (Mar. 28, 2017), available at <http://news.cnstock.com/paper,2017-03-28,796736.htm>.

<sup>177</sup> Xinhua, *China, US Commitment to New Negative List Offers Underpins Optimism in Investment Treaty Talks* (Jun. 28, 2015), available at [http://english.gov.cn/news/international\\_exchanges/2015/06/28/content\\_281475136101020.htm](http://english.gov.cn/news/international_exchanges/2015/06/28/content_281475136101020.htm).

<sup>178</sup> Xinhua, *China, US Commitment to New Negative List Offers Underpins Optimism in Investment Treaty Talks* (Jun. 28, 2015).

<sup>179</sup> HKTD, *China to Expand FTZ Negative List Model Nationwide* (Sept. 6, 2016), available at <http://hkmb.hktdc.com/en/1X0A7BW7/hktdc-research/China-to-Expand-FTZ-Negative-List-Model-Nationwide>.

establishment or change of most FIEs.<sup>180</sup> Moreover, China amended the Legislation Law to improve transparency, requiring public comments on the draft law to be collected for at least 30 days, and the occurrence of public comment collection to be publicized.<sup>181</sup> It is the first time public comment collection has been provided for as an obligation of the legislature.<sup>182</sup>

## 2. *Long-term responses*

Regulatory responses directly address the concerns of the United States. The U.S. trade approach highlights regulatory requirements and is about much more than just trade. Besides market opening, regulatory protections are a concern of the United States. Regulatory response could directly lead to regulatory improvement.

Regulatory response has the far-reaching effect of ameliorating regulatory standards. It is probably the most effective way to address barriers to trade and investment. For instance, the negative list approach and pre-establishment national treatment will bring a fundamental change in the regulation of investment in China.

## 3. *A holistic approach*

Domestic reform and high-level PTIAs are a holistic approach. On the one hand, domestic reform represents a testing ground. It is not only an integral part of China's FTA strategy,<sup>183</sup> but also serves for the BIT negotiations (e.g., the Shanghai Free-Trade Zone (SFTZ) influenced by the United States-China BIT negotiations<sup>184</sup>). For instance, the negative list approach is tested in FTZs before its nationwide expansion.

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<sup>180</sup> China Reforms Her Foreign Direct Investment Regulatory Regime (Sept. 2016).

<sup>181</sup> Legislation Law of the People's Republic of China Article 37 (2015).

<sup>182</sup> Zhang Yuanan, *Wang Yang: Sino-US Cooperation is the Only Right Choice*, Caixin (Nov. 23, 2016), available at <http://international.caixin.com/2016-11-23/101010192.html>.

<sup>183</sup> State Council. 2015.

<sup>184</sup> Armstrong Teasdale LLP, *China Opens Experimental Free-Trade Zone in Shanghai* (Oct. 18, 2013), available at <http://www.armstrongteasdale.com/china-opens-experimental-free-trade-zone-in-shanghai-10-18-2013/>.

On the other hand, deep PTIA negotiations could build on and even move faster than domestic reform. The pressure to negotiate PTIAs helps to overcome vested interests and accelerate domestic reform.<sup>185</sup> As a major reform in recent years, the reform in investment is arguably triggered by the United States-China BIT negotiations and is linked to China's efforts to join the TiSA negotiations. China recently called for fair participation in government procurement by domestically invested enterprises and FIEs,<sup>186</sup> which probably relates to China's process of acceding the GPA. In China's United States-China BIT negative list offer until November 2016, China's openness in a number of areas (e.g., banking and securities) is higher than that in FTZs.<sup>187</sup>

### C. The Future

#### 1. *Will China adopt a regulatory response?*

China is ambivalent about a regulatory response as discussed below, and there is considerable uncertainty about the future of any regulatory response. China wants to ensure there are no unintended consequences, but regulatory responses often involve sensitive behind-the-border issues (e.g., SOEs and labour). However, regulatory responses could be consistent with China's long-term plan for reform, and PTIA negotiations may promote regulatory reform at home.

On the one hand, China may have the incentive to gradually pursue deep PTIAs for geopolitical, economic and legal considerations. Geopolitically, high-level PTIAs will help China develop close relationships with developed countries, since regulatory response alleviates their concerns regarding regulatory protection. Regulatory response will save China

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<sup>185</sup> Sean Miner, *Why China Wants a BIT with the United States* (Jun. 18, 2015), available at <https://piie.com/blogs/trade-investment-policy-watch/why-china-wants-bit-united-states>.

<sup>186</sup> Circular of State Council Concerning Measures on Expanding the Opening Up and the Active Utilization of Foreign Capital Article 11 (2017).

<sup>187</sup> Yuanan, Nov. 23, 2016.

from being an outlier of new generation rules. For instance, the United States-China BIT could 'build on China's efforts to become a leader in global affairs'.<sup>188</sup>

If properly managed, regulatory response may bring economic benefits despite the possible impact on Chinese industries arising out of market opening. It should boost investor confidence in China. By offering regulatory protection requested by the partners, China could leverage more accession from other partners including enhanced market access and better treatment of China's outbound investment. Deep FTAs help to gain preferential access to major economies representing over one third of global GDP.<sup>189</sup> The benefits of the United States-China BIT include the investment of China's SOEs in the United States, the access to U.S. intellectual property, and the shift of manufacturing operations to the United States to avoid the U.S. border measures.<sup>190</sup>

From a legal perspective, regulatory response will promote good governance, and enhance the predictability of economic relationships (such as the treatment available to traders and investors). For instance, the United States-China BIT could improve the review of the Committee on Foreign Investment in the United States regarding enhanced transparency and clarity of criteria.<sup>191</sup> It may help to address the concerns over China's market economy status perhaps in a side agreement.<sup>192</sup>

All these factors are likely part of explanation as to why China preferred speeding up the United States-China BIT negotiations before the new U.S. administration took office, and urges the new U.S. administration to advance BIT negotiations.<sup>193</sup> China is willing to take more regulatory commitments at least under these BITs.

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<sup>188</sup> Morrison, 25.

<sup>189</sup> Mark Wu, *The "China, Inc." Challenge to Global Trade Governance*, 57 HARVARD INTERNATIONAL LAW JOURNAL 261, 315 (2016).

<sup>190</sup> Daniel C.K. Chow, *Why China Wants a Bilateral Investment Treaty with the United States*, 33 BOSTON UNIVERSITY INTERNATIONAL LAW JOURNAL 421, 439-455 (2015).

<sup>191</sup> Miner, *Why China Wants a BIT with the United States* (Jun. 18, 2015).

<sup>192</sup> *Id.*

<sup>193</sup> Louise Radnofsky & Page Jeremy, *U.S., China Make Limited Headway During Summit* (2017).

On the other hand, many challenges exist. Domestic reform involves a variety of stakeholders, and the overhaul of the regulatory system is challenging. Investment is a good example, since it is an area that China prioritizes. The draft Foreign Investment Law of China was released in January 2015 and has not been submitted to the legislature for first reading at the time of writing.<sup>194</sup> This slow process is probably due to the complexity of relevant issues, and the fundamental reform of investment regulation can hardly be undertaken in the short term.<sup>195</sup> Thorny issues include national security review, variable interest entities through which foreign entities invest in sectors restricted by China to foreign investment, the scope of investment, and the treatment of FIEs compared with domestic enterprises.<sup>196</sup> FTZs also face challenges such as coordination with ministries and approval to deviate from national law.

As the game changer, high-level PTIAs are challenging in negotiations, interpretation and implementation given their depth and width. For instance, FTA negotiations are ‘extremely resource intensive and often involve highly technical and specialised discussions’.<sup>197</sup> A regulatory gap between China and developed countries also exists, which is the biggest challenge in the TiSA.<sup>198</sup> As an example, TPP SOEs rules may match some of China’s domestic reforms, but it will be a wide canyon to cross on such strict SOE disciplines given ‘the strength of the vested interests there’.<sup>199</sup> China would not take the TPP-style rules without fully understanding the political and economic implications since ‘[a]t root it is a fundamental challenge of politics and governance’.<sup>200</sup>

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<sup>194</sup> MOFCOM, *Regular Press Conference of the Ministry of Commerce (March 2 2017)* (Mar. 4, 2017), available at <http://english.mofcom.gov.cn/article/newsrelease/press/201703/20170302529366.shtml>.

<sup>195</sup> Qing Ren, *The "Small" Reform Is Not So Small: China's Foreign Investment Law Enters the Era of Negative List* (Aug. 30, 2016), available at <http://opinion.caixin.com/2016-08-30/100983287.html>.

<sup>196</sup> Feng Wang, *First Step Taken for the Amendment of Foreign Investment Law, the Determination of VIE Enterprises "To Be Further Studied"* (Sept. 1, 2016), available at [http://epaper.21jingji.com/html/2016-09/01/content\\_45980.htm](http://epaper.21jingji.com/html/2016-09/01/content_45980.htm).

<sup>197</sup> David Evans, *Bilateral and Plurilateral PTAs*, in *BILATERAL AND REGIONAL TRADE AGREEMENTS: COMMENTARY AND ANALYSIS* 59, (Simon Lester, et al. eds., 2016).

<sup>198</sup> Stephenson, et al., 36. 2016.

<sup>199</sup> Sean Miner, *Commitments on State-Owned Enterprises*, in *ASSESSING THE TRANS-PACIFIC PARTNERSHIP, VOLUME 2: INNOVATIONS IN TRADING RULES* 98, (Jeffrey J. Schott & Cimino-Isaacs Cathleen eds., 2016).

<sup>200</sup> Du, *JOURNAL OF INTERNATIONAL ECONOMIC LAW*, 431 (2015).

## 2. *How may China adopt a regulatory response?*

First, a regulatory response, if taken by China, will probably take an incremental approach: from BITs to FTAs, from investment to other issues, and from soft law to hard law.

China may start with high-level BITs and incrementally move to FTAs with more regulatory requirements than before. This is mainly because BITs have narrower scope and contain fewer regulatory requirements than FTAs that cover wide-ranging issues (e.g., trade and non-trade concerns). China's BITs focus on investment protection and progressively move towards liberalization.<sup>201</sup> Meanwhile, China has not received as strong external negotiation pressure in FTAs as in the BIT negotiations. China's BIT negotiations with the United States and European Union and deep FTAs (e.g., the TPP) could serve as the basis for China's possible high-level FTA negotiations with partners such as Canada.

Investment takes centre stage in regulatory response in the short and medium term, which is supported by the negotiation plan in China's FTAs with Korea and Australia and domestic reform to introduce a fair competition review system in policies concerning foreign investment to forbid arbitrary restrictions on FIEs.<sup>202</sup> Regulatory response may gradually expand to other areas such as the environment. Concerning the environment, China has incentives to address pollution and faces external pressure from the Paris Agreement and PTIAs (e.g., China's BIT negotiations with the United States and European Union, and the China-Korea FTA). In other areas, there is arguably less strong pressure at least from an agreement like the Paris Agreement, while China may lack strong incentive to promote major regulatory improvements.

China may first adopt soft law regulatory obligations in PTIAs and gradually move to hard law. It is worth noting that U.S. practice has taken the same approach, in the context of

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<sup>201</sup> Heng Wang, *The RCEP and Its Investment Rules: Learning from Past Chinese FTAs*, 3 CHINESE JOURNAL OF GLOBAL GOVERNANCE 160, 163 (2017).

<sup>202</sup> PwC (Feb. 2, 2017).

investment provisions on labour and the environment (which have evolved from non-binding to binding language). For reasons discussed above, it could happen in social issues in BITs and environment issues in FTAs. However, the progress may be rather limited for sensitive areas such as SOEs.

Second, the prospects for China to join the TPP or its successor (i.e. the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)) are low in the short term, and China will prefer to be an original rather than new PTIA member. The absence of the United States in the TPP substantially reduces the geopolitical and economic attractiveness of this pact. Even if China wants to join the TPP, there is uncertainty about other TPP countries' positions. Japan was cool to inviting China into the TPP.<sup>203</sup> In contrast, PTIA negotiations avoid the humiliating and time-consuming accession process and TPP-plus conditions. In a 'face saving' manner, PTIA negotiations with the United States may help China engage with the global market to climb the manufacturing value chain, and take advantage of the complementariness of American and Chinese interests.<sup>204</sup> From a legal perspective, TPP accession is much more complex than WTO accession or negotiating PTIAs due to stringent TPP-plus regulatory requirements. China prefers to shape PTIA rules and avoid the circle of accessions after its WTO entry.

Third, China is likely to selectively adapt high-level regulatory requirements proposed by partners largely due to its capacity limit. China has adopted high-level regulatory rules in selected areas (e.g., the negative list approach and pre-establishment national treatment for investment). Again, the selective adaptation of high-level rules would probably happen first in investment for internal and external conditions discussed above.<sup>205</sup> Overall, China is more

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<sup>203</sup> Linda Sieg & Nakagawa Izumi, *Japan Cool to Inviting China into TPP as Abe Repeats Free Trade Mantra* (Jan. 25, 2017), available at <http://www.reuters.com/article/us-japan-tpp-idUSKBN159000>.

<sup>204</sup> Lester & Huan, 3-4.

<sup>205</sup> For the analysis of selective adaptation, see, e.g. Pitman Potter, *China and the International Legal System: Challenges of Participation*, 191 THE CHINA QUARTERLY 699, 699-715 (2007).



likely to be affected by the U.S.-style rules due to the strong, albeit fading, negotiation power of the United States, but may also adapt the rules of other developed economies. As an example of selective adaptation, the China-Canada BIT models a number of innovative features of the North American Free Trade Agreement countries' approach, but lacks a commitment to investment liberalisation.<sup>206</sup> That said, the European Union-China BIT negotiations have covered the European Union text proposals on SOEs, domestic regulation, sustainable development, and procedural fairness in competition related procedures and standard setting.<sup>207</sup>

## VI. THE IMPLICATIONS

### A. A Political-Legal Spectrum

This part will discuss the implications of these responses to help deepen understanding of U.S.-China trade relations. Critically, three kinds of responses exist on a political-legal spectrum, and reflect some kind of continuum. Retaliatory, inclusive and regulatory responses deter against specific measures, engage with partners, and improve regulatory protection respectively. These three responses are likely to remain possibilities regardless of changes in the U.S. trade approach. However, the utilisation of different responses may change with the rise of China as China gains more capacity to design its own trade path.

Retaliation and regulatory responses exist at the end of the political-legal spectrum, whereas inclusive response occupies some kind of middle ground. Retaliation is the most political among the three responses. It is a largely political rather than legal response, and may elevate trade issues to sensitive political ones.<sup>208</sup> As discussed above, this is not least because the concepts in retaliation often defy legal definition. Retaliation involves areas in

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<sup>206</sup> Berger, 6, footnote 9.

<sup>207</sup> *EU-China Investment Agreement: Report of the 12th Round of negotiations, Brussels 26-30 September 2016* (2016), available at [http://trade.ec.europa.eu/doclib/docs/2016/october/tradoc\\_155061.pdf](http://trade.ec.europa.eu/doclib/docs/2016/october/tradoc_155061.pdf).

<sup>208</sup> Pasha L. Hsieh, *China-United States Trade Negotiations and Disputes: The WTO and Beyond*, 4 *ASIAN JOURNAL OF WTO & INTERNATIONAL HEALTH LAW & POLICY* 369, 377 (2009).

which multilateral rules are vague or lacking. Retaliatory response is largely based on the retaliating country's own subjective criteria of fairness. Therefore, it is dependent on future events and political choices. Through retaliation against unilateral measures, use of this strategy mainly responds to the shift toward unilateralism and trade enforcement. Although retaliation may respond to measures related to trade imbalances (e.g., border adjustment tax, and the declaration of China as a currency manipulator), the highly politicized and adversarial approach underpinning retaliation suggests that it can hardly address trade deficit issues. Retaliation is not likely to bring normative developments that promote good governance, and can hardly address regulatory concerns.

Occupying the middle ground, an inclusive response is legally regulated but is more of devolution into political responses. Inclusive responses provide predictability from a legal perspective, and contrast with the oft-politicized and unpredictable retaliation. As an illustration, WTO dispute settlement involves complicated legal issues and may lead to changes in municipal law. At the same time, inclusive response involves political considerations. For instance, China believes that the market openness level depends on national conditions and is closely related to the political and economic system, the development level and regulatory capacity.<sup>209</sup> If properly managed, inclusive responses could partially respond to trade deficit issues (such as through the U.S.-China trade dialogues and arrangements), the shift away from multilateralism toward unilateralism (such as increasing China's negotiation power through building a BRI-related trade network), and trade enforcement (such as WTO disputes initiated by China against U.S. measures).

Regulatory response appears to be the most legalized approach among the three responses, although political considerations do play a role. Regulatory response is often reflected in new domestic rules. Major regulatory response not only requires the change of

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<sup>209</sup> Ministry of Commerce of the People's Republic of China, 80. 2017.

municipal law but also carries systematic and legal implications (e.g., obligations for administrative agencies). Through measures such as those to promote good governance, regulatory responses could address regulatory concerns underlying stringent U.S.-style regulatory disciplines, and may partially address the unfair trade practice issues in trade enforcement.

### B. China's Preference for Inclusive Approach?

Different responses may overlap with each other, and China is likely to give the inclusive approach primacy over the others. The three types of responses may be deployed simultaneously and are often complementary strategies based on their different functions. For instance, a regulatory response may overlap with an inclusive response. High-level PTIAs promote market access, which is intertwined with regulatory requirements (such as the negative list that is closely related to the regulation of investment under United States-China BIT negotiations, and the relationship between domestic regulation and discriminatory licensing requirements in the market access offers in the European Union-China BIT negotiations<sup>210</sup>). Therefore, China's FTAs largely fall within an inclusive response, while a very limited number of their components are regulatory responses. These components include a hybrid approach in the Agreement on Trade in Services under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA),<sup>211</sup> the envisaged negative list approach for investment and services trade in China's FTAs with Korea<sup>212</sup> and Australia,<sup>213</sup> and the negative list approach in the CEPA Investment Agreement.

China prefers inclusive responses to the other two responses. Retaliation is largely a reactive response. It will likely only be utilized when the United States initiates punitive

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<sup>210</sup> EU-China Investment Agreement: Report of the 12th Round of negotiations, Brussels (Sept. 26-30, 2016).

<sup>211</sup> *Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA): Further Liberalisation in 2015* (2016), at [https://www.tid.gov.hk/print/english/cepa/further\\_liberal.html](https://www.tid.gov.hk/print/english/cepa/further_liberal.html) (last visited Sept. 19, 2017)

<sup>212</sup> China-Korea FTA Annex 22-A, para 3 (2015).

<sup>213</sup> ChAFTA Article 8.24.3, 9.9.3(c). 2015.

actions and other options (particularly recourse to the DSM) are not effective. Since retaliation brings negative interactions and is a short-term response, it is not likely to be commonly used. Although the threat of retaliation can be used as a negotiation strategy, retaliation can hardly reduce trade deficit or address regulatory issues, two core concerns of the United States.

Although regulatory responses are proactive, China will likely be ambivalent about adopting any regulatory response given the difficulties in accepting stringent regulatory disciplines. Regulatory response usually involves long-term measures but is less flexible given the sensitive nature of regulatory disciplines. It is demanding in practice, requiring a holistic approach and close domestic coordination. Based on previous practice, two conditions seem to be crucial to adopting a regulatory response: internally, China has an interest in it, and externally, there is strong negotiation pressure. The typical example is investment in which China has an interest in enhanced regulatory protection, given its increased outbound investment and the need to attract investment. Meanwhile, China faces BIT negotiation pressure from the United States and European Union. In reality, it is not easy to meet both conditions.

In contrast with the reactive and short-term retaliation, China could proactively adopt a long-term inclusive response, and generally produce positive outcomes. Essentially, it avoids confrontation and could convey soft power (e.g. the BRI). It relieves certain concerns of the United States (e.g., China's recent domestic measures on market opening in the financial sector) or offsets the lack of PTIA benefits with the United States (e.g. increasing China's negotiation power and opening new markets by developing the BRI). Compared with regulatory response, inclusive response is more feasible in practice. In interacting with partners, inclusive response is the most flexible amongst these responses and adopts wide-ranging devices. PTIAs could promote China-style rules while avoid undertaking regulatory

obligations. However, there is a limit to inclusive response in narrowing the huge gap between, and addressing some genuine problems in, the U.S. and Chinese trade approaches.

To sum up, an inclusive response could respond to most aspects of the U.S. trade approach except for U.S.-style regulatory disciplines. It arguably responds to more U.S. trade measures than regulatory responses and retaliation. China's preference towards inclusive response is also because China's trade strategy aims to create a favourable trade environment but China does not intend to adopt stringent regulatory obligations in the short term. China may not benefit from confrontation, and therefore will generally prefer inclusion. For instance, China now seems to be engaging more actively with the United States, such as by highlighting the 'common circle of friends' of both countries.<sup>214</sup>

### C. Proper Responses Needed

China's responses will profoundly affect global economic governance, and proper responses may move the bilateral relationship forward and strengthen global trade. For instance, inclusive response involves international and regional governance. The former includes the WTO and the G20. For the latter, China has attached a lot of attention to the development of relevant institutions or mechanisms under the BRI, including the Asian Infrastructure Investment Bank, and the Belt and Road Forum for International Cooperation. The framework of such institutional development covers input (participation), throughput (deliberation), or output (material results).<sup>215</sup>

Regulatory and inclusive responses could be useful indicators for China's possible role change from a rule follower to a rule maker. Inclusive response engages more countries, and may theoretically help China to become a rule maker. However, such role change arguably

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<sup>214</sup> Kor Kian Beng, *Let's Cultivate Circle of Friends - Not Cliques, China Tells US* (Jun. 7, 2016), available at <http://www.straitstimes.com/asia/lets-cultivate-circle-of-friends-not-cliques-china-tells-us>.

<sup>215</sup> Gregory Shaffer, *Transnational Legal Process and State Change*, 37 *LAW & SOCIAL INQUIRY* 229, 250 (2012).

requires normative development. The reliance on inclusive response means that China is unlikely to develop new trade norms in the short term. Judging from the limited progress regarding regulatory response, it seems it will be a long way before China becomes a leader in regulatory disciplines.

Inclusive and regulatory responses are better than a retaliatory response in avoiding unilateralism and maintaining international legal order as well as security in global economic relations. Each country's response to the other's policy should be rationalized within a rule-based system, and trade should be a positive sum game rather than a zero-sum one. Reliance on coercion alone is costlier than through consent, and it leads to a less stable global order.<sup>216</sup> For instance, dispute resolution through a rule-based WTO mechanism lowers political costs compared with retaliation.

In the long run, regulatory response and direct engagement between the two states under an inclusive response are a possible solution for U.S.-China trade frictions, and, if managed properly, may increase the convergence of the U.S. and Chinese trade approaches. Retaliation and other inclusive responses may bring divergence. That said the advantages of inclusive response should not be exaggerated as one may argue that some of these responses (e.g. PTIAs) can be considered exclusionary to outsiders. In any case, cooperation between the United States and China regarding trade will promote world peace and development.

#### D. The Shift Toward a Proactive Approach

China's reaction to the U.S. trade approach is more than pure responses, and China may shift to a proactive trade approach during this process. This is not least because China has an independent domestic growth policy and an overarching strategy of power-accumulation, which does not necessarily aim at the U.S. policy. More than selective adaptation, China may

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<sup>216</sup> Krzysztof J. Pelc, *Will Trump's Unilateral Trade Approach Work? History Says No.* (Mar. 7, 2017), available at [https://www.washingtonpost.com/news/monkey-cage/wp/2017/03/07/will-trumps-unilateral-trade-approach-work-history-says-no/?utm\\_term=.542cf814df14](https://www.washingtonpost.com/news/monkey-cage/wp/2017/03/07/will-trumps-unilateral-trade-approach-work-history-says-no/?utm_term=.542cf814df14)

selectively innovate trade norms or pursue the favourable interpretation of existing rules. For instance, different views exist between the United States and China regarding issues such as trade remedies (e.g. zeroing, NME). Through an inclusive response, China could use PTIAs (as is the case with China's FTAs with Korea on trade remedies) and the BRI to affect trade rules or their interpretation.

## VII. CONCLUDING REMARKS

Retaliatory, inclusive and regulatory responses enable China to interact with the United States in a direct or indirect way. Essentially, China is likely to take a flexible, pragmatic and adaptive approach to its trade relationship with the United States. China both counterbalances<sup>217</sup> and engages with the United States. China uses a regulatory response and some elements of an inclusive response (e.g., the governmental dialogue) to deal with the US strategy of engaging Beijing. Meanwhile, China adopts retaliatory and other forms of inclusive response (e.g., the FTAs and BRI) to address the U.S. strategy of hedging Beijing.

Both the new U.S. administration's China policy and China's response are in the process of shaping and adjustment, and one could affect the other.<sup>218</sup> Significant uncertainties exist in the interaction between the two states. They include high trade tensions and a yawning gap between the United States and China on sensitive issues (e.g., state subsidies and SOEs<sup>219</sup>), the burden on the DSM, the capacity limit of negotiating PTIAs simultaneously while managing trade policy in the WTO and other fora,<sup>220</sup> and the complexity of institutional, regulatory, linguistic, legal, cultural, informational, and political factors involved in trade.<sup>221</sup>

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<sup>217</sup> Bryan Mercurio, *China's Trade Strategy: Work in Progress* (Nov. 17, 2016), available at <https://cpianalysis.org/2016/11/17/chinas-trade-strategy-work-in-progress/>.

<sup>218</sup> For the analysis of the United States' response to China, see, e.g., WARREN COHEN, *AMERICA'S RESPONSE TO CHINA: A HISTORY OF SINO-AMERICAN RELATIONS* 1-292 (Columbia University Press Fifth edition ed. 2010).

<sup>219</sup> Clinton, et al., (Jan. 29, 2017).

<sup>220</sup> The availability of time and human resource is even a question for the United State. See, e.g., *Free Trade Agreements: Impact on U.S. Trade and Implications for U.S. Trade Policy*. (2014).

<sup>221</sup> Robert Z. Lawrence, *The United States and the WTO Dispute Settlement System*, available at [https://www.cfr.org/sites/default/files/pdf/2007/03/WTO\\_CSR25.pdf](https://www.cfr.org/sites/default/files/pdf/2007/03/WTO_CSR25.pdf) (last visited Oct. 12, 2017), at 4.

As another example, China is concerned about the unpredictability arising from the unclear aspects of the United States' negative list in the BIT negotiations (e.g., fundamental infrastructure, important technology, and national security).<sup>222</sup> China's response, such as via retaliatory measures and WTO disputes, may in turn affect the U.S. position.

These three types of response could constitute China's counter-model to the United States' deep FTAs in shaping future trade governance. These responses, such as the nations' interactions at the WTO and elsewhere, will have important implications both domestically and for the partners worldwide of the United States and China. It remains to be seen whether they present a threat to the coherence and integrity of the international legal order or instead offer a liberating opportunity for innovation. Moreover, it needs to be observed whether there will be new potential routes between the United States and China regarding trade. In this process, it is crucial to understand the strategic elements underlying each side's moves with reference to moves that the other has made or might take, and take into account China's increasingly proactive trade policy as well as the global trade landscape.

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<sup>222</sup> Jingwei Zhang, *How to Break Through Barriers in the US-China BIT?*, China.org.cn (Sept. 26, 2016), available at [http://www.china.org.cn/chinese/2016-09/26/content\\_39371606.htm](http://www.china.org.cn/chinese/2016-09/26/content_39371606.htm).



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