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# We Need a Global Food Safety Agency: Reflections on the Hidden Jurisprudence of the WTO

*Francis Snyder\**

## ABSTRACT

*Globalization has irrevocably altered the world of food safety. This article focuses on WTO cases about food safety regulation, which arise under WTO agreements other than or in addition to the SPS or the TBT Agreements and which are not directly concerned with relations between the WTO and international standardization bodies. It asks: What do these cases—which are not mainly about relations between WTO and international food standards—teach us about the role of the WTO in food safety regulation?*

*The WTO dispute settlement system deals with food safety more frequently than is sometimes thought. Virtually all such cases were settled, withdrawn or reached stalemate during consultation; in only a very few cases was a panel established. Complainants always won, and the winner was usually of equal or higher income category than the respondent, except when the case went to a panel.*

*These cases are the “hidden jurisprudence” of the WTO with regard to food safety. They are mostly resolved, or at least concluded, by bilateral*

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*negotiations, sometimes between very unequal parties, rather than by decisions taken by a third party on the basis of multilaterally agreed rules. They also represent the basic philosophy or orientation of the WTO regarding food safety. Food safety is treated as simply another trade issue, rather than as a distinct subject matter with economic, political, social and cultural implications far beyond trade, as it should be. Powerful complainants use the WTO dispute settlement mechanism to export and if possible impose their national standards and practices.*

*Complainants, such as China, are well advised for the time being to use a strategy of “aggressive legalism” or of “assertive legalism.” China should participate more actively throughout the WTO dispute settlement procedures, especially at the consultation phase.*

*Neither “aggressive legalism” nor “assertive legalism,” however, can in any way guarantee food safety. The globalization of local food safety standards through a dispute settlement mechanism designed to settle trade disputes is not an appropriate way to determine which standards should regulate food safety in an increasingly integrated, yet inescapably diverse global food economy. The hidden jurisprudence of the WTO is not a good way to regulate food safety today. We need a global food safety agency.*

## I Introduction

Globalization has irrevocably altered the world of food safety. Consumers, economists, legal scholars and pundits alike agree that, in today's world, we are witnessing the creation of a more or less integrated global food economy. This process of economic integration has been accompanied, conditioned and sometimes even shaped by the diffusion of food safety standards emanating from international institutions and/or leading food trading countries.<sup>1</sup> As a result of these interconnected economic and legal processes, food safety standards today are worldwide concerns. We all ask: Is my food safe to eat? How do I know? What does "safe" mean? What are food safety standards? How are they made? How are they enforced, if at all? Which local standards are globalized? Can and should all countries in the world follow the same standards? If not, what about trade?

When we as lawyers try to discern the outlines of this transformation, we usually turn to WTO law. There are many WTO cases about agricultural or food products,<sup>2</sup> but most of them are concerned only indirectly or remotely, if at all, with food safety.<sup>3</sup> Most WTO cases involving agricultural or food products refer not to food safety, still less to food safety standards, but rather to matters such as import or export licensing, anti-dumping duties, safeguards,<sup>4</sup> agricultural subsidies or intellectual property rights, which bear little relation to food safety, at least if we regard only the relevant legal documents and do not take account, for example, of what we might learn from a more detailed contextual

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<sup>1</sup> See generally PAUL ROBERTS, *THE END OF FOOD: THE COMING CRISIS IN THE WORLD FOOD INDUSTRY* (2008); LA SECURITE ALIMENTAIRE (Ahmed Mahiou & Francis Snyder eds., 2006); ALBERT ALEMANN, *TRADE IN FOOD: REGULATORY AND JUDICIAL APPROACHES IN THE EC AND THE WTO* (2007); Francis Snyder, *Global Legal Pluralism and Regulation of Food Safety* (2012) (Course at the Xiamen Academy of International Law, Xiamen, China, July 2-6, 2012; revised version to be published in the COLLECTED COURSES OF THE XIAMEN ACADEMY OF INTERNATIONAL LAW) [hereinafter Snyder, Xiamen Academy].

<sup>2</sup> For a survey up to 2007, see Tim Josling, *Agricultural Trade Disputes in the WTO*, [http://iis-db.stanford.edu/pubs/23522/Agricultural\\_Trade\\_Disputes\\_in\\_the\\_WTO.pdf](http://iis-db.stanford.edu/pubs/23522/Agricultural_Trade_Disputes_in_the_WTO.pdf) (last visited Jan. 17, 2013).

<sup>3</sup> E.g., World Trade Organization, *Chile – Provisional Safeguard Measure on Certain Milk Products*, WT/DS351, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds351\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds351_e.htm) (last visited Sept. 12, 2012) (which involved Articles I and XIX of GATT and articles of the Safeguards Agreement).

<sup>4</sup> E.g., World Trade Organization, *Chile – Definitive Safeguard Measures on Certain Milk Products*, WT/DS356, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds356\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds356_e.htm) (last visited Sept. 12, 2012).

analysis of the implications of the specific case for the economic sectors involved over a longer time period.<sup>5</sup>

Consequently, in order to understand the impact of the WTO on food safety we tend to focus on the main agreements of the WTO that deal directly with food safety standards, namely the Agreement on Sanitary and Phytosanitary Measures (SPS Agreement) and the Agreement on Technical Barriers to Trade (TBT Agreement).<sup>6</sup> Cases involving these agreements are frequently concerned with food safety in the sense of food safety standards, in particular because they involve relations between the WTO and international standardization bodies and their norms regarding food safety.<sup>7</sup> However, not all cases involving the SPS Agreement or in particular the TBT Agreement deal with food safety standards. It would therefore be a mistake to imagine that these two agreements and relevant case law exhaust the field of WTO food safety law.

This means that, even leaving aside the Trade Policy Review Mechanism (TPRM), the work of WTO councils and committees and the contribution of technical assistance, some of which I explore elsewhere,<sup>8</sup> the SPS Agreement and the TBT Agreement are not the only WTO agreements which give rise to cases about food safety, including food safety standards. Yet the cases about food safety which arise under other WTO agreements other than or in addition to the SPS Agreement or the TBT Agreement and which deal with issues other than international standards have rarely, if ever, been grouped together and analyzed in any systematic way from the standpoint of food law. This perspective on food safety regulation is distinct, for example, from studying individual cases in order to understand their contribution to the elaboration of general WTO legal rules and legal concepts, such as “discrimination” or “necessity.” As a result, despite their legal, political, economic and symbolic

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<sup>5</sup> For a complex and controversial example, see World Trade Organization, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds103\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds103_e.htm) (last visited Sept. 11, 2012); World Trade Organization, *Canada – Measures Affecting Dairy Exports*, WT/DS113, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds113\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds113_e.htm) (last visited Sept. 11, 2012). The United States on Oct. 8, 1997 in the first case and New Zealand on Dec. 29, 1997 in the second case requested consultations concerning a Canadian dairy export scheme. They argued that the scheme was incompatible with the GATT and the Agreement on Agriculture, and the US also challenged the scheme on the basis of the Import Licensing Agreement and the SCM Agreement. In both cases, following unsuccessful consultations, the case went through a panel, the AB and two Article 21.5 panels, both of which were appealed, before the parties notified the WTO on May 9, 2003 (in both cases) of their mutually satisfactory solution.

<sup>6</sup> *E.g.*, Snyder, Xiamen Academy, § III Cross-References.

<sup>7</sup> *See generally* Snyder, Xiamen Academy.

<sup>8</sup> *Id.*



significance, these cases remain the “invisible case law” or the “hidden jurisprudence” of the WTO from the standpoint of food safety regulation.

Here I focus on the WTO cases about food safety regulation which arise under WTO agreements other than or in addition to the SPS or the TBT Agreements and which are not directly concerned with relations between the WTO and international standardization bodies. My basic question is: What do these cases—which are not mainly about relations between WTO and international food standards—teach us about the role of the WTO in food safety regulation, in particular in promoting other food safety standards, especially national food safety standards, and about specific conceptions of food safety?

As a law professor in China, I am very interested in what these cases can teach us about relations between the WTO and China regarding food safety. Since acceding to the WTO on December 11, 2001, China has so far been a complainant in 11 cases, a respondent in 30 cases, and a third party in 97 cases.<sup>9</sup> However, China was not a complainant or a respondent in any of the cases discussed here. Nevertheless, China was a third party in six cases, in particular because Chinese government policy has been to participate as a third party in as many cases as possible in order to learn quickly how the WTO dispute settlement system worked and to express its viewpoint on specific issues. China’s third party status in these cases is noted in the text. Any lessons that the cases may contain for China, as well as other WTO Members, are summarized in the conclusion.

The article argues, first, the WTO dispute settlement system deals with food safety and food safety standards much more frequently than is sometimes thought. While the SPS Agreement and the TBT Agreement are the most important WTO agreements in the field of food safety, they are not by any means the only relevant WTO agreements. Second, it argues that these cases constitute the “hidden jurisprudence” of the WTO in two different senses; each sense reflects a different meaning of the term “jurisprudence” as currently used in English-language legal scholarship. On one hand, these cases constitute building blocks in the construction of WTO food safety law. Here, “jurisprudence” refers to “case law.” Borrowed from the original French term *jurisprudence*, this meaning of “jurisprudence” is now widely accepted in the English language. On the other hand, the cases help us to elucidate the philosophy or, to put it more modestly, the approach and orientation of the WTO with regard to food

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<sup>9</sup> *China and the WTO*, WORLD TRADE ORGANIZATION, [http://www.wto.org/english/thewto\\_e/countries\\_e/china\\_e.htm](http://www.wto.org/english/thewto_e/countries_e/china_e.htm) (last visited Apr. 9, 2013).

safety. This sense relies on the English-language term “jurisprudence” to mean “legal philosophy,” a connotation which previously was the standard meaning of the term and which is still widely used today.

## II The Cases

Which cases should be considered? WTO law does not provide a definition or even a specific conception of food safety. In this article, for the sake of convenience, I adopt the following definition: Food safety law consists of the norms, institutions and legal processes “intended to ensure, or having the effect of ensuring, that food is safe to eat,” in the sense that it is neither injurious to health nor unfit for human consumption. This definition is based on reasoning *a contrario* from the definition of “unsafe food” provided in the 2009 European Union (EU) Food Law.<sup>10</sup> Even though not perfect, it is for present purposes both sufficiently precise and sufficiently inclusive to serve as a criterion for selecting the cases to be examined.<sup>11</sup>

WTO cases on food safety can be classified in various ways. First, they may be classified according to the WTO agreement(s) involved in the case. Specialists in WTO law usually employ this criterion. This is not surprising, because most lawyers are usually trained to take the law as an authoritative starting point, and the purpose of their research often focuses on issues of positive law or legal doctrine.<sup>12</sup> However, if our objective is to understand the impact of the WTO on food safety regulation, such a legal criterion is less useful than a socioeconomic criterion, because it assumes, counterfactually, that law rather than socioeconomic activity is the structuring principle on which our inquiry is based.

A second method of classification is to classify cases according to the type of measure which gives rise to the case. We might distinguish two groups of cases: those which concerns “border measures,” and those which concern “behind the border measures.” The first group comprises cases concerning measures regarding imports and exports, in other words,

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<sup>10</sup> Regulation (EC) No. 178/2002 of the European Parliament and of the Council of 28 January 2002, art. 14(2), 2002 O.J. (L31/1) 1, 2.

<sup>11</sup> Following this criterion, the paper concerns WTO food safety cases registered at the WTO before Sept. 9, 2012. At the time of writing, numerous recently filed cases are still in progress. A complete list of WTO cases is [http://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_status\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm) (last visited Sept. 12, 2012 and updated to Feb. 2013 with the WTO website [www.wto.org](http://www.wto.org)).

<sup>12</sup> This second approach is the basis for the discussion of relations between the WTO DSM and international standards bodies in Snyder, Xiamen Academy, § III Cross-References.

which affect products by virtue of the fact that they cross a border.<sup>13</sup> The second group embraces cases concerning internal legislation, administrative regulations or other measures, which affect products after they have arrived in the territory of an importing WTO Member. A more specific variant of this method is to distinguish between (a) cases concerning food safety measures imposed on imports, (b) cases concerning food safety measures imposed on exports, and (c) cases concerning the treatment of imported food on a domestic market. For instance, measures affecting exports have recently become an increasing target in WTO cases, for example regarding raw materials,<sup>14</sup> and with a growing shortage of food and water in the world it may be foreseen that WTO cases concerning measures regarding exports of food will increase in number. However, a review of the case law, presented below, reveals that the distribution of cases among these categories is notably uneven. A longer article might examine the reasons for this distribution, but such an objective is outside the scope of the present discussion. More importantly, this classification is based very much on legal categories and takes little account of socio-economic circumstances. Taking law as a starting point hinders our understanding of the impact of specific cases on food safety regulation.

This article adopts a third method of classifying cases. It distinguishes between cases according to the point in the value chain or food chain at which a challenged measure intervenes.<sup>15</sup> In other words, what aspect of food safety does the measure affect? In adopting this method of classification, the article aspires to follow a classification method, which is likely to be adopted by government officials, business people and interested citizens, as well as food safety lawyers. Their point of departure is their own law and their own legal system, the characteristics and industrial structure of their own domestic and export markets, and the impact of foreign trade and international competition on both of these.

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<sup>13</sup> A pertinent example, though not concerning food, is Appellate Body Report, *China – Measures Affecting Imports of Automobile Parts*, WT/DS339/AB/R, WT/DS340/AB/R, WTO/DS342/AB/R (Dec. 15, 2008) (adopted Jan. 12, 2009), [https://www.wto.org/english/tratop\\_e/dispu\\_e/339\\_340\\_342abr\\_e.doc](https://www.wto.org/english/tratop_e/dispu_e/339_340_342abr_e.doc).

<sup>14</sup> See Appellate Body Report, *China – Measures Related to the Exportation of Various Raw Materials*, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R (Jan. 30, 2012) (adopted Feb. 12, 2012), [http://www.wto.org/english/tratop\\_e/dispu\\_e/394\\_395\\_398abr\\_e.pdf](http://www.wto.org/english/tratop_e/dispu_e/394_395_398abr_e.pdf). See also the current cases concerning China's measures on export of rare earths: World Trade Organization, *China – Measures Relating the Exportation of Rare Earths, Tungsten and Molybdenum*, DS 431 (US as complainant), DS 432 (EU as complainant), DS433 (Japan as complainant), [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds431\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds431_e.htm).

<sup>15</sup> On value chains and related concepts, see generally FRANCIS SNYDER, *THE EU, THE WTO AND CHINA: LEGAL PLURALISM AND INTERNATIONAL TRADE REGULATION* (2010) (especially Chapter 3); see generally Gary Gareffi, John Humphrey & Tim Sturgeon, *The Governance of Global Value Chains*, 12(1) Rev Int'l Pol. Econ. 78 (2005).

These concerns (imports, exports, domestic competition) therefore focus more on social and economic relations, in particular on food safety, than on legal criteria. Such a method of classification sets WTO cases more squarely in their domestic economic, political, social and cultural contexts. As a result, it should provide a basis for a more detailed picture of the effects of the WTO dispute settlement mechanism on food safety and on food safety standards.

Using this approach, the remainder of this part of the article first analyses five groups of cases, focusing respectively on (a) pre-importation production and treatment methods, (b) import bans – procedures, (c) import bans – health and quality standards, (d) testing and inspection and (e) shelf-life. It then considers which WTO Members were involved and how, the ways in which their disputes were resolved, who won the cases, and the implications for the globalization of food safety rules and practices. The conclusion draws out the main lessons from this detailed analysis. It identifies some serious shortcomings in the current resolution of disputes about food safety and then proposes the creation of a global food safety agency.

### *A Group 1: Pre-Importation Production and Treatment Methods*

A first category of cases concerns rules about production and treatment methods used in the exporting country, that is, prior to exportation of the product, and therefore prior to importation of the product on the importing country's market. Table 1 shows the cases in this category.

Table 1. Cases on Pre-Importation Production and Treatment Methods

<i>Case No., Filing Date</i>	<i>Case Name</i>	<i>Complainant</i>	<i>Product</i>	<i>Procedural Status</i>
DS20, 8.11.1995	<i>Korea – Bottled Water</i>	Canada	Bottled water	Mutually agreed solution
DS72, 24.3.1997	<i>EC – Butter</i>	New Zealand	Butter	Mutually agreed solution
DS287, 3.4.2003	<i>Australia – Quarantine Regime</i>	EC	Meat	Mutually agreed solution
DS389, 16.1.2009	<i>EC – Poultry</i>	US	Poultry	Panel established but not yet com- posed

Such rules may determine in effect whether a product can be imported and/or sold. Usually, they constitute, at least arguably, not only barriers to market entry but also measures seeking to guarantee food quality and food safety, with complainant and respondent characterizing the measures in opposite ways.

Water, the “noblest of the elements” according to Pindar,<sup>16</sup> is also an economic sector characterized in recent decades by intense competition. This is especially true of bottled water. During the past two decades, international consumption of bottled water increased dramatically. It is perhaps not surprising therefore that the bottled water industry, comprising bottlers, distributors and suppliers, witnessed rapid consolidation.<sup>17</sup> At the time, however, there were no internationally accepted standards on bottled water.

*Korea – Bottled Water* concerned the production and treatment of bottled water by ozonation, a commonly used but nevertheless controversial method of treatment.<sup>18</sup> Canada, which used ozonation as a method of treating bottled water, complained about Korean measures prohibiting disinfection of bottled water by ozonation. Korean law allowed only physical water treatments (precipitation, filtration, aeration and ultraviolet disinfection). It considered ozonation to be a prohibited chemical treatment.<sup>19</sup> At the time, and at least for the following decade, Korea was a rapidly growing market for bottled water.<sup>20</sup>

Canada requested formal consultations with Korea under Article 4.3 of the WTO Understanding on Rules and Procedures Governing the

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<sup>16</sup> Pindar, 476 B.C., as quoted on the website of the International Council of Bottled Water Associations (ICBWA), <http://www.bottledwaterweb.com/suppliersdetail.do?k=404> (last visited Jan. 18, 2013).

<sup>17</sup> Peter H. Glieck, *The Myth and Reality of Bottled Water*, in PACIFIC INSTITUTE, *THE WORLD’S WATER: THE BIENNIAL REPORT ON FRESHWATER RESOURCES: 2004–2005*, 21 (2004), [http://www.pacinst.org/wp-content/uploads/2013/04/myth\\_and\\_reality.pdf](http://www.pacinst.org/wp-content/uploads/2013/04/myth_and_reality.pdf) (last visited Jan. 18, 2013).

<sup>18</sup> E.g., D. Van der Kooji, W.A.M. Hijnen & J.C. Kruithof, *The Effects of Ozonation, Biological Filtration and Distribution on the Concentration of Easily Assimilable Organic Carbon (AOC) in Drinking Water*, in 11(3) *OZONE: SCIENCE & ENGINEERING: THE JOURNAL OF THE INTERNATIONAL OZONE ASSOCIATION* 297 (1989); Laurence Meunier, Silvio Canonica & Urs von Gunten, *Implications of Sequential Use of UV and Ozone for Drinking Water Quality*, 40(9) *WATER RESEARCH* 1864 (2006).

<sup>19</sup> World Trade Organization, *Korea – Measures Concerning Bottled Water*, Request for Consultations by Canada, WT/DS20/1G/L/33, G/SPS/W/35G/TBT/D/4, G/MA/3, G/AG/w/14 (Nov. 22, 1995), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds20\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds20_e.htm).

<sup>20</sup> Euromonitor International, *Passport: Bottled Water in South Korea* (Sample Report, Sept. 2011), [http://www.euromonitor.com/medialibrary/pdf/samples/sample\\_report\\_soft\\_drinks\\_bottled\\_water.pdf](http://www.euromonitor.com/medialibrary/pdf/samples/sample_report_soft_drinks_bottled_water.pdf) (last visited Jan. 18, 2013).

Settlement of Disputes (DSU), probably after the failure of early informal discussions.<sup>21</sup> WTO Members are required to provide an opportunity for consultation if another Member requests consultations concerning measures that affect obligations under the WTO agreements.<sup>22</sup> “Members duty to consult is absolute.” Requests for consultations must be notified to the WTO Dispute Settlement Body (DSB) and relevant Councils and Committees.<sup>23</sup> During consultations, “before resorting to any further action under [the DSU],” namely requesting a panel, “Members should attempt to obtain satisfactory adjustment of the matter.”<sup>24</sup> Consultations are required before a panel can be requested.<sup>25</sup> Consultations are “confidential, and without prejudice to the rights of any Member in any further proceedings.”<sup>26</sup> The Appellate Body has described the purpose of consultations as follows:

Through consultations, parties exchange information, assess the strengths and weaknesses of their respective cases, narrow the scope of the differences between them and, in many cases, reach a mutually agreed settlement in accordance with the explicit preference expressed in Article 3.7 of the DSU. Moreover, even when no such agreed settlement is reached, consultations provide the parties an opportunity to define and limit the scope of the dispute between them. Clearly, consultations afford many benefits to complaining and responding parties as well as to third parties and to the dispute settlement system as a whole.<sup>27</sup>

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<sup>21</sup> On consultations, see especially Christiane Schuchhardt, *Consultations*, in 1 THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS 1197 (Patrick F.J. Macrory, Arthur E. Appleton & Michael G. Plummer eds., 2005). For a review of the case law on Article 4 consultations up to Sept. 30, 2011, see WORLD TRADE ORGANIZATION, WTO ANALYTICAL INDEX—GUIDE TO WTO LAW AND PRACTICE 1543–1555 (Cambridge Univ. Press 3rd ed. 2012); World Trade Organization, *WTO Analytical Index: Supplement Covering New Developments in WTO Law and Practice*, [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/ai\\_new\\_dev\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/ai_new_dev_e.pdf) (last visited Mar. 16, 2013) (covering developments after Sept. 30, 2011).

<sup>22</sup> Understanding on Rules and Procedures Governing the Settlement of Disputes art. 4.2, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401 [hereinafter DSU]; Panel Report, *Brazil – Measures Affecting Desiccated Coconut*, ¶ 287, WT/DS22/R (Oct. 17, 1996) (adopted Mar. 20, 1997), [http://www.worldtradelaw.net/reports/wtopanel/brazil-coconut\(panel\).pdf](http://www.worldtradelaw.net/reports/wtopanel/brazil-coconut(panel).pdf).

<sup>23</sup> DSU art. 4.4.

<sup>24</sup> DSU art. 4.5.

<sup>25</sup> DSU art. 4.7 & 6.2.

<sup>26</sup> DSU art. 4.6.

<sup>27</sup> Appellate Body Report, *Mexico - Anti-Dumping Investigation of High Fructose Corn Syrup from the United States*, ¶ 54, WT/DS132/AB/RW (Oct. 22, 2001) (adopted

As Pauwelyn notes, formal DSU consultations are “as much a final attempt to settle a dispute as a prelude to the litigation stage” and also “a safety valve to let off domestic pressure to take a dispute seriously.”<sup>28</sup>

Canada argued that the Korean measures were inconsistent with Articles III and XI GATT, Articles 2 and 5 SPS, and Article 2 TBT. In April 1996 the parties reached a mutually agreed solution. They agreed that Korea would amend its measures to allow the importation, sale and distribution of ozone-treated water by 1 January 1997 if possible, and in any event no later than 1 April 1997. Article 3.6 DSU requires Members to notify mutually agreed solutions to the DSB and relevant Councils and Committees.<sup>29</sup> As a matter of law, such solutions must be consistent with the WTO agreements and not nullify or impair Member’s benefits under the WTO agreements or impede achievement of the objectives of the WTO agreements.<sup>30</sup>

During the case, neither party referred to any international standards. The World Health Organization had advocated the use of its Guidelines for Drinking Water Quality, adopted in the mid-1990s, as the basis for drafting international standards for bottled water. By the late 1990s, such standards were being drafted by the Codex Alimentarius Commission. However, at the time of *Korea – Bottled Water* there was no such international standard and no universally accepted certification scheme.<sup>31</sup> Adopted only in 2001, the Codex standard permits the treatment of waters intended for bottling by chemical processes, including ozonation, singly or in combination with other processes.<sup>32</sup>

We may hypothesize that Canadian bottled water companies and their trade associations played a significant role not only in the making of the Codex standard but also in pressing the Canadian Government to

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Nov. 21, 2001), [http://www.wto.org/english/tratop\\_e/dispu\\_e/132abrwr\\_e.pdf](http://www.wto.org/english/tratop_e/dispu_e/132abrwr_e.pdf) (recourse to DSU art. 21.5).

<sup>28</sup> Joost Pauwelyn, *The Limits of Litigation: “Americanization” and Negotiation in the Settlement of WTO Disputes*, 19 OHIO ST. J. ON DISP. RESOL. 121, 133 (2003).

<sup>29</sup> DSU art. 3.6.

<sup>30</sup> DSU art. 3.5.

<sup>31</sup> World Health Organization, *Bottled Drinking-Water* (2000), <https://apps.who.int/inffs/en/fact256.html> (last visited Jan. 18, 2013).

<sup>32</sup> Codex Alimentarius, *General Standard for Bottled/Packaged Drinking Waters (other than Natural Mineral Waters)*, Codex Standard 227-2001, [www.codexalimentarius.org/input/download/standards/369/CXS\\_227e.pdf](http://www.codexalimentarius.org/input/download/standards/369/CXS_227e.pdf) (last visited Jan. 17, 2013); Codex Alimentarius, *Code of Hygienic Practice for Bottled/Packaged Drinking Waters (other than Natural Mineral Waters)*, CAC/RCP 48-2001, [www.codexalimentarius.org/input/download/standards/392/CXP\\_048e.pdf](http://www.codexalimentarius.org/input/download/standards/392/CXP_048e.pdf) (last visited Oct. 28, 2012).

bring the complaint against Korea.<sup>33</sup> Three trade associations are likely to have been especially important. One such association is the International Bottled Water Association (IBWA), which was formed in the United States in 1958 and which included US and some non-US companies, mainly small, locally-owned bottlers, distributors and suppliers, as members.<sup>34</sup> Second is the Canadian Bottled Water Association, founded in 1992 and encompassing bottlers, distributors and suppliers in Canada, with some associate members; as of 2013, CBWA members produced 85% of all bottled water sold in Canada. The CBWA is the Canadian chapter of a third association, the International Council of Bottled Water Associations (ICBWA).<sup>35</sup> The ICBWA was incorporated in Toronto, Canada, on 9 February 2001.<sup>36</sup> Today it comprises six regional associations as members: IBWA, CBWA, Middle East Bottled Water Association (ABWA), Australasian Bottled Water Institute (ABWI), European Federation of Bottled Waters (EFBW), including the European Bottled Watercooler Association (EBWA) (Europe), Latin American Bottled Water Association (LABWA) and Asian Bottled Water Association (ABWA), altogether representing a total of 1,567 companies in 141 countries, including Korea.<sup>37</sup>

The outcome of *Korea – Bottled Water* was consistent with Article 3.7 DSU, which provides that “The aim of the dispute settlement mechanism is to secure a positive solution to the dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred.”<sup>38</sup> However, it would appear that WTO law itself did not compel withdrawal of the measure. So far as we can judge from available documents, there was no determination as to

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<sup>33</sup> It is unlikely that WTO Members would bring cases to the WTO dispute settlement system unless important economic interests were at stake. See JOHN BRAITHEWAITE & PETER DRAHOS, *GLOBAL BUSINESS REGULATION* 399–417 (2000); CORPORATE POWER IN GLOBAL AGRIFOOD GOVERNANCE (Jennifer Clapp & Doris Fuchs eds., 2009). On relationships between economic interests and government in WTO litigation, see generally GREGORY C. SHAFFER, *DEFENDING INTERESTS: PUBLIC-PRIVATE PARTNERSHIPS IN WTO LITIGATION* (2003). For Chinese examples, see Yan Luo, *Engaging the Private Sector: EU-China Trade Disputes under the Shadow of WTO Law*, 13(6) EUR. L.J. 800 (2007).

<sup>34</sup> International Bottled Water Association (IBWA), <http://www.bottledwater.org/about> (last visited Jan. 17, 2013).

<sup>35</sup> CANADIAN BOTTLED WATER ASSOCIATION (CBWA), <http://www.cbwa.ca/about-cbwa> (last visited Jan. 17, 2013).

<sup>36</sup> LANDOFFREE, [http://canadiancompanies.landoffree.com/company/International\\_Council\\_Of\\_Bottled\\_Water\\_Associations](http://canadiancompanies.landoffree.com/company/International_Council_Of_Bottled_Water_Associations) (last visited Aug. 1, 2013).

<sup>37</sup> See BOTTLEDWATERWEB, <http://www.bottledwaterweb.com/suppliersdetail.do?k=404> (last visited Jan. 18, 2013).

<sup>38</sup> DSU art. 3.7.



whether the Korean measure was contrary to WTO law, since the case did not proceed to a panel.

Within the consultation phase of the WTO dispute settlement mechanism, Canada was able to export its food safety standards to Korea, or, put it pungently, to impose its bottled water treatment methods on Korea. Korea accepted the Canadian ozonation treatment method as a permitted method for treating bottled water to be imported into Korea. This mutually agreed solution was backed up by the possibility of further recourse to the WTO. At the stage of consultations, it is likely that the parties did “not necessarily know all the claims they w[ould] want to make or not make at this relatively early stage.”<sup>39</sup> Doubtless they also had conflicting views of the interpretation of WTO law. Yet factors outside the consultation process itself were likely to have been the most important factors in determining the outcome.<sup>40</sup> Such factors include the results of diplomacy outside of consultations, the political salience of the dispute, the involvement of important domestic interests such as companies and trade associations, and the threat of recourse to a panel.<sup>41</sup>

Several other cases also concerned pre-importation production and treatment methods, though it is not possible to analyze them in the same detail here. Production methods were at issue in DS72 *EC – Butter Products*. When the United Kingdom acceded to the European Economic Community, its imports of dairy products from New Zealand were a sensitive issue within the EEC’s Common Agricultural Policy,<sup>42</sup> which had a structural surplus of dairy products. In early 1997 New Zealand challenged EC and United Kingdom decisions that certain New Zealand butter manufacturing processes were classified so as to exclude the product from New Zealand’s country-specific tariff quota under the EC’s WTO schedule. New Zealand used the ANMIX butter-making process and the spreadable butter-making process, which the UK Customs and Excise

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<sup>39</sup> Gary N. Horlick & Glenn R. Butterson, *A Problem of Process in WTO Jurisprudence: Identifying Disputed Issues in Panels and Consultations*, 31 LAW & POL’Y INT’L BUS. 573, 580–81 (2000).

<sup>40</sup> Olin L. Wethington, *Commentary on the Consultation Mechanism under the WTO Dispute Settlement Understanding During Its First Five Years*, 31 LAW & POL’Y INT’L BUS. 583, 586–87 (2000).

<sup>41</sup> *Id.* at 588. For example, between 1995–2000, when the *Korea – Bottled Water* case took place, the United States strategy was to see the consultation phase “merely as part of a broader strategy to ratchet up political pressure in order to resolve the problem with a panel decision, or outside the WTO context if necessary.”

<sup>42</sup> On the development of the CAP, see generally FRANCIS SNYDER, *LAW OF THE COMMON AGRICULTURAL POLICY* (1985); Francis Snyder, *CAP [Common Agricultural Policy]*, in *THE OXFORD HANDBOOK OF THE EUROPEAN UNION* 484–95 (Erik Jones, Anand Menon & Stephen Weatherill eds., 2012).

Department did not recognize. It is likely that the main New Zealand producer was Fonterra, long established before 1973 and today one of the world's largest producers of dairy products.<sup>43</sup> It was not until more than two years later that the parties notified the WTO DSB that they had reached a mutually agreed solution.<sup>44</sup> In this case the UK and the EC recognized the New Zealand production processes to the extent of allowing imports of New Zealand butter into the UK under specified conditions and subject to reduced tariff rates. Even today, special terms apply to imports into the United Kingdom of butter from New Zealand.<sup>45</sup>

In DS287, *Australia – Quarantine Regime*, the EC on 3 April 2003 requested consultations with Australia concerning its quarantine regime for imports. The Australian regime was based on legislation, administrative guidance, and the exercise of administrative discretion. The EC complaints included claims concerning the import of processed deboned pig meat from Denmark and poultry meat required to be subject to specific methods of preparation. The EC considered the Australian regime not to be based on a risk assessment, except on an unpredictable and even arbitrary basis. It considered the regime to be incompatible with Articles 2, 3, 4, 5, 8 and Annex C of the SPS Agreement. Canada, Chile, India and the Philippines joined the consultations.<sup>46</sup> China, though a major poultry exporter, did not request to join the consultations.<sup>47</sup> A panel was established on 14 October 2003. At this stage, under Article 4.11 DSU, China reserved its third party rights.<sup>48</sup> However, on 9 March 2007 the parties notified the WTO that they had reached a mutually satisfactory solution. The solution included increased transparency of the Australian quarantine regime, the articulation by Australia of principles for dealing

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<sup>43</sup> For a current example, see *Kauri*, FONTERRA, <http://www.fonterra.com/global/en/About/Our+Locations/NewZealand/Kauri> (last visited Oct. 28, 2012).

<sup>44</sup> Panel Report, *European Communities – Measures Affecting Butter Products*, WT/DS72/R (Nov. 24, 1999), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds72\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds72_e.htm) (last visited Sept. 12, 2012).

<sup>45</sup> See HM Revenue & Customs, *Common Agricultural Policy import procedures and special directions for goods*, § 5.41 New Zealand butter, [http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?\\_nfpb=true&\\_pageLabel=pageLibrary\\_ShowContent&id=HMCE\\_CL\\_000195&propertyType=document#P204\\_27015](http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ShowContent&id=HMCE_CL_000195&propertyType=document#P204_27015) (last visited Oct. 28, 2012).

<sup>46</sup> Since 1958 third parties have been allowed to join consultations under Article XXII GATT: Christiane Schuchhardt, *Consultations*, in 1 THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS 1197, 1200 (Patrick F.J. Macrory, Arthur E. Appleton & Michael G. Plummer eds., 2005); DSU art. 4.11.

<sup>47</sup> See World Trade Organization, *Australia – Quarantine Regime for Imports*, WT/DS287, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds287\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds287_e.htm) (last visited Apr. 9 2013).

<sup>48</sup> *Id.*

with EC market access applications and “continued expert discussions on scientific aspects associated with trade in pig meat and chicken meat.”<sup>49</sup>

In early 2009 in DS389 *EC - Poultry* the United States challenged various EC measures which blocked US exporters of poultry meat and poultry meat products from having access to EC [European Community, now EU: European Union] markets. The challenge was the most recent sally in a long-running conflict between the EU and the US concerning the chemical treatment of poultry products. Starting in 1997, the EC prohibited the use of pathogen reduction treatments (PRTs) in the treatment of poultry products. The EC prohibited poultry imports if the products had been treated with any substance other than water unless the substance had been approved by the EC. The US used various PRT chemical treatments. In challenging the EC measure, it invoked the Agreement on Agriculture, Articles III, X and XI GATT, the SPS Agreement and the TBT Agreement. Despite US requests and several EC scientific reports, the EC had not yet approved the import of poultry processed with PRTs. Indeed EC marketing standards defined “poultry meat” to include only “poultry meat suitable for human consumption, which has not undergone any treatment other than cold treatment.” As of November 2009, a panel was established but had not yet been composed.<sup>50</sup> China, most likely because of the importance of its poultry sector and its poultry exports to the US and the EU,<sup>51</sup> reserved its third party rights.<sup>52</sup> There appears not to have been any change to date. It is fair to assume that the dispute has been abandoned or otherwise resolved, even though one author notes that “the [United States Trade Representative] and poultry industry officials remain interested in moving forward on this case.”<sup>53</sup> In 2011, however, the

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<sup>49</sup> *Id.* at Summary of the Dispute to Date.

<sup>50</sup> World Trade Organization, *European Communities – Certain Measures Affecting Poultry Meat and Poultry Meat Products from the United States*, WT/DS389 (Oct. 12, 2009), [http://www.wto.org/english/tratop\\_e?dispu\\_e/cases\\_e/ds389\\_e.htm](http://www.wto.org/english/tratop_e?dispu_e/cases_e/ds389_e.htm) (last visited Sept. 12, 2012).

<sup>51</sup> This sector has been the subject of WTO cases involving China and the USA. See Panel Report, *United States – Certain Measures Affecting Imports of Poultry from China*, WT/DS392/R (Sept. 29, 2010) (adopted Oct. 25, 2010), [http://www.wto.org/english/tratop\\_e/dispu\\_e/392r\\_e.pdf](http://www.wto.org/english/tratop_e/dispu_e/392r_e.pdf); World Trade Organization, *China – Anti-Dumping and Countervailing Duty Measures on Broiler Products from the United States*, WT/DS427, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds427\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds427_e.htm).

<sup>52</sup> World Trade Organization, *supra* note 52.

<sup>53</sup> Renée Johnson, *U.S.-EU Poultry Dispute* (CRS Report for Congress, R40199), <http://www.fas.org/sgp/crs/row/R40199.pdf> (last visited Feb. 21, 2013); Conciliation, *US/EEC Negotiation on Poultry*, Establishment of Panel (12S/65) & *Panel on Poultry*, Report of Panel (L/2088), [http://www.wto.org/english/tratop\\_e/dispu\\_e/63poultr.pdf](http://www.wto.org/english/tratop_e/dispu_e/63poultr.pdf) (last visited Jan. 21, 2013) (the EEC and the US undertook conciliation under the GATT); Panel Report, *European Communities – United Kingdom Application of EEC Directives to Importation of Poultry from the United States*, L/5155-28S/90 (adopted

Codex Alimentarius Commission adopted Guidelines for the Control of *Campylobacter* and *Salmonella* spp. in Chicken Meat, which may provide a “happy end” to this case.<sup>54</sup>

### *B Group 2: Import Bans - Procedures*

A second category of cases concerns measures establishing specific import procedures that in effect amount to a total ban on imports. Table 2 shows these cases.

Table 2. Cases on Import Bans – Procedures

<i>Case No., Filing Date</i>	<i>Case Name</i>	<i>Com- plainant</i>	<i>Product</i>	<i>Procedural Status</i>
DS100, 18.8.1997	<i>US – Poultry Products</i>	EC	Poultry	In consultation
DS133, 7.7.1997	<i>Slovak Republic – Dairy Products</i>	Switzer- land	Dairy prod- ucts	In consultation
DS144, 19.12.1997	<i>US – Cattle, Swine and Grain</i>	Canada	Cattle, swine, grain	In consultation
DS237, 31.12.2001	<i>Turkey – Fresh Fruit</i>	Ecuador	Fresh fruit	Mutually agreed solution
DS270, 18.10.2002	<i>Australia – Fresh Fruit and Vegetables</i>	Philip- pines	Fresh fruit and vegeta- bles	Panel established but not yet com- posed
DS284, 17.5.2003	<i>Mexico – Black Beans</i>	Nicaragua	Black beans	Withdrawn

Such total bans may result from very different kinds of factors, such as the exercise of overly broad discretion by policy-making institutions of the importing country, or a failure to provide specific information, or a general lack of transparency. Their common feature, however, is that on their face they seem to be deliberate attempts to limit imports. In order to be legally acceptable under the WTO international trade regime, such

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June 11, 1981), <http://www.worldtradelaw.net/reports/gattpanels/ukpoultry.pdf> (last visited Jan. 21, 2013).

<sup>54</sup> On the “happy end,” see Daniele Pisanello, *Happy End for US-EC Dispute on Poultry SPS Measures*, <http://www.lexalimentaria.eu/ing/news/46-happy-end-for-us-ec-dispute-on-poultry-sps-measures.html> (last visited Jan. 21, 2013). On the guidelines, see Joint FAO/WHO Food Standards Programme Codex Alimentarius Commission 34th Session, *Report of the Forty-Second Session of the Codex Committee on Food Hygiene, Kampala, Uganda, 29 November – 3 December 2010*, ¶ 63 & Appendix III, [http://www.ift.org/public-policy-and-regulations/advocacy/~media/Public%20Policy/International%20Advocacy/Codex\\_CCFH.pdf](http://www.ift.org/public-policy-and-regulations/advocacy/~/media/Public%20Policy/International%20Advocacy/Codex_CCFH.pdf) (last visited Jan. 21, 2013).

total bans must be justified under WTO law. Importing Members almost always try to justify such bans on grounds of product safety, public health or product quality. Rarely, however, are such justifications successful.

The poultry sector has been a continual source of tension between the EU and the US since the early 1960s,<sup>55</sup> at least until the recent already noted Codex Guidelines.<sup>56</sup> We have already noted its importance to China. DS 100 *US – Poultry Meat* concerned an import ban that was alleged to be due to food safety concerns but which also exemplified the exercise of overly broad discretion on the part of domestic institutions of the importing country. It arose during the period when the EC began to prohibit imports of poultry treated with PRTs, a concern that eventually led the US to bring DS389 *EC – Poultry* (discussed above). It was the first case involving poultry brought to the WTO. On 18 August 1997 the European Communities requested consultations with the United States. It challenged a US ban on imports of poultry and poultry products from the EC. A letter from the USDA Food Safety Inspection Service communicated the ban in the following terms: “poultry and poultry products produced in the EC after April 30, 1997 will not be eligible for entry into the United States until the United States is able to obtain additional assurances of product safety.” However it did not indicate any grounds for what appeared to be a sudden change of policy, which doubtless lay in domestic market conditions and consequent political pressures. The EC considered the ban to be contrary to the GATT, the SPS Agreement and the TBT Agreement.<sup>57</sup> Formally speaking, the case remains in consultation. China did not request third-party status.

DS133 *Slovak Republic – Dairy Products* also concerned measures that in effect banned imports. On 11 May 1998 Switzerland requested consultations with the Slovak Republic about several Slovak measures concerning importation of dairy products and transit of cattle. It alleged that the measures were incompatible with numerous articles of GATT, Article 5 SPS and Article 5 of the Import Licensing Agreement.<sup>58</sup> The

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<sup>55</sup> E.g., Herman Walker, *Dispute Settlement: The Chicken War*, 58 AM. J. INT’L L. 671 (1964); ROSS TALBOT, *THE CHICKEN WAR: AN INTERNATIONAL TRADE CONFLICT BETWEEN THE UNITED STATES AND THE EUROPEAN ECONOMIC COMMUNITY, 1961–64* (Iowa State Univ. Press, 1978).

<sup>56</sup> Joint FAO/WHO Food Standards Programme, *supra* note 56.

<sup>57</sup> World Trade Organization, *United State – Measures Affecting Imports of Poultry Products*, Request for Consultations by the European Communities, WT/DS100/1 (Aug. 25, 1997), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds100\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds100_e.htm) (last visited Sept. 12, 2012); *id.* at Summary of the Dispute to Date.

<sup>58</sup> World Trade Organization, *Slovak Republic – Measures Concerning the Importation of Dairy Products and the Transit of Cattle*, Request for Consultations by Switzerland & Summary of the Dispute to Date, WT/DS133/1, G/L/243, G/LIC/D/22 (May 18,

dispute was apparently settled, as no further information appears to be available.

In DS144 *United States – Cattle, Swine and Grain from Canada*, Canada on 25 September 1998 requested consultations with the United States concerning US measures affecting Canadian exports import of cattle, swine and grain.<sup>59</sup> The measures were imposed by the state of South Dakota and other states and prohibited entry to Canadian lorries carrying these products. Canada considered the measures to be contrary to the Agreement on Agriculture, the GATT, the SPS Agreement and the TBT Agreement.<sup>60</sup> The case remains in consultation.

The requirement of specific import documents can also constitute a ban on imports. For example, in DS237 *Turkey - Fresh Fruit*, Ecuador on 31 August 2001 requested consultations with Turkey regarding Turkey's import procedures for fresh fruit, in particular bananas. For fresh fruit imports, Turkey required a specific import document, called "Kontrol Belgesi" (control certificate), which was to be issued by the Turkish Ministry of Agriculture, pursuant to a governmental Communiqué for Standardization in Foreign Trade. Ecuador claimed that the requirement was a trade barrier inconsistent with Articles II, III, X and XI GATT, several articles of the SPS Agreement, and provisions of other WTO Agreements.<sup>61</sup> On the failure of consultations, a panel was established in late July 2002 but was immediately suspended since the parties were seeking to find a negotiated solution. The parties reached a mutually satisfactory solution in November 2002.<sup>62</sup> Turkey changed its control certificate system to provide for automatic issue of import licenses once the required documents had been produced. It also undertook not to revert to

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1998), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds133\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds133_e.htm) (last visited Sept. 12, 2012).

<sup>59</sup> As to factors possibly explaining why Canada had recourse to the WTO rather than to NAFTA, see Marc L. Busch, *Overlapping Institutions, Forum Shopping, and Dispute Settlement in International Trade*, 61 INT'L ORG. 735 (2007) (Busch argues that a complainant chooses among different possible dispute-settlement institutions according to whether it wants to set a regional or multilateral precedent, or not file a case at all).

<sup>60</sup> World Trade Organization, *United States – Certain Measures Affecting the Import of Cattle, Swine and Grain from Canada*, Request for Consultations from Canada & Summary of the Dispute to Date, WT/DS144/1, G/L/260/G/SPS/W/90, G/TBT/D/18, G/AG/GEN/27 (Sept. 29, 1998), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds144\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds144_e.htm) (last visited Sept. 12, 2012).

<sup>61</sup> World Trade Organization, *Turkey – Certain Import Procedures for Fresh Fruit*, Request for Consultations by Ecuador, DS237/1, G/L/472, G/SPS/GEN/275, G/LIC/D/323, G/AG/GEN/48, S/L/101 (Sept. 10, 2010), [http://www.wto.org/english/tratop\\_e?dispu\\_e/cases\\_e/ds237\\_e.htm](http://www.wto.org/english/tratop_e?dispu_e/cases_e/ds237_e.htm) (last visited Sept. 12, 2012).

<sup>62</sup> *Id.* at Summary of the Dispute to Date.

its previous practices. However both parties stated that the mutually satisfactory solution was without prejudice to their WTO rights and obligations, thus making it clear that they might invoke WTO law in the event of problems in the future.<sup>63</sup>

Often an import ban may reflect deep-seated political and economic conflicts. Such tensions are rarely evident in case reports, though clearly the poultry disputes between the EU and the US were based on competition and structural conflicts between the two parties' poultry industries as well as differences in domestic regulatory arrangements. An exception is *DS 270 Australia – Fresh Fruit and Vegetables*.<sup>64</sup> On 18 October 2002 the Philippines requested consultations with Australia. The case concerned an Australian import ban on fresh fruits and vegetables, in particular bananas, papayas and plantain.<sup>65</sup> Section 64 of the Australian 1998 Quarantine Proclamation provided that “the importation into Australia of a fresh fruit or vegetable is prohibited unless the Director of Quarantine has granted the person a permit to import it into Australia”.<sup>66</sup> The Philippines claimed that Section 64, implementing regulations and amendments of the Section and the application of these measures was inconsistent with the GATT, the Import Licensing Agreement and numerous provisions of the SPS Agreement. There were powerful political and economic interests on both sides. The Philippine Banana Growers and Exporters Association (PBGEA) consisted mainly of larger companies affiliated with multinational companies such as Dole, Del Monte and Chiquita Brands, while the then Secretary of the Philippine Department of Agriculture was the “former chair of the PBGEA, the family-controlled Lapanday Foods Corporation,<sup>67</sup> and Del Monte Philippines, Inc.”<sup>68</sup> On the other side, the Australia Banana Growers' Council (ABGC), established in 1961, represented 1,900 banana growers.<sup>69</sup> The EC and Thailand joined the consultations. On 7 July 2003 the Philippines requested

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<sup>63</sup> *Id.* at Notification of Mutually Agreed Solution.

<sup>64</sup> World Trade Organization, *Australia – Certain Measures Affecting the Importation of Fresh Fruit and Vegetables*, Summary of the Dispute to Date, WT/DS270 (Feb. 24, 2010), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds270\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds270_e.htm) (last visited Sept. 11, 2012).

<sup>65</sup> For an analysis of the case up to 2005, see Josyline Javelos & Andrew Schmitz, *Costs and Benefits of a WTO Dispute: Philippine Bananas and the Australian Market*, 7(1) THE ESTEY CENTRE J. INT'L L. & TRADE POL'Y 58 (2006).

<sup>66</sup> *Id.* at 59.

<sup>67</sup> For more information, see LAPANDAY FOOD CORPORATION, <http://www.lapanday.com> (last visited Oct. 30, 2012).

<sup>68</sup> Josyline Javelos & Andrew Schmitz, *supra* note 67, at 66; FAO COMMODITY STUDIES, THE WORLD BANANA ECONOMY, 1985–2002, ch. 2, <http://www.fao.org/docrep/007/y5102e/y5102e00.htm> (last visited Jan. 21, 2013).

<sup>69</sup> Josyline Javelos & Andrew Schmitz, *supra* note 67, at 67.

the establishment of a panel, which however was deferred. A panel was established on 29 August 2003. China, the EC, Ecuador, India, Thailand and the US all reserved their third party rights.<sup>70</sup> So far it does not seem as if a panel has been constituted. The long delay and lack of progress in dispute settlement indicate the political and economic sensitivity of the case.

Lack of transparency can also be equivalent to a ban on imports. An extreme example is the case in which an importing country simply fails to provide information on its domestic requirements. In DS284 *Mexico – Black Beans*, Nicaragua on 17 March 2003 requested consultations with Mexico. It complained that Mexico refused, contrary to Mexico's own standards, to provide importers with documents containing phytosanitary requirements for importation of black beans from Nicaragua, gave more favorable treatment to like products from other countries and failed to publish phytosanitary requirements for imports of Nicaraguan black beans. It considered the Mexican measures to be violation of the GATT, the Licensing Agreement and the SPS Agreement.<sup>71</sup> Following negotiations, Nicaragua formally withdrew its complaint.<sup>72</sup> It is likely that the outcome took account of the transparency requirements in the WTO agreements. For example, Article X GATT requires WTO Members to publish their trade regulations,<sup>73</sup> while the SPS requires them to publish and provide information about their sanitary and phytosanitary regulations.<sup>74</sup>

These cases reveal that often countries do not really try to justify total bans on imports. Such bans are very difficult to justify under WTO law. In such instances, WTO Members often delay in providing any reasonable rationale or legal justification, perhaps seeking to gain time by delaying imports or to limit the quantity of imports to what policy-makers or specific interest groups consider to be the absorptive capacity of the domestic market. The main objective, which is more or less apparent in virtually all cases, is to avoid or restrict competition.

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<sup>70</sup> World Trade Organization, *supra* note 66.

<sup>71</sup> World Trade Organization, *Mexico – Certain Measures Preventing the Importation of Black Beans from Nicaragua*, Request for Consultations by Nicaragua, WT/DS284/1, G/L/614, G/LIC/D/37, G/SPS/GEN/375 (Mar. 20, 2003), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds284\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds284_e.htm) (last visited Sept. 12, 2012).

<sup>72</sup> *Id.* at Summary of the Dispute to Date.

<sup>73</sup> General Agreement on Tariffs and Trade art. X:1, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT].

<sup>74</sup> The WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) art. 7 & Annex B(1), 1867 U.N.T.S. 493, [http://www.wto.org/english/docs\\_e/legal\\_e/15-sps.pdf](http://www.wto.org/english/docs_e/legal_e/15-sps.pdf).



### *C Group 3: Import Bans – Health and Quality Standards*

In addition to the use of procedural devices to prohibit imports, countries frequently use health and quality standards as de facto import bans (see Table 3).

Table 3. Cases on Import Bans based on Health and Quality Standards

<i>Case No., Filing Date</i>	<i>Case Name</i>	<i>Complainant</i>	<i>Product</i>	<i>Procedural Status</i>
DS240, 18.10.2001	<i>Romania – Wheat and Wheat Flour</i>	Hungary	Wheat, wheat flour	Measures abrogated, complaint with- drawn
DS256, 3.5.2002	<i>Turkey – Pet Food</i>	Hungary	Pet food	In consultation
DS297, 9.7.2003	<i>Croatia – Live Animals and Meat Products</i>	Hungary	Live ani- mals, meat products	Mutually agreed solution
DS391, 9.4.2009	<i>Korea – Bovine Meat</i>	Canada	Beef	Mutually agreed solution
DS430, 6.3.2012	<i>India – Agricultural Products</i>	USA	Agricultural products	Panel established, not yet constituted
DS447, 30.8.2012	<i>USA – Animals and Meat</i>	Argentina	Beef	Panel established 28 January 2013
DS448, 3.9.2012	<i>USA – Fresh Lemons</i>	Argentina	Lemons	In consultation

This category is the most highly populated among the categories of cases distinguished for analysis here, with a total of seven cases.

Hungary joined the WTO in 1995. Subsequently it became a Member State of the European Union in 2004. On the eve of its accession to the EU, Hungary brought three complaints to the WTO dispute settlement system in rapid succession. The first case was DS240 *Romania – Wheat and Wheat Flour*. On 18 October 2001, Hungary requested consultations with Romania, which joined the EU only in 2007. It complained that a Romanian joint decree of the Ministry of Agriculture, Food Industry and Forestry, the Ministry of Family and Health and the National Consumer Protection Authority was contrary to Articles III and XI GATT. The joint decree prohibited the importation of wheat and wheat flour that did not meet certain quality standards; domestic products were

not subject to the same requirements.<sup>75</sup> Subsequently Hungary requested the DSU urgency procedure, because Romania proposed consultations only a month after the request and the decree totally blocked all Hungarian wheat exports.<sup>76</sup> The Romanian measures clearly were incompatible with Romania's WTO obligations, in particular the Article III GATT principle of national treatment. During the consultations, Romania abrogated the measures and on 20 December Hungary withdrew its complaint.<sup>77</sup>

In a second case, DS256, Hungary on 3 May 2002 requested consultations with Turkey concerning Turkey's import ban on pet food from Hungary.<sup>78</sup> The ban had been applied since early 2001 to pet food imports from any European countries to protect against bovine spongiform encephalopathy (BSE, "mad cow disease"). However, Hungary was a BSE-free country, the products in question were used only for feeding cats and dogs, and Hungary claimed that the ban had been neither officially published nor notified to the relevant WTO committee.<sup>79</sup> It argued that the ban was contrary to Article XI GATT, the Agreement on Agriculture, and Articles 2, 5, 6 and 7 and Annex B of the SPS Agreement. According to the WTO website the case is still in consultation.<sup>80</sup> However, a Turkish Government website lists the case as having been resolved during consultations.<sup>81</sup> The latter is the most likely result. Given Hungary's accession to the EU and taking account of the strength of its legal arguments, it was to be expected that the case would be settled by mutual agreement, even though no mutually agreed solution seems to have been notified to the WTO.

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<sup>75</sup> World Trade Organization, *Romania – Import Prohibition on Wheat and Wheat Flour*, Request for Consultations by Hungary, WT/DS240/1 (Nov. 7, 2001), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds240\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds240_e.htm) (last visited Sept. 12, 2012).

<sup>76</sup> *Id.* at Addendum.

<sup>77</sup> *Id.* at Summary of the Dispute to Date.

<sup>78</sup> The case is included here because it concerns public health and the SPS Agreement. Note that pet food is not considered to be "food" under EU food law. See Regulation (EC) No. 178/2002 of the European Parliament and of the Council of 28 January 2002, art. 2, 2002 O.J. (L31/1) 1, 2 (laying down the general principles and requirements of food law, establishing the European Food Safety Authority and laying down procedures in matters of food safety).

<sup>79</sup> World Trade Organization, *Turkey – Import Ban on Pet Food from Hungary*, Request for Consultations by Hungary, WT/DS256/1, G/L/538, G/SPS/GEN/316, G/AG/GEN/51 (May 7, 2002), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds256\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds256_e.htm) (last visited Jan. 22, 2013).

<sup>80</sup> *Id.* at Summary of the Dispute to Date.

<sup>81</sup> *Turkey and the WTO Dispute Settlement Mechanism* (Nov. 19 2012), [http://www.economy.gov.tr/upload/6B6ABC30-F711-49A7-ABB99AB74DB973DF/Turkey and the Dispute Settlement Mechanism 19.11.2012.doc](http://www.economy.gov.tr/upload/6B6ABC30-F711-49A7-ABB99AB74DB973DF/Turkey%20and%20the%20Dispute%20Settlement%20Mechanism%2019.11.2012.doc) (last visited Jan. 22, 2013).

Hungary and an alleged threat of BSE were also concerned in a third case, DS 297, *Croatia – Live Animals and Meat Products*. In 2003 Hungary challenged measures introduced by Croatia allegedly to prevent the spread of BSE. Referring to Articles XI and XX GATT and to the SPS Agreement, it argued that the measure had not been notified to the SPS Committee, was overly broad, was not based on any scientific principle or international standard relating to BSE and did not appear to be based on a risk assessment. The parties reached a mutually satisfactory solution later in 2003; this was notified to the WTO DSB about six years later, on 30 January 2009.<sup>82</sup>

Another import ban case, DS391 *Korea – Bovine Meat and Meat Products*, also involved BSE. Canada complained regarding Korean measures on importation of bovine meat and meat products from Canada. It requested consultations on 9 April 2009. It challenged a Korean administrative order prohibiting the importation of beef and other meat products from Canada and provisions of the Korean Livestock Epidemic Prevention Act, which subjected such meat imports to the approval of the Korean National Assembly. Korea purportedly maintained a ban on such products to protect against alleged risks from BSE. Canada argued that the measures contravened Articles 2.2, 2.3, 3.1, 3.3, 5.1, 5.5, 5.6 and 8, together with Annex C(1)(a) SPS; that the Korean measures did not meet the requirements of Article 5.7 SPS; and that the measures were inconsistent with Articles I:1, III:4 and XI:1 GATT. On 9 July 2009 Canada requested that a panel be established, but establishment was deferred until the DSB meeting on 11 August 2009. China reserved its third-party rights. However, on 19 June 2012 the parties notified the WTO that they had reached a mutually satisfactory solution; Korea confirmed that it would apply newly enacted import health requirements to Canadian beef.<sup>83</sup>

In DS430 *India – Agricultural Products* the United States in March 2012 requested consultations with India about the India Livestock Importation Act 1898, related orders and amendments and implementing measures. The measures prohibited various agricultural imports from the United States, purportedly because of the danger of Avian influenza. The

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<sup>82</sup> World Trade Organization, *Croatia – Measures Affecting Imports of Live Animals and Meat Products*, WT/DS297, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds297\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds297_e.htm) (last visited Sept. 12, 2012).

<sup>83</sup> World Trade Organization, *Korea – Measures Affecting the Importation of Bovine Meat and Meat Products from Canada*, Request for the Establishment of a Panel by Canada, WT/DS391/3 (July 10, 2009), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds391\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds391_e.htm) (last visited Sept. 12, 2012) (suspended under DSU art. 12.12 on July 4, 2011; mutually agreed solution reached by the parties, according to press reports from [www.worldtradelaw.net](http://www.worldtradelaw.net)).

United States argued that the measures contravened Articles I and XI GATT as well as numerous provisions of the SPS Agreement. A panel was established on 23 June 2012. China, Colombia, Ecuador, the EU, Guatemala, Japan, Viet Nam and subsequently Argentina, Australia and Brazil reserved their third party rights, demonstrating the widespread concern and interest in the Indian measures.<sup>84</sup> As of the date of writing (23 January 2013), the case is still in progress.

Two recent cases formed part of continuing trade conflicts between the US and Argentina.<sup>85</sup> They reflect not only the significance of trading relationship between these countries but also other tensions between them, such as outstanding Argentinian payments of International Center for Settlement of Investment Disputes (ICSID) awards in investment disputes and the consequent US suspension of Argentina's access to the US Generalized Scheme of Preferences (GSP) programme, which directly influences trade.<sup>86</sup> In DS447 *United States – Animals and Meat*, Argentina on 30 August 2012 requested consultations with the United States concerning the US prohibition on imports of fresh (chilled or frozen) bovine meat and its failure to recognize Argentina as being free of foot-and-mouth disease (FMD). Argentina considered the US measures to be contrary to numerous provisions of GATT, the SPS Agreement and the WTO Agreement. It complained that there was no scientific or legal basis for the ban or for non-recognition, because the World Organization for Animal Health (OIE) had already recognized Argentina as FMD-free with vaccination and had recognized part of the country as FMD-free without vaccination. Argentina also complained about undue delays in the US approval procedure, even though the US recognized that a risk

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<sup>84</sup> World Trade Organization, *India – Measures Concerning the Importation of Certain Agricultural Products from the United States*, Summary of the Dispute to Date, WT/DS430, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds430\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds430_e.htm) (last visited Apr. 9, 2013).

<sup>85</sup> World Trade Organization, *Argentina and the WTO*, [http://www.wto.org/english/thewto\\_e/countries\\_e/argentina\\_e.htm](http://www.wto.org/english/thewto_e/countries_e/argentina_e.htm) (as of Jan. 23, 2013, 5 of the 18 cases in which Argentina was a complainant were against the US, and 5 of the 22 cases in which Argentina was a respondent were brought by the US. Argentina also complained 5 times against Chilean measures and was a respondent in 8 cases brought by the EU, but none of these cases concerned food safety). For examples of the different perspectives, see *Argentina Hits Back at the US and will Complain to the WTO Trade Barriers on Meats and Lemons*, MERCOPRESS (Aug. 21, 2012), <http://en.mercopress.com/2012/08/21/argentina-hits-back-at-us-and-will-complain-in-wto-trade-barriers-on-meats-and-lemons> (last visited Jan. 23, 2013); Tom Miles, *US, EU Blast Argentina's Trade Restrictions at WTO*, REUTERS (Mar. 30, 2012), <http://www.reuters.com/article/2012/03/30/us-argentina-wt-o-idUSBRE82T1H520120330> (last visited Jan. 23, 2013).

<sup>86</sup> E.g., Tom Barkley & Ken Parks, *U.S. Cuts Trade Preferences to Argentina*, THE WALL STREET JOURNAL (Mar. 26, 2012), <http://online.wsj.com/article/SB10001424052702304177104577305652479085184.html> (last visited Jan. 23 2013).

analysis had been completed and that the imports posed “a negligible risk.”<sup>87</sup> Its first request for the establishment of a panel was blocked by the US,<sup>88</sup> but following Argentina’s second request a panel was established on 28 January 2013.<sup>89</sup> At this stage China reserved its third-party rights.<sup>90</sup>

In a second case, DS448, *United States – Fresh Lemons*, Argentina on 3 September 2012 requested consultations with the United States about US measures affecting, and in effect banning, for almost the previous eleven years imports of citrus fruits, including fresh lemons from the North-West region of Argentina, failure to grant approval for such imports and alleged delays in approval procedures. Argentina based its challenge of the ban on several US measures, including federal legislation, an administrative rule of the US Animal and Plant Inspection Service (APHIS) and a case brought successfully by 5000 Arizona and California citrus growers to challenge the US Department of Agriculture’s decision to allow citrus imports from Argentina.<sup>91</sup> Argentina considered the US measures to be lacking in scientific justification and to be contrary to numerous articles of GATT, the SPS Agreement and the WTO Agreement.<sup>92</sup> The case is currently underway.

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<sup>87</sup> World Trade Organization, *United States – Measures Affecting the Importation of Animals, Meat and Other Animal Products from Argentina*, Request for Consultations by Argentina, WT/DS447/1, G/L/998, G/SPS/GEN/1186 (Sept. 4, 2012), [http://www.worldtradelaw.net/cr/ds447-1\(cr\).pdf](http://www.worldtradelaw.net/cr/ds447-1(cr).pdf); *id.* at Corrigendum.

<sup>88</sup> DSU art. 6.1 (provides that “If the complaining party so requests, a panel shall be established at the DSB meeting following that at which the request first appears as an item on the DSB’s agenda, unless at that meeting the DSB decides by consensus not to establish a panel”). Hence the respondent is able to block establishment of a panel on the first request only.

<sup>89</sup> World Trade Organization, *Panel established on Argentina’s disputes with EU, US and Japan* (Jan. 28, 2013), [http://www.wto.org/english/news\\_e/news13\\_e/dsb\\_28jan13\\_e.htm](http://www.wto.org/english/news_e/news13_e/dsb_28jan13_e.htm) (last visited Feb. 3, 2013).

<sup>90</sup> World Trade Organization, *United States – Measures Affecting the Importation of Animals, Meat and Other Animal Products from Argentina*, Current status & Summary of the Dispute to Date, WT/DS447, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds447\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds447_e.htm) (last visited Apr. 9, 2013).

<sup>91</sup> *Harlan Land Co. v. United States Deptment of Agriculture*, 186 F. Supp.2d 1076 (2001). For comment on the legal and political context by the U.S. Citrus Science Council, see *California Citrus Growers Sue USDA Over Argentina Citrus Imports*, RISKWORLD PR NEWSWIRE (July 27, 2000), <http://www.riskworld.com/pressrel/2000/00q3/PR00a029.htm> (last visited Sept. 23, 2012).

<sup>92</sup> World Trade Organization, *United States – Measures Affecting the Importation of Fresh Lemons*, Request for Consultations by Argentina, WT/DS448/1, G/L/1000, G/SPS/GEN/1187 (Sept. 5, 2012), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds448\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds448_e.htm) (last visited Sept. 12, 2012); *id.* at Corrigendum; *id.* at Summary of the Dispute to Date.

#### D Group 4: Post-Importation Testing and Inspection

Challenges in the WTO system may also concern measures that require testing and inspection of products once imported (see Table 4).

Table 4. Cases on Post-Importation Testing and Inspection Measures

<i>Case No., Filing Date</i>	<i>Case Name</i>	<i>Complainant</i>	<i>Product</i>	<i>Procedural Status</i>
DS3, 4.4.1996	<i>Korea – Testing and Inspection of Agricultural Products</i>	US	Agricultural Products	In consultation
DS41, 24.5.1996	<i>Korea – Inspection of Agricultural Products</i>	US	Agricultural products	In consultation

The United States and Korea were both founding Members of the WTO. In April 1995, soon after the WTO was established, the United States in DS3 *Korea – Testing and Inspection of Agricultural Products* requested consultations with Korea about measures for testing and inspection of imported agricultural products.<sup>93</sup> For most of the preceding years (and afterwards except for 1996), the United States had a negative trade balance with Korea.<sup>94</sup> It may have seen recourse to the WTO as an important means of improving its export trade. Korea, in contrast, was a reluctant litigant, then characterized by an “dispute aversion attitude,” lacking sufficient expertise in WTO law and also benefitting from a trade surplus with countries, such as the US, which adopted protectionist measures, and therefore reluctant to litigate.<sup>95</sup>

In June 1996, in DS41 *Korea – Inspection of Agricultural Products*, the United States again requested consultations with Korea about similar measures.<sup>96</sup> The US request included “all amendments, revisions, and

<sup>93</sup> World Trade Organization, *Korea – Measures Concerning Inspection of Agricultural Products*, Summary of the Dispute to Date, WT/DS3, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds3\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds3_e.htm) (last visited Sept. 12, 2012).

<sup>94</sup> United States Department of Commerce, United States Census Bureau, *Trade in Goods with Korea, South, 1990 – 96*, <http://www.census.gov/foreign-trade/balance/c5800.html> (last visited Jan. 23, 2013).

<sup>95</sup> Dukgeun Ahn, *Korea in the GATT/WTO Dispute Settlement System: Legal Battle for Economic Development*, 6(3) J. INT’L ECON. L. 597, 610 (2003); Henry Gao, *Aggressive Legalism: The East Asian Experience and Lessons for China*, in CHINA’S PARTICIPATION IN THE WTO 320 (Henry Gao & Donald Lewis eds., 2005) (relying mainly on Ahn but extending his insights).

<sup>96</sup> World Trade Organization, *Korea – Measures Concerning Inspection of Agricultural Products*, Summary of the Dispute to Date, WT/DS41, [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds41\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds41_e.htm) (last visited Sept. 12, 2012).

new measures” adopted by Korea after the first US request for consultations.<sup>97</sup> In both cases, the US argued that the measures were contrary to several WTO agreements, including GATT, the Agreement on Agriculture, the SPS Agreement and the TBT Agreement.<sup>98</sup> According to the WTO website, both DS3 and DS41 are still in consultation. In fact they were both suspended, because after the request for consultations “the United States did not take additional steps.”<sup>99</sup> However, there seems to have been no formal indication of a mutually agreed solution.

### *E Group 5: Shelf-Life*

The final category of cases examined here concerns the shelf-life of product (see Table 5). Shelf-life refers to “the period of time under defined conditions of storage, after manufacture or packing, for which a food product will remain safe and fit for use.”<sup>100</sup>

Table 5. Cases on the Shelf-Life of Products

<i>Case No., Filing Date</i>	<i>Case Name</i>	<i>Com- plainant</i>	<i>Product</i>	<i>Procedural Status</i>
DS5, 20.7.1995	<i>Korea – Shelf Life</i>	US	Sausages, canned meat, etc.	Mutually agreed solution
DS20, 8.11.1995	<i>Korea – Bottled Water</i>	Canada	Bottled water	Mutually agreed solution

The shelf-life of food products is increasingly considered to be a crucial element in informing consumers about and seeking to ensure food safety. Rules about shelf-life affect when, and possibly whether a product can actually be marketed. Such rules may especially affect imports. They may thus in practice may have different effects on domestic and imported products.

Most countries use shelf-lives or “use-by” dates which are determined, usually but not always, by the manufacturer.<sup>101</sup> DS5 *Korea –*

<sup>97</sup> World Trade Organization, *Korea – Measures Concerning Inspection of Agricultural Products*, Request for Consultation by the United States, WT/DS41/1, G/L/76, G/SPS/W/64, G/TBT/D/6, G/AG/W/25 (May 31, 1996), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds41\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds41_e.htm) (last visited Jan. 23, 2013).

<sup>98</sup> World Trade Organization, *supra* note 98.

<sup>99</sup> Dukgeun Ahn, *supra* note 97.

<sup>100</sup> DOMINIC MAN, *SHELF LIFE: FOOD INDUSTRY BRIEFING SERIES 3* (2002).

<sup>101</sup> *Id.*; New Zealand Food Safety Authority, *A Guide to Calculating the Shelf-Life of Food: Information Booklet for the Food Industry* (2005), [http://www.foodsafety.govt.nz/e/library/industry/guide\\_calculating-contains\\_background.pdf](http://www.foodsafety.govt.nz/e/library/industry/guide_calculating-contains_background.pdf) (last visited Jan. 24, 2013); Food Science Australia, *Shelf-Life Testing: Methods for Determining the Claim-*

*Measures Concerning the Shelf-Life of Products* exemplifies the conflict over who should determine shelf-life. Brought soon after the WTO was established, it was another case in which the US sought to use the WTO to open Korean markets and improve its trade balance. The shelf-life of many food products sold in Korea was determined by national legislation, the Korean Food Code. In contrast, the US does not have any uniform national system, an open-dating system addressed principally to retailers rather than a sell-by or use-by system is frequently used, dates are usually determined by manufacturers, and some food products are undated.<sup>102</sup> The Republic of Korea in February 1994 applied its Food Code in enforcing a 30-day shelf life against United States sausages. According to the US, the period was so short that “by the time a product cleared ... customs and reached the shops, the dates were close to expiration or had already expired.”<sup>103</sup> The dispute expanded to other products. Subsequently the main trade organizations of the United States meat industry, the National Cattlemen’s Association, the National Pork Producers’ Council and the American Meat Institute, filed a Section 301 petition against Korea. The USTR accepted the Section 301 petition in November 1994. Its investigation reportedly showed that “South Korean shelf-life standards were not supported by scientific studies and were applied in an arbitrary and discriminatory manner.”<sup>104</sup> The US and Korea began bilateral consultations but could not resolve the dispute, so the US requested consultations through the WTO. The US complained that the Korean Food Code requirements regarding the shelf-life of numerous products were contrary to Article III (national treatment) and Article XI (general elimination of quantitative restrictions) GATT, Article 2 (basic rights and obligations) and Article 5 (risk assessment and determination of the appropriate level of sanitary protection) of the SPS Agreement, Article 2 of the TBT Agreement (preparation, adoption and application of technical

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*able Life of Meat Products*, MEAT TECHNOLOGY UPDATE (Apr. 2006), [http://www.mulwarra.com.au/resources/site1/general/MEAT\\_TECHNOLOGY\\_UPDATE\\_06-2.pdf](http://www.mulwarra.com.au/resources/site1/general/MEAT_TECHNOLOGY_UPDATE_06-2.pdf) (last visited Jan. 24, 2013).

<sup>102</sup> United States Department of Agriculture Food Safety and Inspection Service, *Food Product Dating*, [http://www.fsis.usda.gov/wps/wcm/connect/19013cb7-8a4d-474c-8bd7-bda76b9defb3/Food\\_Product\\_Dating.pdf?MOD=AJPERES](http://www.fsis.usda.gov/wps/wcm/connect/19013cb7-8a4d-474c-8bd7-bda76b9defb3/Food_Product_Dating.pdf?MOD=AJPERES). Twenty states require dating of some foods, but many do not require dating at all, see Ralph Meer & Scottie Misner, *Food Product Dating and Storage Times*, <http://cals.arizona.edu/pubs/hearth/az1068.html> (last visited Jan. 24, 2013).

<sup>103</sup> United States Department of Agriculture, *South Korea’s World Trade Organization Cases*, <http://www.ers.usda.gov/topics/international-markets-trade/countries-region/s/south-korea/issues-analysis.aspx#shelf> (last visited Oct. 28, 2012). This article is the source of the information about the background to the WTO case.

<sup>104</sup> *Id.*



regulations by central government bodies), and Article 4 (market access) of the Agreement on Agriculture.<sup>105</sup>

Within a month the parties reached a mutually satisfactory solution. The discussions were not public, and available documents do not indicate what role specific WTO agreements played in the discussions, though it is likely that the parties invoked all three WTO agreements that formed the basis of the US complaint. The US and Korea agreed that, on the basis of the WTO principles of most-favored-nation and national treatment, shelf-life requirements for vacuum-packed chilled beef and pork, frozen meat, certain other frozen foods and numerous dried, packaged, canned or bottled products would be determined by the manufacturer of the product. The storage temperature of the products for which shelf-life requirements were removed from the Korean Food Code was also to be determined by the manufacturer. Korea also agreed to ensure that maximum residue levels for “imported excretory organ meats” (such as kidney) were consistent with Codex Alimentarius international standards.<sup>106</sup> Korea subsequently notified the WTO Secretariat of the Harmonized System (HS) headings for the products for which self-life requirements had been removed from the Korean Food Code; it noted however that the classification method used in the Food Code differed from the HS system “in its basic purpose, nature, scope and coverage” so the fit between the two classification systems was not exact.<sup>107</sup> Korean Food Code shelf-life requirements for other products were also eliminated.<sup>108</sup> This mutually agreed solution set aside numerous provisions of the Korean Food Code.<sup>109</sup> The mutually agreed solution was without prejudice to the rights or obligations of the parties under the WTO agreements.<sup>110</sup>

The USDA considered the case to be “a precedent-setting case for settling disputes on trade barriers couched as food safety requirements

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<sup>105</sup> World Trade Organization, *Korea – Measures Concerning the Shelf-Life of Products*, Request for Consultations by the United States, WT/DS5/1 (May 5, 1995), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds5\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds5_e.htm).

<sup>106</sup> World Trade Organization, *Korea – Measures Concerning the Shelf-Life of Products*, Notification of Mutually Agreed Solution, WT/DS5/5, G/SPS/W/27, G/TBT/D/3, G/AG/W/8 (July 31, 1995); *id.* at Corrigendum.

<sup>107</sup> *Id.* at Revision, Communication from the Republic of Korea, WT/DS5/5/Add.1/Rev.1; *id.* at Communication from the Republic of Korea, Addendum, WT/DS5/5/Add.4.

<sup>108</sup> *Id.* at WT/DS5/5/Add.2.

<sup>109</sup> *Id.* at WT/DS5/5/Add.3; *id.* at WT/DS5/5/Add.5, G/SPS/W/27/Add.5 (a number of products remained subject to the shelf-life requirements in the Korean Food Code).

<sup>110</sup> World Trade Organization, *supra* note 108.

under WTO Article XX".<sup>111</sup> For the US, it was also a victory for the interests of the American meat industry and for the ideology of open markets. From the Korean standpoint, however, the WTO dispute settlement procedure provided an institutional mechanism for exporting and imposing the United States' decentralized, market-based shelf-life system. In other words, it exported US shelf-life practices. Date-marking of foods, including shelf-life, has been a controversial issue in international discussions about food safety. It does not appear that international standards as such require shelf-life to be set by the manufacturer.<sup>112</sup> For example, in September 2012, the Twelfth Session of the FAO/WTO Coordinating Committee for North America and the South West Pacific agreed to discontinue consideration of a discussion paper introduced by New Zealand on a harmonized approach to date marking.<sup>113</sup> In this light, we may also recognize the case as constituting a victory, not only for the US shelf-life marking system, but also for a vision of the food economy as a global rather than a local activity. The case exported a view of food production, supply and consumption based on industrialized agriculture, global supply chains and international trade in food products, with market regulation determined by bilateral agreement, to the disadvantage of local food production, the consumption of local products and local regulation of local markets. From this perspective, it is easier to understand the logic underlying US recourse to WTO law in order to request consultations and thus begin the WTO dispute settlement process. It is less easy to grasp whether basic WTO principles were actually applied, as distinguished from justifying particular positions in the negotiations. Certainly a manufacturer may have the greater knowledge and be most capable of carrying out testing to determine the shelf-life for its products. However, this is not the only means of determining shelf-life, and there is no indication in the available documents of the case that Korean law actually discriminated among trading partners or against foreign products.

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<sup>111</sup> United States Department of Agriculture, *supra* note 105. Article XXII GATT refers to the settlement of disputes by consultation; DSU art. 4.

<sup>112</sup> Codex Alimentarius Standard on Labelling of Prepackaged Foods (CODEX STAN 1-1985) applies to date marking, including date of manufacture, date of packaging, sell-by date, date of minimum durability and use-by date. Sell-by date refers to shelf-life. However, this standard does not give any indication about how the shelf-life or other date marking is to be determined. Nor are further details provided in Article 4.7 of the Standard.

<sup>113</sup> Codex Alimentarius Commission Joint FAO/WHO Food Standards Programme, *Report of the Twelfth Session of the FAO/WHO Coordinating Committee for North America and the South West Pacific* (Sept. 19-22, 2012 REP13/NASWP), [http://www.codexalimentarius.org/input/download/report/782/REP13\\_NAe.pdf](http://www.codexalimentarius.org/input/download/report/782/REP13_NAe.pdf) (last visited Oct. 28, 2012). Korea was not part of this regional grouping.

DS20 *Korea – Bottled Water* also concerned shelf-life. After the US and Korea reached a mutually agreed solution in *Korea – Shelf-Life*, Canada separately complained about Korean measures setting the shelf-life of bottled water at six months from its production date, as well as about the Korea prohibition on certain treatment methods. Canada requested consultations in November 1995.<sup>114</sup> The parties agreed that Korea would make its best efforts to ensure transparency of procedures for extending the shelf-life of bottled water. In addition, by focusing on procedures rather than substance, the parties reached agreement on shelf-life. They agreed that Korea would make its best efforts to ensure transparency of procedures for extending the shelf-life of bottled water. However, Canada recorded its views that it considered the undertaking to be merely a temporary solution and that it intended “to continue to encourage Korea to adopt a manufacturer determined shelf-life system for bottled water.”<sup>115</sup> As with the US in *Korea – Shelf Life*, Canada achieved its aim of gaining ground in the process leading toward a system determining shelf-life which was market-based rather than state-based and which favored the development of a globalized food industry.

### III Discussion

#### A Introduction

Based on the preceding case summaries, this section looks at the number and types of cases and then considers which WTO Members were involved and how, the ways in which their disputes were resolved, who won the cases, and the implications for the globalization of food safety rules and practices. It also notes how dispute settlement in cases involving food safety is related to dispute settlement in WTO cases in general.

#### B Number and Categories of Cases

The paper presented a total of 21 cases.<sup>116</sup> The cases fall into five categories: pre-importation production and treatment measures (4 cases),

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<sup>114</sup> World Trade Organization, *Korea – Measures Concerning Bottled Water*, Request for Consultations by Canada, WT/DS20/1G/L/33, G/SPS/W/35G/TBT/D/4, G/MA/3, G/AG/w/14 (Nov. 22, 1995), [http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds20\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds20_e.htm).

<sup>115</sup> *Id.* at Notification of Mutually Agreed Solution, WT/DS20/6G/L/33, Add.1.

<sup>116</sup> One case (DS20 *Korea – Bottled Water*) is counted more than one because it falls into more than one category (pre-importation production and treatment measures, and shelf-life).

post-importation testing and inspection (6 cases), import procedures (7 cases), import standards (2 cases), and rules about product shelf-life (2 cases).

### C Participants

Leaving aside third party participants, the cases involved a total of 18 WTO Members. The United States was involved in the most cases with a total of 10 cases (5 as complainant and 5 as respondent), followed by Korea (6 as respondent), Canada (4 as complainant), EC (2 as complainant, 2 as respondent), Hungary (3 as complainant), Argentina (2 as complainant), Australia (2 as respondent), Turkey (2 as respondent). All other Members were involved in only one case each. These statistics reflect, in particular, the very active role of the US in the WTO dispute settlement system generally, the US government policy of supporting its exporters, and the desire of other WTO Members to have access to the large US market. They also reflect the attraction for food exporting countries of rapidly developing markets, in particular Korea. Overall, the statistics appear to be generally consistent with the pattern of WTO cases since 1995, with the notable exception that India has been much more active in WTO litigation overall than the food safety case law statistics might suggest.<sup>117</sup>

We can also analyze participation in these food safety cases according to the per capita income classification of the parties at the time the case was brought. Based on World Bank income classification of countries,<sup>118</sup> the parties in these cases included 7 high-income countries (Australia, Canada, European Community, Korea, New Zealand, Switzerland and US), 5 upper-middle income countries (Argentina, Croatia,

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<sup>117</sup> *WTO Complaints Filed by Selected WTO Members*, WORLDTRADELAW, <http://www.worldtradelaw.net/dsc/database/complaintscomplainant.asp> (last visited Jan. 30, 2013); *WTO Complaints Filed against Specific WTO Members as Respondents*, WORLDTRADELAW, <http://www.worldtradelaw.net/dsc/database/complaintsrespondent.asp> (last visited Jan. 30, 2013).

<sup>118</sup> This income classification of countries according to per capita income is based on the World Bank classification for the year in which the case was brought, see *WTO Complaints Sorted by Type of Economy*, WORLDTRADELAW, <http://www.worldtradelaw.net/dsc/database/complaintsclassification.asp> (last visited Jan. 24, 2013). The World Bank fixes income classification of countries on July 1 each year. The most recent criteria are High Income \$12,476 or more, Upper Middle Income \$4,036-\$12,475, Lower Middle Income \$1026-\$4,035 and Low Income \$1,025 or less. See *How we Classify Countries*, THE WORLD BANK, <http://data.worldbank.org/about/country-classifications> (last visited Jan. 24, 2013). This range does not of course apply to all cases considered here, notably the older cases. It is given for general indicative purposes only. The income classification of countries when the case was brought is more important for present purposes.

Hungary, Mexico and Slovakia), 4 lower-middle income countries (Ecuador, Philippines, Romania and Turkey) and 2 low-income countries (Nicaragua and India).<sup>119</sup> The classification according to income category is far from perfect. Nevertheless it is useful in giving a general indication of the per capita income differences between the parties that participate in WTO cases. This breakdown of parties in the food safety cases examined here appears to be generally consistent with the overall pattern of participation in WTO case law since 1995.<sup>120</sup>

If, however, we distinguish between complainants and respondents according to income classification of the parties, a more interesting picture emerges. There are 21 cases with a total of 42 participants. Table 6 shows complainants and respondents in the food safety cases according to their income classification. For each entry, it gives the numbers and percentage [of 42 total participants].

Table 6. Income Classification of Complainants and Respondents in Food Safety Cases Considered Here

<i>Income Classification of Party</i>	<i>Complainant</i>	<i>Respondent</i>	<i>Total</i>
High Income	13 (31%)	14 (33%)	27 (64%)
Upper Middle Income	5 (12%)	3 (7%)	8 (19%)
Lower Middle Income	2 (5%)	3 (7%)	5 (12%)
Low Income	1 (2%)	1 (2%)	2 (4%)
Total	21 (50%)	21 (50%)	42 (100%)

This table shows that high-income countries bring the most cases and also are targeted most often as respondents, reflecting their export capacity and the attraction of their markets. Upper middle income countries participated slightly more often as complainants than as respondents, though their total participation was much lower than that of high income countries. Lower middle income countries and lower income countries participate most frequently as respondents, reflecting their trade balance and weak capacity to participate in the WTO.<sup>121</sup>

<sup>119</sup> *WTO Complaints Sorted by Type of Economy*, supra note 120; *How we Classify Countries*, supra note 120.

<sup>120</sup> *WTO Complaints Sorted by Type of Economy*, supra note 120; *WTO Complaints Grouped by Income Classification*, WORLDTRADELAW, <http://www.worldtradelaw.net/dsc/database/classificationcount.asp> (last visited Jan. 30, 2013).

<sup>121</sup> See generally Marc Busch, Eric Reinhardt & Gregory Shaffer, *Does Legal Capacity Matter: A Survey of WTO Members*, 8 WORLD TRADE REV. 559 (2009).

In this respect, however, food safety cases are not unique. While recognizing the potential shortcomings of statistics based on such a small universe of cases (21 cases in total), we can push the calculations one step further and compare these food safety cases to all WTO cases since 1995. The breakdown of WTO cases to date is shown in Table 7.

Table 7. Income Classification of Complainants and Respondents in All WTO Cases

<i>Income Classification of Party</i>	<i>Complainant</i>	<i>Respondent</i>	<i>Total</i>
High Income	274	263	537
Upper Middle Income	103	92	195
Lower Middle Income	66	76	142
Low Income	28	24	52
Total	471	455	926

Note: This Table is drawn from WorldTradeLaw.Net, *WTO Complaints Grouped by Income Classification*, <http://www.worldtradelaw.net/dsc/database/classificationcount.asp> (last visited 24 January 2013).

This pattern is consistent with the hypothesis of an implicit “institutional bias” in the WTO dispute settlement system,<sup>122</sup> if by this we refer to the way in which the institution reflects an orientation to using or not using the system. At least as illustrated by the cases examined here, however, this bias is against low-income countries rather than against developing countries as a whole. In other words, it refers to the use of the system by specific groups of WTO Members classified according to per capita income.<sup>123</sup> It does not necessarily refer to whether Members in such groups win cases or not, as will be seen below. WTO Members in the low-income category usually, if not always, have a lower trade volume and less legal and institutional capacity than other WTO Members.

Now we can compare the 21 food safety cases with 42 participants to the total of 455 WTO cases with 926 participants according to the in-

<sup>122</sup> Chad P. Bown, *Participation in WTO Dispute Settlement: Complainants, Interested Parties, and Free Riders*, 9 WORLD BANK ECON. REV. 287 (2005); David Evans & Gregory Shaffer, *Introduction: The Developing Country Experience in WTO Dispute Settlement*, in DISPUTE SETTLEMENT AT THE WTO: THE DEVELOPING COUNTRY EXPERIENCE 1–15 (Gregory Shaffer & Ricardo Mendez-Ortiz eds., 2010).

<sup>123</sup> Turk argues that reputation is the main factor influencing recourse to the WTO dispute settlement system by Upper Middle Income and Lower Middle Income countries, as distinguished from Low Income countries for which resources are the main factor: Matthew Turk, *Why Does the Complainant Always Win at the WTO: A Reputation-Based Theory of Litigation at the World Trade Organization*, 31 NW. J. INT’L L. & BUS. 385 (2011).

come classification of complainants and respondents.<sup>124</sup> Table 8 presents a comparison of the food safety cases considered here with the totality of WTO cases to date according to the income classification of complaints and respondents.

Table 8. Comparison of Food Safety Cases Considered Here and Total WTO Cases According to Income Classification of Complainants and Respondents

	<i>High Income</i>	<i>Upper Middle Income</i>	<i>Lower Middle Income</i>	<i>Low Income</i>	<i>Total</i>
Complainant: Food Safety	31%	12%	5%	2%	50%
Complainant: WTO	30%	11%	7%	3%	51%
Respondent: Food Safety	33%	7%	7%	2%	49%
Respondent: WTO	28%	10%	8%	3%	49%
Total: Food Safety	64%	19%	12%	4%	99%
Total: WTO	58%	21%	15%	6%	100%

The two sets of calculations are strikingly similar. From the standpoint of income classification groupings of the complainants and respondents, the food safety cases and WTO cases in general present virtually the same profile. From this standpoint at least, there is nothing special about the food safety cases considered here. The case law is dominated by high income countries, with upper middle income and lower middle income countries playing a much less significant role, and low income countries hardly being visible at all.

#### *D Mode of Settlement*

Next, let us consider how disputes are settled. Table 9 presents the procedural outcomes of the 21 cases on food safety.

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<sup>124</sup> These calculations are my own (FS), based on the statistical information provided by WorldTradeLaw.Net, see *WTO Complaints Grouped by Income Classification*, *supra* note 122.

Table 9. Procedural Outcome of Cases on Food Safety

<i>Case Numbers</i>	<i>Procedural Outcome</i>	<i>Total Cases</i>
DS5, DS20, DS20 <sup>125</sup> , DS72, DS237, DS287, DS297, DS391	Mutually agreed solution	8
DS240, DS284	Complaint withdrawn, measure abro- gated and complaint withdrawn	2
DS3, DS41, DS100, DS133, DS144, DS256	In consultation > 3 years	6
DS270, DS389	Panel established >3 years ago but not composed	2
DS448	In consultation <3 years	1
DS430, DS447	Panel established <3 years ago but not yet composed	2

Eight cases were resolved by a mutually satisfactory agreement. One case was withdrawn. In another case the challenged measure was abrogated and the case was withdrawn. Six cases were at least nominally in consultation even after a period of three years. In two cases a panel was established more than three years ago but had not yet been composed. These cases are sufficiently old that we may consider them to have been settled by stalemate or de facto withdrawal, even though no procedural outcome was notified to the WTO.<sup>126</sup> One recently registered case is still in consultation. In two recent cases a panel has been established but not yet composed. In other words, out of a total of 21 cases, 18 cases have been settled by negotiations, were withdrawn, or otherwise ended in apparent stalemate during the consultation phase of the WTO dispute settlement process. So far, none of these cases have proceeded to a panel, and none have been appealed to the Appellate Body. Since so far only one of these cases has proceeded to a panel, these findings do not lend support Busch and Reinhardt's suggestion suggest that democratic states are most likely to settle their disputes early and cooperatively because their governments are accountable at the ballot box and do not want to risk greater publicity of alleged breaches of WTO law.<sup>127</sup>

<sup>125</sup> DS20 is counted twice because it involves two distinct issues.

<sup>126</sup> Marc Busch & Eric Reinhardt, *Bargaining in the Shadow of the Law: Early Settlement in GATT/WTO Disputes*, 24 *FORDHAM INT'L L.J.* 158, 171 (2001) (Busch and Reinhardt remark that consultations are "sometimes not even reported to the GATT/WTO until after they are concluded").

<sup>127</sup> *Id.* at 167.



From this perspective, the food safety cases examined here might seem to differ significantly, not only from the high-profile SPS and TBT cases which have been heard by a panel or by a panel and the Appellate Body,<sup>128</sup> but also from WTO cases in general. They differ of course from cases which, following consultations, went to a panel and sometimes also to the Appellate Body, because the cases examined here were all settled before the panel stage, except for those few cases (see above) for which a panel has been established but not yet composed. Regarding WTO cases in general, however, the food safety cases considered here are typical of all WTO cases in their mode of settlement. On the basis of a study of 600 GATT/WTO disputes from 1948 through 1999, Busch and Reinhardt report that 60% of all disputes end before a panel ruling, most without even a request for a panel.<sup>129</sup> In about 55% of cases a panel is not established, and another 8% end before issuance of a panel report. According to another study,<sup>130</sup> between 1 January 1995 and mid-December 1999, there were 185 requests for consultations, of which 78 were resolved. Forty-one of the 78 (53%) were resolved without recourse to a panel, “thirty ... by bilateral settlement, three by withdrawal of the contested measure, and seven by withdrawal of the request for establishment of a panel or other provable abandonment.”<sup>131</sup> “Settlement and the withdrawal of cases are thus the norm, not the exception.”<sup>132</sup>

On the whole, the DSU “is crafted to facilitate pre-panel resolutions.”<sup>133</sup> Consultations are confidential, with no published record. Usually consultations focus on factual issues, since governments are often reluctant to discuss legal issues, which could be used in any subsequent panel proceedings.<sup>134</sup> In addition, as Davey and Porges report, “[a] typi-

<sup>128</sup> On these cases, see Snyder, Xiamen Academy, §III Cross-References.

<sup>129</sup> Marc L. Busch & Eric Reinhardt, *supra* note 128, at 158–59. Their empirical study is based on all cases which refer to GATT/WTO law, name defendants, and allege infringement of specific legal rights, most often in the form of a “request for consultations,” see *id.* at 161.

<sup>130</sup> C. Christopher Parlin, *Operation of Consultations, Deterrence, and Mediation*, 31 LAW & POL’Y INT’L BUS. 565, 567–68 (2000).

<sup>131</sup> *Id.*

<sup>132</sup> *Id.* at 161.

<sup>133</sup> Gary N. Horlick & Glenn R. Butterson, *A Problem of Process in WTO Jurisprudence: Identifying Disputed Issues in Panels and Consultations*, 31 LAW & POL’Y INT’L BUS. 573, 580–81 (2000).

<sup>134</sup> On the extent to which information gained during consultations can be used subsequently before a panel, see Christiane Schuchhardt, *Consultations*, in 1 THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS 1197, 1197–1232 (Patrick F.J. Macrory, Arthur E. Appleton & Michael G. Plummer eds., 2005). On relations between consultations and panel proceedings in general, see H  ne Ruiz-Fabri, *The Relationship between Negotiations and Third-Party Dispute Settlement at the WTO, with an Emphasis on the EC-Bananas Dispute*, in DIPLOMATIC AND JUDICIAL MEANS OF DISPUTE SETTLEMENT 86–118 (Laurence Boisson de Chazournes, Marcelo G. Kohen &

cal consultation lasts no longer than two to three hours and takes place in a small WTO meeting room or a Geneva mission. Consultations are generally conducted in English with no interpreters, no transcript, and no taping.<sup>135</sup> Usually only the parties to the dispute are involved, unless a party approves the request of other Members with a substantial trade interest in the dispute to join the consultations.<sup>136</sup> Any mutually accepted solution reached during the consultation phase must be compatible with the WTO agreements.<sup>137</sup> Parties are required to notify mutually agreed solutions to the DSB and relevant Councils and Committees.<sup>138</sup> If a dispute proceeds to litigation, the panel, the Appellate Body and the DSB consider only whether consultations have taken place as required. They do not review the conduct or substance of consultations, so there is no formal WTO supervision over the requirement to consult in good faith or the adequacy of consultation.<sup>139</sup>

Now we can consider the outcomes of these cases in relation to several hypotheses regarding the escalation of WTO disputes, in other words, whether disputes are settled during consultations or whether they continue to the panel/Appellate Body stage.<sup>140</sup> Guzman and Simmons analyze how the nature of the disputed issue affects the mode of dispute

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Jorges E. Viñuales eds., 2013). See also William J. Davey & Amelia Porges, *Performance of the System I: Consultations & Deterrence*, 32(3) INT'L LAW. 695, 705 (1998).

<sup>135</sup> William J. Davey & Amelia Porges, *supra* note 136, at 704. When the article was written, Professor Davey was Director of the Legal Affairs Division of the WTO, and Dr. Porges was Senior Counsel for Dispute Settlement of the United States Trade Representative.

<sup>136</sup> DSU art. 4.11.

<sup>137</sup> DSU art. 3.5. For further discussion, see Héñe Ruiz-Fabri, *supra* note 136.

<sup>138</sup> DSU art. 3.6. However, most mutually agreed solutions are not notified to the WTO, or if at all are notified after full implementation: see Héñe Ruiz-Fabri, *supra* note 139, at 109, 116.

<sup>139</sup> Panel Report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, ¶ 7.17, WT/DS27/R/USA (May 22, 1997). The DSB is not involved; no panel is involved and the consultations are held in the absence of the Secretariat; Panel Report, *Korea – Taxes on Alcoholic Beverages*, ¶ 10.19, WT/DS75/R, WT/DS84R (Sept. 17, 1998) (*adopted* Feb. 17, 1999) (“In our view, the WTO jurisprudence so far has not recognized any concept of ‘adequacy’ of consultations. The only requirement under the DSU is that consultations were in fact held, or were at least requested, and that a period of sixty days has elapsed from the time consultations were requested to the time a request for a panel was made. What takes place in those consultations is not the concern of a panel. ... [C]onsultations are a critical and important part of the DSU. But, we have no mandate to investigate the adequacy of the consultation process that took place between the parties”); for further discussion, see Christiane Schuchhardt, *supra* note 136, at 1222–26.

<sup>140</sup> For a brief summary of such research up to 2012, see Thomas Bernauer, Manfred Elsig & Joost Pauwelyn, *Dispute Settlement Mechanism – Analysis and Problems*, in *THE OXFORD HANDBOOK ON THE WORLD TRADE ORGANIZATION* 494–95 (Amrita Narlikar, Martin Daunton & Robert Stern eds., 2012).

settlement. They argue that “continuous, easily divisible problems would tend to be resolved in the consultation phase, while issues that have an all-or-nothing quality—lumpy issues—are more likely to escalate to the panel phase.”<sup>141</sup> The disputes considered here concern pre-importation production and treatment methods, import bans by means of procedures, import bans by means of health and quality standards, testing and inspection and shelf-life. In Guzman and Simmons’ terms, they involve discontinuous, or all-or-nothing, issues.<sup>142</sup> The analysis here is admittedly based on a small universe of cases. It shows that these food safety cases were, with few exceptions, settled during the consultation phase. It does not support Guzman and Simmons’ main hypothesis. It gives slightly more support to their suggestion that democracies “tend to take lumpy problems to panels.” DS270 (brought by the Philippines against Australia), DS389 (brought by US against EC), DS430 (brought by US against India) and DS447 (brought by Argentina against the US) all involved democracies. However, in DS270 and DS389 a panel was established but even after three years has not yet composed; DS430 is too recent; and in DS447 a panel was established only on 28 January 2013. The number of cases examined here is too small to support or contest Schuchhardt’s finding that larger Members take consultation seriously in cases with each other, while in cases against smaller Members they frequently view consultations merely as a formal step on the way to a panel.<sup>143</sup>

In contrast, the cases analyzed here would tend to support Bernauer and Sattler’s finding that disputes over environment, health and safety (EHS) are not more likely than other cases to escalate from consultation to a panel. None of the cases analyzed here actually went before a panel, so it is not possible to comment on their other hypothesis to the effect that if EHS cases do go to a panel, they “are more likely than other disputes to escalate into compliance disputes.”<sup>144</sup> In another recent paper, Sattler, Spilker and Bernauer distinguish between WTO disputes concerned with enforcement and those concerned with reduction of complexity and clarification of rules. They argue that the WTO DSM focuses

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<sup>141</sup> Andrew Guzman & Beth A. Simmons, *To Settle or Empanel? An Empirical Analysis of Litigation and Settlement at the World Trade Organization*, 31 J. LEGAL STUD. 205, 227 (2002).

<sup>142</sup> *Id.* at 211 & note 17.

<sup>143</sup> Christiane Schuchhardt, *supra* note 136, at 1199 & 1225.

<sup>144</sup> Thomas Bernauer & Thomas Sattler, *Sind WTO-Konflikte im Bereich des Umwelt-und Verbraucherschutzes Eskalationsträchtiger als Andere WTO-Konflikte*, 13 ZEITSCHRIFT FÜR INTERNATIONALE BEZIEHUNGEN 5–37 (2006), summarized in Thomas Bernauer, Manfred Elsig & Joost Pauwelyn, *Dispute Settlement Mechanism – Analysis and Problems*, in THE OXFORD HANDBOOK ON THE WORLD TRADE ORGANIZATION 495 (Amrita Narlikar, Martin Daunton & Robert Stern eds., 2012).

primarily on the former, with more complex or more politicized disputes being more likely to escalate to the panel stage.<sup>145</sup> As virtually all of the cases analyzed here were settled during consultations, and the complainant won in all cases, they would appear to be most concerned with enforcement; we simply have no information about whether and how the consultations might have clarified the rules. However, the hypothesis that complex or more politicized cases are more likely to escalate to the panel stage is borne out by the only cases in which a panel was established. All four of these cases, DS270 *Australia – Fresh Fruit and Vegetables* (complainant: the Philippines against Australia), DS389 *EC - Poultry* (complainant: US), DS430 *India – Agricultural Products* (complainant: US against India), and DS447 *US – Animals and Meat* (complainant: Argentina) were highly politicized. They signal long-standing structural conflicts, which are deeply embedded in a set of multi-stranded continuing relations and complex domestic legal regulatory schemes.

Table 10 indicates the mode of settlement according to the income categories of the complainant and respondent. The cases examined here involved the following complainant/respondent pairs: HC vs. HR, HC vs. UMR, HC vs. LR, UMC vs. HR, UMC vs. UMR, UMC vs. LMR, UMC vs. LR, LMC vs. HR, LMC vs. LMR, and LC vs. LMR.

Table 10. Mode of Settlement by Income Category of Parties

<i>Parties by Income Category (Respondent First)</i>	<i>MAS</i>	<i>Withdrawn</i>	<i>In Consultation &gt; 3 Years</i>	<i>Panel Established &gt; 3 Years But Not Composed</i>	<i>In Consultation &lt; 3 Years</i>	<i>Panel Established &lt; 3 Years</i>
HC/HR	DS5, DS20, DS20, DS72, DS287, DS391		DS3, DS41, DS100, DS144	DS389		
HC/UMR			DS133			
HC/LR					DS430	
UMC/HR						DS447, DS448

<sup>145</sup> Thomas Sattler, Gabriele Spilker & Thomas Bernauer, *Dispute Settlement as Rule Clarification or Enforcement? Evidence from the World Trade Organization* (2010), <http://147.142.190.246/joomla/peio/files2011/papers/Sattler,%20Spilker,%20Bernauer%2029.09.2010.pdf>.

UMC/UMR	DS297					
UMC/LMR			DS256			
UMC/LR		DS240				
LMC/HR				DS270		
LMC/LMR	DS277					
LC/LMR		DS284				

Based on these cases, it would seem that parties of the same income category tend to (a) reach a mutually agreed solution, or (b) have a long consultation period with no notified result, or (c) move to the beginning of litigation without proceeding further, with a panel being established but not composed, even after three years. In cases in which the parties belong to different income categories, the patterns are different. If the complainant belongs to a higher income category than the respondent, the case tends to settle during consultations. I hypothesise that the settlement reflects the power imbalance between the two parties, which renders potentially very effective any threat by the complainant to move towards request for a panel. However, if the respondent belongs to a higher income category than the complainant, the case ends more often with withdrawal of the complaint. In this case, I hypothesise that the settlement reflects either the respondent's capacity at least partly to satisfy the complaint or the respondent's refusal to change its law. In the two cases of UMC/HR (DS447, DS448) a panel has been established but is not yet composed. In the single LMC/HR case (DS270) a panel has not yet been composed even three years after its establishment. In the single LC/LMR case (DS284) the complaint was withdrawn. These cases thus tend to support Schuchhardt's conclusion that, because of their weaker bargaining power, developing countries are less likely to settle a dispute during consultations in a case against a developed country and more likely to go to the panel stage.<sup>146</sup> Overall, the cases examined here support Palin's conclusion, based on all cases during the first five years of the WTO, that "[n]o one category of dispute—developed v. developed Member, developed v. developing Member, developing v. developed Member, or developing v. developing Member—appears to have a markedly different rate of settlement."<sup>147</sup>

### E Who Wins

<sup>146</sup> Christiane Schuchhardt, *supra* note 136, at 1222–26 & 1230.

<sup>147</sup> C. Christopher Parlin, *supra* note 132, at 569.

We can carry the analysis further by focusing on who complains, against whom, and who wins. For the 21 cases, Table 11 shows the winners according to two dimensions: whether the winner was the complainant (or not), and the winner's income category compared to that of the loser. Parties are grouped, as above, into four categories: High Income, Upper Middle Income, Lower Middle Income, and Low Income. The left-hand column indicates cases brought by Members in each category against Members in each of the other categories. Complainants are indicated first. Most cases (11 of 21) were brought by High Income WTO Members against other High Income Members. All of these cases, however, involved Members which, with one exception (Canada-US), were not geographically contiguous (US-Korea, Canada-Korea, New Zealand-EC, EC-Australia, USA-EC). In all cases, complainants and respondents were important trading partners for at least one and often both of the pair. Of the remaining ten cases, more than half were brought by higher income countries against lower income countries. In four of these ten cases, however, the complainant belonged to a lower income category than the respondent in four cases. In DS447 and DS448 the complainant was an Upper Middle Income country (Argentina in both) and the respondent was a High Income country (US in both). In DS270 the complainant was a Lower Middle Income country (Philippines) and the respondent was a High Income country (Australia). In DS284 a Low Income country (Nicaragua) was the complainant and an Upper Middle Income country (Mexico) was the respondent. Some potential category pairs did not produce any cases (HC/LMR, LMC/UMR, LMC/LR, LC/HR, LC/LMR, LC/LR). Lower Middle Income and Low Income Members participated in fewer food safety cases than did other groups of Members.

Table 11. Complainants, Respondents and Winners in Food Safety Cases

<i>Parties by Income Category (Respondent first)</i>	<i>Case Numbers</i>	<i>Number of Cases</i>	<i>Complainant Wins</i>	<i>Income Category of Winner</i>
HC/HR	DS3, DS5, DS20, DS20, DS41, DS72, DS100, DS144, DS287, DS389, DS391	11	11	parties equal
HC/UMR	DS133	1	1	higher
HC/LMR		none		
HC/LR	DS430	1		in progress

UMC/HR	DS447, DS448	2		in progress; panel established in DS447 on 28 Jan. 2013
UMC/UMR	DS297	1	1	parties equal
UMC/LMR	DS256	1	1	higher
UMC/LR	DS240	1	1	higher
LMC/HR	DS270	1	1*	*Philippines/Australia: appears to be a stalemate
LMC/UMR		none		
LMC/LMR	DS237	1	1	parties equal
LMC/LR		none		
LC/HR		none		
LC/UMR	DS284	1	1**	**Nicaragua/ Mexico: case withdrawn
LC/LMR		none		
LC/LR		none		
TOTAL		21	18	higher: 18; in progress: 3

Based on this distribution of complainants and respondents, Table 11 indicates who won according to two dimensions. First, the fourth column from the left indicates cases in which the winner was the complainant. The complainant won in all 18 cases that have been concluded; three of the 21 cases are still in progress. Second, in all cases the winner was of equal or higher income category than the loser. None of these cases went to a panel, though in some cases (DS389, DS270, DS430, and DS447) a panel was established but has not (or not yet) been composed. In the absence of an adjudicated settlement I treat three different situations as a win for the complainant. (a) A mutually agreed settlement is treated as a win for the complainant, because if the complainant had not achieved its (main) objectives it would have requested a panel. Mutually agreed settlement occurs in the shadow of and in the light of a threat to request a panel. (b) The complainant is considered to have won the case if the case has been in consultation for more than three years (DS3, DS41, DS256, and DS389), even though no mutually agreed settlement has been notified to the WTO. I assume that, if the complainant were not satisfied with the result, it would have requested a panel before the end of three years of consultations.<sup>148</sup> (c) The complainant is considered as having

<sup>148</sup> This cut-off is consistent with the assumption by Guzman and Simmons that a panel is “highly unlikely to be formed” in cases which have been in consultation for

won the case if a panel was established more than three years ago but it has not yet been composed (DS287 and DS270). This is consistent with Schuchhardt's hypothesis that developed countries tend to settle cases against other developed countries, and developing countries tend to settle cases in which they are respondents against complaints brought by developed countries.<sup>149</sup> It is also consistent with Palmer and Roberts' conclusions about the role of power in negotiations.<sup>150</sup> In sum, winners tend to be the complainants, and they are usually but not always of equal or higher income category than respondents, unless the case goes to a panel or ends in stalemate. In the first respect at least, these cases echo the pattern of WTO cases in general.<sup>151</sup>

#### IV Conclusion

The WTO dispute settlement system deals with food safety more frequently than is sometimes thought. If we are interested in the role of the WTO in regulating food safety, we cannot limit our attention to the relatively small number of high-profile WTO cases that deal with international standards. This article analyzed all WTO cases up to now which arose under WTO agreements other than or in addition to the SPS or TBT Agreements and which were not directly concerned with relations between the WTO and international standards bodies. Virtually all such cases were settled, withdrawn or reached stalemate during consultation; in only a very few cases was a panel established. Complainants always won, and except when the case went to a panel, the winner was of equal or higher income category than the respondent.

These cases are the "hidden jurisprudence" of the WTO with regard to food safety. They are not high-profile cases well known to the public. They do not reach the upper levels of the WTO dispute settlement system, and indeed they rarely proceed to the panel stage. Instead they are mostly handled, by settlement or otherwise, during consultations. Disputes are resolved, or at least concluded, by bilateral negotiations, sometimes between very unequal parties, rather than by decisions taken by a third party

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more than 3 years. In their study of settlement and litigation before the WTO, they coded such cases as "nonpaneled," see Andrew Guzman & Beth A. Simmons, *supra* note 143, at 212.

<sup>149</sup> Christiane Schuchhardt, *supra* note 136, at 1199 & 1231.

<sup>150</sup> MICHAEL PALMER & SIMON ROBERTS, DISPUTE PROCESSES: ADR AND THE PRIMARY FORMS OF DECISION MAKING 70–71 (1998).

<sup>151</sup> Matthew Turk, *Why Does the Complainant Always Win at the WTO: A Reputation-Based Theory of Litigation at the World Trade Organization*, 31 NW. J. INT'L L. & BUS. 385 (2011).



on the basis of multilaterally agreed rules. These processes represent “bargaining in the shadow of WTO law,” if only because both complainants and respondents initially justify their position in terms of compatibility with WTO law. This is even though, as others have argued, in WTO law the “shadow” is much less menacing than in domestic courts, because respondents who lose in WTO cases often do not comply with panel, Appellate Body or Dispute Settlement Body reports and, in any event, compliance in the WTO setting falls along a spectrum instead of being an either-or situation.<sup>152</sup>

In a second sense also, these cases represent the “hidden jurisprudence” of the WTO. This sense refers to the basic philosophy or orientation of the WTO regarding food safety. It has two aspects. First, food safety is treated in these cases as simply another trade issue, rather than as a distinct subject matter with economic, political, social and cultural implications far beyond trade, as it should be. Second, complainants use the WTO dispute settlement mechanism to export and if possible impose their national standards and practices. Of the 21 cases, the US won 5, Canada won 4, and the EC [now EU] won 2, so that the WTO dispute settlement system served to globalize their local law and practices. This pattern reflects a distribution of power, which is becoming less and less appropriate in the contemporary world.<sup>153</sup>

Are these results compatible with WTO law? In principle, the answer should be “yes.”<sup>154</sup> However, a mutually agreed solution, or other pre-panel settlement, does not necessarily resolve questions of the interpretation and application of WTO law. Nor does it decide which of the two parties’ view of the law is legally correct. The basic features of consultations include a lack of “hard constraints” regarding the identification of legal issues.<sup>155</sup> Consequently, it is open to question whether a pre-panel conclusion, except for a mutually agreed solution, is consistent with Article 3.7 DSU to the effect that “*In the absence of a mutually agreed solution*, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are

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<sup>152</sup> Marc L. Busch & Eric Reinhardt, *Bargaining in the Shadow of the Law: Early Settlement in GATT/WTO Disputes*, 24 *FORDHAM INT’L L.J.* 158 (2001) (refer to “bargaining in the shadow of weak law” at page 164); Matthew Turk, *supra* note 153, at 385–437. See also Chad Bown, *Trade Remedies and the WTO Dispute Settlement System: Why Are So Few Challenged*, 34 *J. LEGAL STUD.* 515, 517 (2005).

<sup>153</sup> See generally FRANCIS SNYDER, *THE EU, THE WTO AND CHINA: LEGAL PLURALISM AND INTERNATIONAL TRADE REGULATION* (2010) (especially Chapter 1).

<sup>154</sup> DSU art. 3.6.

<sup>155</sup> Gary N. Horlick & Glenn R. Butterson, *A Problem of Process in WTO Jurisprudence: Identifying Disputed Issues in Panels and Consultations*, 31 *LAW & POL’Y INT’L BUS.* 573 (2000).

found to be inconsistent with the provisions of any of the covered agreements.”<sup>156</sup> Indeed, Article 3.7 DSU suggests that, in legal terms, the withdrawal of a contested measure belongs not to the consultation stage but instead to later stages in the WTO dispute settlement procedure, namely the reports of the panel, Appellate Body and Dispute Settlement Body. The interpretation that the consultation phase itself does not compel withdrawal of a measure is strengthened by Article 4.5 DSU, which provides that “[i]n the course of consultations in accordance with the provisions of a covered agreement, before resorting to further action under this Understanding, Members shall attempt to obtain satisfactory adjustment of the matter.”<sup>157</sup> Satisfactory adjustment based on good faith negotiations, as distinguished from mere withdrawal of the challenged measure, is the core of a mutually agreed solution.<sup>158</sup> So far, panels have not reviewed whether the good faith requirement was met.<sup>159</sup> In consultations, the very meaning of what is “satisfactory” in the sense of acceptable to both parties is inevitably informed by considerations of relative power, even though both power and rules are present, in varying degrees and serving varying purposes, in all forms of dispute settlement.<sup>160</sup>

This suggests two points for countries such as China that are developing a complete system of food safety standards. First, such countries should pay special attention to the consultation phase of WTO dispute settlement. This means that they should aim to participate in relevant consultations as much as possible, in the same way that China has participated very actively as a third party in general. The cases show that China frequently reserved its rights under Article 10 DSU to participate as a third party once a panel had been established, but that it rarely exercised its rights under Article XX GATT and Article 4.11 DSU to participate in consultations. While this pattern might be ascribed partly to the Chinese government’s policy during China WTO “learning period,” one might conclude that this period has now ended and suggest that China should participate more actively throughout the WTO dispute settlement procedures, including consultations. As we have seen, many disputes end at the consultation phase, and certainly China and other BRICSAM countries could benefit by giving this phase more attention.

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<sup>156</sup> DSU art. 3.7.

<sup>157</sup> DSU art. 4.5.

<sup>158</sup> Christiane Schuchhardt, *supra* note 13.

<sup>159</sup> Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*, ¶6.32–35, WT/DS141/R (Mar. 12, 2001).

<sup>160</sup> Francis G. Snyder, *Anthropology, Dispute Processes and Law: A Critical Introduction*, 8(2) *British Journal of Law & Society* 141 (1981), reprinted in *LAW AND ANTHROPOLOGY* 77–79 (Peter Sack & Jonathan Aleck eds., 1992).

Second, China and other BRICSAM countries are well advised for the time being to use a strategy of “assertive legalism”<sup>161</sup> or of “aggressive legalism.”<sup>162</sup> “Assertive legalism” means “primarily aim[ing] to protect ... legitimate trade interests by increasingly resorting to WTO rules.”<sup>163</sup> In contrast, “aggressive legalism” means “a conscious strategy where a substantive set of international trade rules can be made to serve as both a ‘shield’ and ‘sword’ in trade disputes among sovereign states”:<sup>164</sup>

The core idea behind aggressive legalism is the active use of the legal rules in the treaties and agreements overseen by the WTO to stake out positions, to advance and rebut claims, and to embroil all concerned in an intricate legal game...[i]t is meant to be measured, slow, and cautious, carefully trapping everything into the legitimate game of legal tactics.<sup>165</sup>

Both “assertive legalism” and “aggressive legalism” are easy to distinguish from legal passivism. They differ, however, in the extent to which they embody a conscious longer-term strategy, the extent to which they are mainly proactive or mainly reactive, and the extent to which law and politics are intermeshed. Differences in legal culture and legal capacity inform the extent to which a party wishes to use, or is able to use, “assertive legalism” or “aggressive legalism.”<sup>166</sup> China already engages in “assertive legalism” to protect its legitimate interests. The main point here, however, is that China and the other BRICSAM countries should seek to develop a proactive, conscious strategy about the use of WTO law and WTO institutions as part of their normal trade policy.

Such strategies can be especially useful for a complainant in cases where the complainant comes from a lower per capita income group than the respondent. They acquire special force in the cases examined here, which focus mainly on the consultation phase of WTO dispute settlement. To take the example of “aggressive legalism,” such a strategy offers three advantages. First, it may greatly strengthen a complainant’s position at the stage of request for consultations. Second, it offers the possibility of a

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<sup>161</sup> Pasha L. Hsieh, *China’s Development of International Economic Law and WTO Legal Capacity Building*, 13(4) J. INT’L ECON. L. 997, 999 & 1025 (2010).

<sup>162</sup> Saadia M. Pekkanen, *Aggressive Legalism: The Rules of the WTO and Japan’s Emerging Trade Strategy*, 24 THE WORLD ECON. 707 (2001).

<sup>163</sup> Pasha L. Hsieh, *supra* note 163, at 1025.

<sup>164</sup> Saadia M. Pekkanen, *supra* note 164, at 708.

<sup>165</sup> Saadia M. Pekkanen, *supra* note 164, at 732.

<sup>166</sup> E.g., Joost Pauwelyn, *The Limits of Litigation: “Americanization” and Negotiation in the Settlement of WTO Disputes*, 19 OHIO ST. J. ON DISP. SESOL. 121 (2004).

much stronger and more complex negotiating strategy justified in legal terms during the consultation phase. Third, if a party achieves no satisfaction during consultations, it can justify holding out for a panel and strengthen a party's position before a panel, where a lower-income party may have more advantages than during consultations. The facts that consultations do not reach a legal decision on the merits and do not produce a binding interpretation of WTO law may actually be advantages for a party which resorts to "aggressive legalism" or "assertive legalism."

Neither "assertive legalism" nor "aggressive legalism" by itself, however, can in any way guarantee food safety. Consequently, these conclusions are intended, not as an argument against consultation as a means of settling trade disputes, but rather as a plea for a different institutional solution to the problem of how to regulate international food safety. The cases examined here show that a WTO Member, especially a powerful WTO Member, can usually globalize its own food safety standards, assuming they can arguably be justified in the light of WTO law, by bringing a complaint to the WTO and then reaching a settlement during consultation. To be successful, such cases should ideally be brought against a respondent in a lower per capita income category; a favorable settlement is likely also in cases brought against a respondent of the same income category. However, the results of this process are not necessarily equal to international food standards, even though during or after a dispute, Codex Alimentarius may step in and engage in re-regulation of food safety, as in *DS389 EC - Poultry*. Nor do the results of WTO consultations necessarily amount to an optimum solution from the standpoint of food safety, global or national. Indeed international standards and an optimum solution may not be the same.

What is clear, however, is that the globalization of local food safety standards through a dispute settlement mechanism designed to settle trade disputes is not an appropriate way to determine which standards should regulate food safety in an increasingly integrated, yet inescapably diverse global food economy. The hidden jurisprudence of the WTO is not a good way to regulate food safety today. We need a global food safety agency.<sup>167</sup>

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<sup>167</sup> For discussion of how this might be done, see Francis Snyder, *supra* note 155, at 381–423; Ching-Fu Lin, *Global Food Safety: Exploring Key Elements for an International Regulatory Strategy*, 51(3) VA. J. INT'L L. 637, 684–94 (2011); *Global Food Protection: A New Organization is Needed*, in IMPROVING IMPORT FOOD SAFETY (Wayne Ellefson, Lorna Zach & Darryl Sullivan eds., 2013).

# **A Fair Labor Future for Foxconn? The 2012 FLA Audit of Apple's Largest Chinese Supplier**

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## **ABSTRACT**

*Following worldwide media attention to problematic working conditions at assembly factories for Apple's popular i-products, Apple publicly committed in early 2012 to employment standards established by the non-profit Fair Labor Association (FLA). At Apple's request, the FLA conducted an extensive audit of three enormous facilities in China, owned and operated by mega-manufacturer Foxconn, which assemble products for Apple. Foxconn then embarked on an effort to implement substantial, FLA-recommended changes at those factories over the course of fifteen months.*

*This article explores the significance of Apple's commitment to the FLA's transnational standards; the FLA's highly transparent and detailed assessment of Apple's supplier Foxconn; and Foxconn's efforts to comply with the FLA's recommendations. It also raises questions about the ultimate benefits of the process for Chinese workers and the ultimate impact on Foxconn's business relationship with Apple. After describing the events leading up to this audit, the*

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*article analyzes the findings, shortcomings, and potential impact of the FLA's groundbreaking audit. In so doing, it considers whether the recommendations are likely to result in meaningful improvements for the workers and the extent to which the audit represents a new approach to addressing the working conditions at Asian suppliers of multinational retail companies.*

## I Introduction

For several decades, companies seeking to be cost-competitive in the global economy have contracted with suppliers in countries where employees will work long hours for low pay. Apple, which once took pride that all of its products were manufactured in the United States, eventually outsourced all of its manufacturing to suppliers located outside of the United States, with the bulk of the work moving to China.<sup>1</sup> Foxconn, the Taiwanese mega-manufacturing company with huge facilities in mainland China, became Apple's largest supplier.

Reliance on Asian suppliers like Foxconn has allowed Apple and other global retailers to press their suppliers for rapid deliveries at low cost, without concern for the effect of these demands on the suppliers' employees. This is because a "core operating assumption" of multinational companies such as Apple is that "their employment and human resources obligations run to their employees and independent contractors but do not extend to other stakeholders, such as the employees of unaffiliated business from which they purchase products."<sup>2</sup> At the same time, however, some companies have responded to this dynamic by imposing codes of conduct on their suppliers "to protect the suppliers' employees from inhumane practices and employment law violations."<sup>3</sup> The Fair Labor Association (FLA), a Washington, D.C.-based non-profit organization, grew out of similar efforts by companies, universities, and civil society organizations working together to monitor and enforce workplace standards among suppliers of multinational companies.<sup>4</sup>

With the global media focus on working conditions at Foxconn potentially jeopardizing Apple's global brand, Apple joined the FLA in January 2012 and subscribed to its international Workplace Code.<sup>5</sup> The FLA promptly completed an audit of three large Foxconn facilities in

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<sup>1</sup> Apple Computer, Inc., *2005 SEC Form 10-K (Annual Report)*, 49 (Dec. 1, 2005), <http://files.shareholder.com/downloads/AAPL/2462957491x0xS1104659-05-58421/320193/filing.pdf>.

<sup>2</sup> Donald C. Dowling, Jr., *U.S.-Based Multinational Employers and the Social Contract Outside the United States*, 26 ABA J. LAB. & EMP. L. 77, 90 (2010).

<sup>3</sup> *Id.* at 97.

<sup>4</sup> See *infra* Part I.A.

<sup>5</sup> *Fair Labor Association Launches Independent Investigation of Foxconn*, FAIR LAB. ASS'N (Feb. 13, 2012), <http://www.fairlabor.org/blog/entry/fair-labor-association-launches-independent-investigation-foxconn>.

China that do the final assembly of iPads, iPhones, iPods and Macs.<sup>6</sup> The audit revealed “serious and pressing non-compliances” with the FLA Code and employment law of People’s Republic of China (PRC),<sup>7</sup> and both Foxconn and Apple immediately pledged to implement the FLA recommendations.<sup>8</sup> In August 2012, the FLA issued a status report, announcing that Foxconn had timely completed all 195 remedial tasks that had been due by May 31, 2012, and was ahead of schedule in implementing the remaining 165 recommendations that were due by July 1, 2013.<sup>9</sup> In May 2013 the FLA issued a second status report, in which it claimed that Foxconn had implemented 98% of its 360 recommended remedial actions.<sup>10</sup>

This article reviews the extensive data that the audit generated on the Foxconn employees and their working conditions and uses this information to assess the findings and recommendations of the FLA. Although praising the audit’s thoroughness and its focus on working hour abuses and safety and health issues, the article identifies a number of deficiencies in the audit, including its failure to examine the treatment of female employees and to raise the issue of sexual harassment.

The article also explores the broader significance of the audit. It posits that the audit reports set a new standard of transparency for employment audits of Asian suppliers for multinational retailers, because the FLA conducted an extremely thorough audit and made public both its findings and much of the underlying data. In addition, the audit is significant because the FLA judged Foxconn against a set of transnational employment standards, encompassing not only the requirements of PRC law but also detailed international requirements that extend far beyond the issues of underage and coerced labor. Finally, the public commitment by Apple and Foxconn to implement all of the FLA recommendations should ensure that the audit will serve as an effective mechanism to enforce employment standards at these Foxconn facilities.

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<sup>6</sup> *Independent Investigation of Apple Supplier, Foxconn*, FAIR LAB. ASS’N, 8 (Mar. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/foxconn\\_investigation\\_report.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/foxconn_investigation_report.pdf) [hereinafter *March 2012 Report*].

<sup>7</sup> *Id.* at 1.

<sup>8</sup> Charles Duhigg & Steven Greenhouse, *Electronic Giant Vowing Reforms in China Plants*, N.Y. TIMES (Mar. 29, 2012), <http://www.nytimes.com/2012/03/30/business/apple-supplier-in-china-pledges-changes-in-working-conditions.html>.

<sup>9</sup> *Foxconn Verification Status Report*, FAIR LAB. ASS’N, 2 (Aug. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/foxconn\\_verification\\_report\\_final.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/foxconn_verification_report_final.pdf) [hereinafter *August 2012 Status Report*].

<sup>10</sup> *Second Foxconn Verification Status Report*, FAIR LAB. ASS’N, 3 (May 2013), [http://www.fairlabor.org/sites/default/files/documents/reports/second\\_foxconn\\_verification\\_status\\_report\\_0.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/second_foxconn_verification_status_report_0.pdf) [hereinafter *May 2013 Status Report*].



As a result, the FLA assessment of Foxconn may mark the moment when the impact of globalization begins to exert pressure on Asian suppliers to improve the working conditions for their employees, rather than undermining employment standards.

But it is no easy task to bring about meaningful change in large institutions, and there are additional challenges when an international organization like the FLA seeks to effectuate change in an institution located in China. In light of these challenges, the article raises questions as to how much the audit will ultimately benefit Chinese workers. In part this is because it cannot yet be determined how effectively the audit grappled with the realities of China, including, for example, the distinctive demographics of the Foxconn workforce, the particular concerns of the employees and the role of the union as an arm of the Communist Party, not as an independent representative of the workers. In part it is because it remains to be seen whether Apple and Foxconn's commitment to implement the changes recommended by the FLA will wane in the event that the working conditions at these facilities cease to command worldwide media attention.

Section One of the article sets the stage for the analysis of these issues: it introduces the work of the FLA, traces the history of Apple's efforts at enforcing corporate social responsibility norms among its global suppliers, and describes some of the public, international scrutiny of Foxconn working conditions through early 2012. Section Two describes the information collected during the FLA investigation about the Foxconn workforce and the general conditions at the three Foxconn facilities visited by the FLA, noting both the wealth of information gathered by the FLA and the important issues that the FLA overlooked. In Section Three, the article analyzes in detail the specific concerns identified by the FLA in March 2012, the recommendations for improvement, and Foxconn's subsequent progress toward compliance with the FLA recommendations. Finally, the article concludes with reflections on both the groundbreaking nature and potential limitations of the FLA's efforts to bring Foxconn into compliance with transnational employment standards.

## **II Background**

### *A The Fair Labor Association*

The FLA, a Washington, D.C.-based nonprofit organization, originated in 1996 as the White House Apparel Industry Partnership, a Presidential Task Force created in response to growing concerns about sweatshop conditions in the garment industry.<sup>11</sup> In 1997, the task force's representatives from apparel and footwear companies, human rights and labor groups, and U.S. universities worked together to adopt a Workplace Code of Conduct for "decent and humane working conditions" as well as principles for monitoring compliance with those standards.<sup>12</sup> In 1999, the organization formally became the Fair Labor Association and expanded its focus and membership beyond apparel and footwear.<sup>13</sup>

Companies joining the association commit to uphold the FLA Workplace Code of Conduct, which establishes minimum standards relating to conditions of employment; nondiscrimination; harassment and abuse; forced labor; child labor; freedom of association and collective bargaining; safety, health, and environmental concerns; work hours; and compensation.<sup>14</sup> FLA members agree to undergo independent assessments of working conditions throughout their supply chains as well as to implement systems of internal monitoring.<sup>15</sup> The FLA accredits independent external monitors, who then assess facilities and publish reports describing "significant and/or persistent patterns of noncompliance, or instances of serious noncompliance, with the Workplace Code or Monitoring Principles."<sup>16</sup> According to the FLA, the organization uses "sustainable compliance methodology" to provide broader and deeper assessment of factories than conventional audits, going beyond identifying and resolving code violations.<sup>17</sup> The assessments aim to identify "root causes of problems and provide

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<sup>11</sup> See *History*, FAIR LAB. ASS'N, <http://www.fairlabor.org/about-us/history> (last visited Aug. 1, 2013); *Towards Improving Workers' Lives (August 1, 2001–July 31, 2002)*, FAIR LAB. ASS'N, [http://www.fairlabor.org/sites/default/files/documents/reports/2003\\_annual\\_public\\_report.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/2003_annual_public_report.pdf).

<sup>12</sup> *Workplace Code of Conduct*, FAIR LAB. ASS'N, pmbl., [http://www.fairlabor.org/sites/default/files/fla\\_code\\_of\\_conduct.pdf](http://www.fairlabor.org/sites/default/files/fla_code_of_conduct.pdf) (last visited Aug. 1, 2013) [hereinafter *FLA Workplace Code of Conduct*]; *Fair Labor Association Charter Document*, FAIR LAB. ASS'N, pmbl. (as amended Feb. 20, 2013), [http://www.fairlabor.org/sites/default/files/fla\\_charter.pdf](http://www.fairlabor.org/sites/default/files/fla_charter.pdf) [hereinafter *FLA Charter Document*].

<sup>13</sup> *FLA Charter Document*, *supra* note 12.

<sup>14</sup> *FLA Workplace Code of Conduct*, *supra* note 12.

<sup>15</sup> *FLA Charter Document*, *supra* note 12, at 12–13.

<sup>16</sup> *FLA Charter Document*, *supra* note 12, at 23.

<sup>17</sup> *Sustainable Compliance Methodology*, FAIR LAB. ASS'N, 2, [http://www.fairlabor.org/sites/default/files/sci-factsheet\\_7-23-12.pdf](http://www.fairlabor.org/sites/default/files/sci-factsheet_7-23-12.pdf) (last visited Aug. 1, 2013); see also *March 2012 Report*, *supra* note 6, at 5.

systemic, sustainable solutions so that problems are fixed in a lasting way.”<sup>18</sup> Assessment reports are published on the FLA’s website.<sup>19</sup>

### *B Apple and Foxconn before the FLA Assessment*

Apple for many years manufactured its products at its own plants located in the United States, Ireland and Singapore.<sup>20</sup> Starting in 1996 Apple increasingly turned to outsourcing for both manufacture of components and final assembly.<sup>21</sup> Apple ceased manufacturing in the United States in 2003 and increasingly relied on vendors, many of which were located in China.<sup>22</sup>

For final assembly of virtually all of its portable products—iPods, iPhones and iPads—Apple turned to Foxconn Technology Group, which is part of the Taiwanese giant, Hon Hai Precision Industry Company. Foxconn was established in 1974 and first set up operations in China in 1988.<sup>23</sup> As of 2000 Foxconn had 30,000 employees.<sup>24</sup> The explosive growth in sales of Apple’s portable products since 2005 resulted in enormous growth in Foxconn’s workforce and its operations in China. Today, Foxconn’s 1.2 million or more employees place it among the ten largest employers in the world, along with the U.S. Defense Department, the People’s Liberation Army of China, the Indian Railway, Wal-Mart and McDonald’s.<sup>25</sup>

<sup>18</sup> *Sustainable Compliance Methodology*, *supra* note 17.

<sup>19</sup> See Tracking Charts, FAIR LAB. ASS’N, <http://fairlabor.org/transparency/tracking-charts> (last visited Aug. 1, 2013).

<sup>20</sup> Apple Computer, Inc., *1995 SEC Form 10-K (Annual Report)*, 6 (Dec. 19, 1995), <http://files.shareholder.com/downloads/AAPL/2462957491x0xS320193-95-16/320193/filing.pdf>.

<sup>21</sup> Apple Computer, Inc., *1996 SEC Form 10-K (Annual Report)*, 16 (Dec. 19, 1996), <http://files.shareholder.com/downloads/AAPL/2462957491x0xS320193-96-23/320193/filing.pdf>.

<sup>22</sup> *Compare* Apple Computer, Inc., *2003 SEC Form 10-K (Annual Report)*, 14 (Dec. 19, 2003) (listing a manufacturing facility in California), <http://files.shareholder.com/downloads/AAPL/2462957491x0xS1047469-03-41604/320193/filing.pdf>, *with* *2004 SEC Form 10-K (Annual Report)*, 15, 17 (Dec. 3, 2004) (describing no Apple manufacturing facility in the United States and listing locations for vendors), <http://files.shareholder.com/downloads/AAPL/2462957491x0xS1047469-04-35975/320193/filing.pdf>.

<sup>23</sup> *Group Profile*, FOXCONN, [http://www.foxconn.com/GroupProfile\\_En/GroupProfile.html](http://www.foxconn.com/GroupProfile_En/GroupProfile.html) (last visited Aug. 1, 2013); Jason De An, *The Forbidden City of Terry Gou*, WALL ST. J. (Aug. 11, 2007), <http://online.wsj.com/public/article/SB118677584137994489.html>.

<sup>24</sup> Jason De An, *supra* note 23.

<sup>25</sup> *Defending Jobs*, THE ECONOMIST (Sept. 12, 2011), <http://www.economist.com/bl ogs/dailychart/2011/09/employment>.

As both Foxconn and Apple have grown substantially over the last eight years, increasing attention has turned to working conditions at this large Apple supplier. Apple has developed its own audit system to monitor its suppliers worldwide. At the same time, employee unrest and complaints at Foxconn facilities in China have attracted public attention from international media and advocacy organizations. The following discussion outlines the history of Apple's own supplier audit program and the external public pressure leading up to Apple's 2012 decision to join the FLA and to subject Foxconn to an audit by an independent organization.

a) *Apple's Own Audits of Its Suppliers*

As it became increasingly dependent on the operations of its foreign suppliers, Apple in 2005 published its first Supplier Code of Conduct, which requires "that working conditions in Apple's supply chain are safe, that workers are treated with respect and dignity, and that manufacturing processes are environmentally responsible."<sup>26</sup> The next year Apple instituted annual supplier audits. Starting with eleven audits in 2006 and a four-page summary report, the program has steadily grown, exceeding 100 audits in 2010, with a 24-page report, and nearing 400 audits in 2012, with a 37-page report.<sup>27</sup> Each year the audits include both first-time and repeat visits to Apple suppliers. The 17 final assembly plants, which include seven operated by Foxconn, have been audited each year.<sup>28</sup>

Apple's annual audit reports present the results in summary form. They do not identify which facilities have been audited, or the countries in which the violations have been found. Although the final assembly

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<sup>26</sup> Apple Computer, Inc., *Apple Supplier Code of Conduct*, 1, [http://images.apple.com/supplierresponsibility/pdf/Apple\\_Supplier\\_Code\\_of\\_Conduct.pdf](http://images.apple.com/supplierresponsibility/pdf/Apple_Supplier_Code_of_Conduct.pdf) (last visited Aug. 1, 2013) [hereinafter *Apple Supplier Code of Conduct*].

<sup>27</sup> Apple Computer, Inc., *Supplier Responsibility Progress Reports 2007–2013*, <http://www.apple.com/supplierresponsibility/reports.html> (last visited Aug. 1, 2013) [hereinafter *Supplier Progress Reports 2007–2013*].

<sup>28</sup> Apple Computer, Inc., *Apple Supplier Responsibility 2013 Progress Report*, 10 (2013), [http://images.apple.com/supplierresponsibility/pdf/Apple\\_SR\\_2013\\_Progress\\_Report\\_2013\\_Progress\\_Report.pdf](http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2013_Progress_Report_2013_Progress_Report.pdf) [hereinafter *Supplier Progress Report 2013*]. The 17 final assembly plants include 14 in China and one each in Brazil, Ireland and the United States. In addition to Foxconn, the final assembly suppliers in 2012 were Cheng Uei Precision Industry Co., Ltd (a/k/a Foxlink), Inventec Appliances Corporation, PCH International, Pegatron Corporation, Primax Electronics Ltd., and Quanta Computer Inc. *Our Suppliers*, APPLE COMPUTER, INC., <http://www.apple.com/supplierresponsibility/our-suppliers.html> (last visited Aug. 1, 2013).

plants are audited each year,<sup>29</sup> the reports do not indicate whether any of the violations occurred at a final assembly plant.

The summary data in the annual reports do reveal the eight areas that are examined in the Apple audits: antidiscrimination, fair treatment, prevention of involuntary labor, prevention of under-age labor, juvenile worker protections, working hours, wages and benefits, and freedom of association.<sup>30</sup> Apple's audit findings in two of these areas, working hours and freedom of association, are particularly noteworthy when compared to the FLA's findings, as discussed in greater detail below.

Apple's audit reports acknowledge that enforcement of work hour restrictions has been among its highest priorities. Apple's Code of Conduct sets a 60-hour cap on weekly work hours and requires a weekly rest day.<sup>31</sup> Notwithstanding the emphasis placed on this issue, it appears that for many years Apple's audit program, although documenting the extent of non-compliance with working hour requirements, did little to encourage compliance. Apple conceded in its 2012 report that excessive hours "has been a challenge throughout the history of our [audit] program."<sup>32</sup> It observed in its 2013 report that despite trying "different ways to fix the problem" posed by workweeks in excess of 60 hours, "we weren't seeing results."<sup>33</sup> In 2006, for example, Apple found that 38% of the employees of the audited suppliers had exceeded the 60-hour limit.<sup>34</sup> Five years later, non-compliance was still the norm, with more than 60% of the audited facilities failing to achieve compliance with the working hours standard.<sup>35</sup> The persistence of these violations suggests flaws in Apple's audit process. Moreover, Apple's audit reports have consistently ignored the fact that PRC law since 2008 has limited the work week to 40 hours, with a maximum of 36 hours of overtime per month—and that the

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<sup>29</sup> *Supplier Progress Report 2013*, *supra* note 28, at 9.

<sup>30</sup> Charles Duhigg & David Barboza, *In China Human Costs Are Built into an iPad*, N.Y. TIMES (Jan. 25, 2012), <http://www.nytimes.com/2012/01/26/business/ieconomy-apples-ipad-and-the-human-costs-for-workers-in-china.html>; *see also* *Supplier Progress Reports 2007–2013*, *supra* note 27.

<sup>31</sup> *Apple Supplier Code of Conduct*, *supra* note 26, at 2.

<sup>32</sup> Apple Computer, Inc., *Apple Supplier Responsibility 2011 Progress Report*, 8, 11 (2011), [http://images.apple.com/supplierresponsibility/pdf/Apple\\_SR\\_2011\\_Progress\\_Report.pdf](http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2011_Progress_Report.pdf) [hereinafter *Supplier Progress Report 2011*].

<sup>33</sup> Apple Computer, Inc., *Apple Supplier Responsibility 2012 Progress Report*, 17 (2012), [http://images.apple.com/supplierresponsibility/pdf/Apple\\_SR\\_2012\\_Progress\\_Report.pdf](http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2012_Progress_Report.pdf) [hereinafter *Supplier Progress Report 2012*].

<sup>34</sup> Apple Computer, Inc., *Final Assembly Supplier Audit Report*, 3 (Feb. 2007), [http://images.apple.com/supplierresponsibility/pdf/Apple\\_SR\\_2007\\_Progress\\_Report.pdf](http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2007_Progress_Report.pdf) [hereinafter *Apple Supplier Audit Report 2007*].

<sup>35</sup> *Supplier Progress Report 2012*, *supra* note 33, at 7.

Apple's Supplier Code of Conduct requires suppliers to operate "in full compliance" with local law.<sup>36</sup>

Apple's 2013 Supplier Responsibility Progress Report describes a new effort to address excessive working hours, in which Apple itself tracks the weekly hours of its suppliers' employees. This is a surprisingly vigorous step towards active involvement in the operations of its suppliers and represents an abrupt change from the past pattern of detecting but not correcting working-hours violations. Applied to a few suppliers in 2011, the program was expanded in 2012 to cover supplier operations with a million workers.<sup>37</sup> This resulted in the first significant audited improvement in compliance with the 60-hour standard, up to 92% in 2012, with workers averaging less than 50 work hours per week.<sup>38</sup> But even the 2013 Report ignores the monthly cap of 36 overtime hours mandated by PRC law.

In addition, Apple's approach to possible violations of the freedom of association standard raises questions about the effectiveness of the Apple supplier audit process. Apple's Supplier Code of Conduct begins its statement of principle regarding freedom of association by declaring, "Suppliers must respect the rights of workers to associate freely with, form, and join workers' organizations of their own choosing, seek representation, and bargain collectively, *as permitted by and in accordance with applicable law and regulations.*"<sup>39</sup> By identifying only "violations" of the freedom of association that fail to comply with local laws, Apple has consistently concluded that its suppliers do not impede collective action by their workers, reporting 100% compliance with this standard in 2006 and 99% compliance in 2010.<sup>40</sup> In countries like China, however, local law is the problem.<sup>41</sup> For many years, for example, the FLA has routinely included a comment in its audit reports on companies located in China that PRC law prevents the establishment of trade unions independent of the official All-China Federation of Trade Unions (ACFTU), that many provisions of PRC law are inconsistent with

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<sup>36</sup> *Apple Supplier Code of Conduct*, *supra* note 26, at 1; see 国务院关于职工工作时间的规定 (1995年修订) [Provisions of the State Council on Employee's Working Hours (1995 Amendment)] (promulgated by the St. Council, Mar. 25, 1995, effective May 1, 1995) art. 3, CLI.2.11532 CHINALAWINFO; 劳动法 [Labor Law] (promulgated by the Standing Comm. Nat'l People's Cong., July 5, 1994, effective Jan. 1, 1995, amended and effective Aug. 27, 2009) art. 3, CLI.1.9587 CHINALAWINFO.

<sup>37</sup> *Supplier Progress Report 2013*, *supra* note 28, at 17.

<sup>38</sup> *Id.*

<sup>39</sup> *Apple Supplier Code of Conduct*, *supra* note 28, at 3 (emphasis added).

<sup>40</sup> *Apple Supplier Audit Report 2007*, *supra* note 34, at 2; *Supplier Progress Report 2011*, *supra* note 32, at 15.

<sup>41</sup> See *infra* notes 177-79.

fundamental principles of freedom of association and that “*all* factories in China” therefore fall short of international standards on the right to organize and bargain collectively.<sup>42</sup> As discussed below in Section III, the FLA was not impressed by Foxconn’s performance in this area, finding, for example that at the Guanlan facility that the membership of the union committee included 27 managers and supervisors and not even one worker.<sup>43</sup>

Moreover, few of the other issues examined in the Apple supplier audits have much significance for Foxconn’s operations, even though Foxconn is Apple’s largest supplier. Perhaps the major accomplishment of Apple’s audits has been to obtain relief for victims of “forced labor.” Apple has focused on the abuse of foreign workers at facilities in Singapore and Malaysia, many of whom came from Vietnam, Indonesia, Thailand and the Philippines and were forced to pay excessive fees to employment recruiters.<sup>44</sup> Apple has achieved tangible remedies: Apple reports that it has required that recruiters repay to workers \$13 million in excessive fees charged to workers since 2008.<sup>45</sup> But this has little relevance to Foxconn’s operations in China, where essentially all the employees are Chinese nationals. Similarly, Apple’s investigation of discrimination issues is of relatively little significance to Foxconn, involving a narrow focus on hiring discrimination against pregnant applicants and applicants with hepatitis B.<sup>46</sup> Also, although Apple has consistently focused on enforcing the prohibition on underage labor, the uncovered abuses usually have consisted of the employment of a handful of 15-year-olds, where the employment of 16-year-olds is lawful, in a plant with many thousands of employees.<sup>47</sup>

Beyond the relatively uninformative audit results released publicly by Apple each year, its most recent supplier progress reports note an innovation that is likely to impact Foxconn’s employees. Apple’s 2013 Progress Report put new emphasis on the Supplier Employee Education and Development program (SEED), which began in 2008 and expanded

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<sup>42</sup> *Independent External Monitoring Report—adidas Group (2009)*, FAIR LAB. ASS’N, 9, <http://fairlabor.org/transparency/tracking-charts> (follow “adidas Group” hyperlink, then follow “530015138H\_China.pdf” hyperlink).

<sup>43</sup> *May 2013 Status Report*, *supra* note 10, at 5.

<sup>44</sup> *E.g.*, *Supplier Progress Report 2012*, *supra* note 33, at 9.

<sup>45</sup> *Supplier Progress Report 2013*, *supra* note 28, at 6, 20.

<sup>46</sup> *E.g.*, Apple Computer, Inc., *Apple Supplier Responsibility 2009 Progress Report*, 10 (Feb. 2009), [http://images.apple.com/supplierresponsibility/pdf/Apple\\_SR\\_2009\\_Progress\\_Report.pdf](http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2009_Progress_Report.pdf).

<sup>47</sup> *E.g.*, Apple Computer, Inc., *Apple Supplier Responsibility 2010 Progress Report*, 17 (2010), [http://images.apple.com/supplierresponsibility/pdf/Apple\\_SR\\_2010\\_Progress\\_Report.pdf](http://images.apple.com/supplierresponsibility/pdf/Apple_SR_2010_Progress_Report.pdf).

in 2012 from four final assembly plants in China to nine. In an effort to “empower workers,” this program offers training off-hours to employees in English, computer skills, business and other skills, and 200,000 workers have participated during the program’s five years.<sup>48</sup> As journalist Leslie T. Chang, author of *Factory Girls: From Village to City in a Changing China*, has pointed out, young Chinese who have emigrated in the hundreds of thousands from impoverished rural villages to urban areas are highly motivated to improve their situations through the savings they can accumulate at work, through the personal growth they can obtain by their new experiences and, preferably, through education.<sup>49</sup> Apple’s SEED program responds to those motivations, and its growth confirms Chang’s observations.

*b) Public Scrutiny of Foxconn’s Working Conditions*

Even as Apple has been expanding its audit program, Foxconn’s operations in China on behalf of Apple have been the subject of increasing international criticism. None of the numerous multinational retailers whose suppliers are located in China has attracted comparable scrutiny, and this may well explain why Apple and Foxconn have undertaken unusually public steps to undergo the FLA audit and attempt compliance with its recommendations.

In 2006, for example, reporters from the British newspaper *The Mail on Sunday* secretly visited two Chinese factories that made Apple iPods, including Foxconn’s flagship factory in Longhua, Shenzhen.<sup>50</sup> *The Mail* article described harsh working conditions at the Apple suppliers, including long hours, low wages, heavy security, and limited freedom.<sup>51</sup> In 2010 two advocacy groups, China Labor Watch, a New York-based organization founded in 2000, and SACOM (Students and Scholars Against Corporate Misbehavior), a Hong Kong-based organization founded in 2005, highlighted a series of eighteen suicides by workers at Foxconn’s Longhua and Guanlan facilities, including seven suicides in the month of May alone.<sup>52</sup> China Labor Watch, for example,

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<sup>48</sup> *Id.* at 14.

<sup>49</sup> Leslie T. Chang, *The Voices of Chinese Workers*, TED (June 2012), [http://www.ted.com/talks/leslie\\_t\\_chang\\_the\\_voices\\_of\\_china\\_s\\_workers.html](http://www.ted.com/talks/leslie_t_chang_the_voices_of_china_s_workers.html).

<sup>50</sup> *The Stark Reality of iPod’s Chinese Factories*, MAIL ONLINE (Aug. 18, 2006), <http://www.dailymail.co.uk/news/article-401234/The-stark-reality-iPods-Chinese-factories.html>.

<sup>51</sup> *Id.*

<sup>52</sup> *The Tragedy of the Foxconn Sweatshop*, CHINA LABOR WATCH, <http://www.chinalaborwatch.org/pro/proshow-98.html> (last visited Aug. 1, 2013); *Statements on Foxconn’s Decision to Increase Wages and to Stop Suicide*, CHINA LABOR WATCH, <http://www.chinalaborwatch.org/pro/proshow-95.html> (last visited Aug. 1, 2013);



concluded that, “Clearly, workers’ rights are trampled for the sake of profits at Foxconn, and Foxconn is indeed a sweatshop.”<sup>53</sup> The suicides were reported worldwide.<sup>54</sup>

Apple’s 2011 Progress Report included a separate two-page section, “Responding to Suicides at Foxconn,” which described a meeting with Foxconn’s CEO, Taiwanese billionaire Terry Gou, to address suicides; the hiring of psychological counselors; the establishment of a 24-hour care center; and “even attaching large nets to the factory building to prevent impulsive suicide.”<sup>55</sup> Apple concluded that Foxconn’s response “had definitely saved lives.”<sup>56</sup> Whatever its effectiveness, attaching nets to buildings to catch suicide jumpers was a public relations disaster, attracting the ridicule of a wider range of commentators, including Jon Stewart and Stephen Colbert.<sup>57</sup>

China Labor Watch also highlighted the death in 2010 of an engineer at the Guanlan facility who had reportedly been “working the night shift for more than a month straight, sometimes working 24 hours non-stop.”<sup>58</sup> Calling this “yet another illustration of the extreme overtime work and overwhelming pressures forced upon Foxconn employees,” China Labor Watch urged Foxconn to eliminate illegal overtime, “reduce the pressures and strains afflicting workers on its production lines,” allow for the election of a trade union that represents the interests of workers and allow workers to sit to work.<sup>59</sup>

In addition, in 2011, shortly after SACOM had issued a report complaining that Foxconn had begun production at the Chengdu factory

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*Another Suicide Case at Foxconn Reveals the Predicament of Worker Remains*, STUDENTS & SCHOLARS AGAINST CORPORATE MISBEHAVIOR (SACOM) (Nov. 2010), <http://sacom.hk/wp-content/uploads/2010/11/20101112-statement-on-pay-rise-at-foxconn.pdf>.

<sup>53</sup> *The Tragedy of the Foxconn Sweatshop*, *supra* note 52.

<sup>54</sup> E.g., David Barboza, *After Suicides, Scrutiny of China’s Grim Factories*, N.Y. TIMES (June 6, 2010), <http://www.nytimes.com/2010/06/07/business/global/07suicide.html>; Tania Branigan, *Latest Foxconn Suicide Raises Concern over Factory Life in China*, THE GUARDIAN (May 17, 2010), <http://www.guardian.co.uk/world/2010/may/17/foxconn-suicide-china-factory-life>.

<sup>55</sup> *Supplier Progress Report 2011*, *supra* note 32, at 19.

<sup>56</sup> *Id.* at 18–19.

<sup>57</sup> See *Fear Factory*, THE DAILY SHOW WITH JON STEWART (Jan. 16, 2012), <http://www.thedailyshow.com/watch/mon-january-16-2012/fear.factory>; Charles Taylor & Naomi Campbell, *Foxconn*, THE COLBERT REPORT (June 2, 2010), <http://www.colbertnation.com/the-colbert-report-videos/310025/june-02-2010/tip-wag--foxconn--charles-taylor--naomi-campbell>.

<sup>58</sup> *Another Foxconn Worker Died of Fatigue*, CHINA LABOR WATCH, <http://www.chinalaborwatch.org/pro/proshow-96.html> (last visited Aug. 1, 2013).

<sup>59</sup> *Id.*

before construction was complete and reporting employee complaints that the air was “full of aluminum dust,” an explosion at Chengdu, caused by aluminum dust, killed three workers and injured fifteen.<sup>60</sup> This too generated wide publicity.<sup>61</sup>

In late January 2012, *the New York Times* published a lengthy front-page article detailing conditions at Apple’s supplier factories in China and describing the “human cost” of manufacturing Apple products, including lives lost.<sup>62</sup> The *Times* outlined Apple’s history of efforts to ensure compliance with its Supplier Code of Conduct and highlighted the tension between Apple’s desires to improve factory conditions and to produce new products quickly and at low cost.<sup>63</sup>

Not long after Apple learned of the upcoming *Times* piece, Apple for the first time published the names of its largest suppliers.<sup>64</sup> At the same time, it announced that it had become the first technology company to join the FLA.<sup>65</sup> Shortly thereafter, it also reported that the FLA would be inspecting three Foxconn factories in Shenzhen and Chengdu.<sup>66</sup> Despite calling in an independent third party to assess these three facilities, Apple has continued its own audit program—one of the requirements of membership in the FLA—and has expanded the number of suppliers that it has audited.<sup>67</sup>

### III The FLA’s Investigation of the Three Foxconn Facilities

The level of detail in the FLA’s reports on the three Foxconn facilities is surprisingly generous and makes clear that the FLA gathered an enormous amount of information about the three facilities during the

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<sup>60</sup> *Foxconn and Apple Fail to Fulfill Promises: Predicaments of Workers after the Suicides*, SACOM, 14 (May 2011), [http://sacom.hk/wp-content/uploads/2011/05/2011-05-06\\_foxconn-and-apple-fail-to-fulfill-promises1.pdf](http://sacom.hk/wp-content/uploads/2011/05/2011-05-06_foxconn-and-apple-fail-to-fulfill-promises1.pdf).

<sup>61</sup> David Barboza, *Explosion at Apple Supplier Caused by Dust, China Says*, N.Y. TIMES (May 24, 2011), <http://www.nytimes.com/2011/05/25/technology/25foxconn.html>; James T. Areddy & Yukari Iwatani Kane, *Explosion Kills 3 at Foxconn Plant*, WALL ST. J. (May 21, 2011), <http://online.wsj.com/article/SB10001424052748704816604576335262591187804.html>.

<sup>62</sup> Duhigg & Barboza, *supra* note 30.

<sup>63</sup> *Id.*

<sup>64</sup> *Supplier Progress Report 2012*, *supra* note 33, at 3 (noting the simultaneous publishing of 156 suppliers).

<sup>65</sup> *Id.*

<sup>66</sup> Apple Press Info, *Fair Labor Association Begins Inspections of Foxconn*, APPLE INC. (Feb. 13, 2012), <http://www.apple.com/pr/library/2012/02/13Fair-Labor-Association-Begins-Inspections-of-Foxconn.html>.

<sup>67</sup> *See Supplier Progress Reports 2007–2013*, *supra* note 27.

course of its investigation. As stated by the FLA, its investigation was “more than an audit for compliance;” it was “best described as an in-depth, top-down and bottom-up examination of the entire operation.”<sup>68</sup>

The initial report, issued by the FLA in March 2012, includes five appendices and totals 197 pages. The information in the report was gathered through inspections, employee interviews, focus groups with numerous employees and managers, a 35,000-employee survey consisting of 163 questions, and review of written policies and employment records.<sup>69</sup> The published materials include the survey questions and tabulated answers but not summaries of the interviews. The initial report was followed by a status report, issued in August 2012, and another status report, issued in May 2013, both of which include detailed charts tabulating the progress made by each of the three facilities on the implementation of the FLA’s 360 recommendations.<sup>70</sup> All of these reports were made public.

By contrast, the typical audit of an Asian supplier is conducted in virtual secrecy. As noted above, Apple’s annual reports on its own supplier audits, including the report issued in January 2013, have been remarkably uninformative as to individual facilities, providing the total number of audits and the number of violations by category but no identification of the supplier or the facility that committed the violation, nor any general information about the working conditions at any location.<sup>71</sup> Most other companies, such as Nike, revealed even less.<sup>72</sup> Even the audit reports that the FLA posts on its website, mostly relating to the apparel industry, are neither lengthy nor detailed.<sup>73</sup> As noted by Free2Work, an organization that seeks to evaluate working conditions of suppliers for the apparel industry, most audit reports provide so little

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<sup>68</sup> *March 2012 Report*, *supra* note 6, at 1.

<sup>69</sup> *Id.* at 6; *Independent Investigation of Apple Supplier, Foxconn* app. 2, FAIR LAB. ASS’N, 1–2 (Mar. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/appendix\\_2\\_scope\\_workforce\\_satisfaction\\_report.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/appendix_2_scope_workforce_satisfaction_report.pdf) [hereinafter *March 2012 Report* app. 2]. The FLA audit was based on a 163-question survey completed by 35,000 employees; 54 focus groups involving 543 employees; on-site interviews with 1,141 employees; off-site interviews with 183 employees; interviews with 108 managers; on-site inspection; and a review of written policies, time and payroll records covering 12 months.

<sup>70</sup> *August 2012 Status Report*, *supra* note 9, at 6; *May 2013 Status Report*, *supra* note 10, at 3.

<sup>71</sup> *See Supplier Progress Reports 2007–2013*, *supra* note 27.

<sup>72</sup> *E.g., Reporting and Governance*, NIKE, INC., <http://nikeinc.com/pages/reporting-governance> (last visited Aug. 22, 2013).

<sup>73</sup> *See generally* Tracking Charts, *supra* note 19.

meaningful information that no assessment can be made of the working conditions:

The overwhelming majority of companies are not transparent with working condition information. Except in a few cases, companies have not made monitoring reports, corrective action plans, or line-by-line statistics on the implementation of code standards available to the public. Without this information, a direct analysis of the impact of these management systems on child labor, forced labor and many broader worker rights is not possible.<sup>74</sup>

Because the FLA reports are so much more detailed than the usual audit, they provide a unique opportunity to understand the workforce at these three Foxconn facilities, including the working conditions and employee opinions about their employment. And unlike the reports criticized by Free2work, the detailed background information about the facilities and the workers in the FLA reports permits a critical assessment of the FLA findings and its proposed remedies.

### A *The FLA's Portrait of Foxconn*

The data in the FLA report, including the very helpful questionnaire answered by 35,000 employees, paints a detailed picture of the three Foxconn facilities.

All three Foxconn facilities audited by the FLA are final assembly plants: two in the Longhua and Guanlan districts of Shenzhen (a special economic development zone near Hong Kong) and one in the relatively new economic development zone in the city of Chengdu, located in Sichuan Province in Western China.<sup>75</sup> These are three of Apple's fourteen final assembly plants in China, seven of which are operated by Foxconn.<sup>76</sup> All three facilities had been the subject of previous press reports.<sup>77</sup> The massive Longhua complex, also known as Foxconn City, has been Foxconn's flagship, employing over 400,000 employees on behalf of many technology companies in addition to Apple.<sup>78</sup> Longhua

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<sup>74</sup> Haley Wrinkle, Elin Eriksson & Adrienne Lee, *Apparel Industry Trends: From Farm to Factory*, FREE2WORK, 1 (2012), <http://www.free2work.org/trends/apparel/Apparel-Industry-Trends-2012.pdf>.

<sup>75</sup> *March 2012 Report* app. 2, *supra* note 69, at 1.

<sup>76</sup> *Our Suppliers*, *supra* note 28.

<sup>77</sup> *See infra* Part I.B.1.

<sup>78</sup> *See* Pun Ngai & Jenny Chan, *Global Capital, the State, and Chinese Workers: The Foxconn Experience*, MODERN CHINA 38(4) 383, 392 (2012).

was one of the facilities infiltrated by *Mail on Sunday* reporters in 2006.<sup>79</sup> Longhua and Guanlan were the sites where most of the worker suicides occurred in 2010, and where Foxconn set up suicide prevention nets.<sup>80</sup> The Chengdu facility, which was established in 2010, was the site of the deadly explosion in 2011 that killed several workers.<sup>81</sup>

All three facilities are huge, with 288,000 employees working on Apple products alone.<sup>82</sup> The FLA assessment focused on only one of the business units handling Apple products at each facility, but each of these units is enormous: 73,004 employees in the integrated Digital Product Business Group (iDPBG) at the Guanlan facility in Shenzhen, which assembles iPhones and iPods;<sup>83</sup> 66,680 employees in the innovation Digital Systems Business Group (iDSBG) at the Longhua facility in Shenzhen, which assembles iPads and Macs;<sup>84</sup> and 38,393 employees in the Super Precision Mechanical Business Group (SPMBG) in Chengdu, which assembles iPads and manufactures components.<sup>85</sup> More Foxconn employees work on Apple products at these three facilities alone than the combined U.S. workforces of Microsoft, Hewlett Packard, Google, Facebook and Apple.

Foxconn employees at these plants are not a cross section of the Chinese workforce. They are very young, and most have recently emigrated from rural China. The 35,000 employees at the three facilities who participated in the FLA survey are, on average, just 23 years old with less than two years tenure.<sup>86</sup> More are male (64%) than female (36%).<sup>87</sup> Most are Han Chinese (80%), single (79%), come from a village (64%) or small town (22%), did not complete college (87%) and list themselves as migrants (72%).<sup>88</sup> “Migrant” is a term with a special meaning in China, since Chinese citizens need governmental permission to change their permanent residency location or legally work outside it, and rights to a number of government benefits, including access to medical care, certain housing and free education for their children are

<sup>79</sup> See *The Stark Reality of iPod's Chinese Factories*, *supra* note 50.

<sup>80</sup> See Ngai & Chan, *supra* note 78, at 393, 404–05.

<sup>81</sup> See *id.*

<sup>82</sup> *March 2012 Report* app. 2, *supra* note 69, at 1.

<sup>83</sup> *March 2012 Report*, *supra* note 6, at 4.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *March 2012 Report* app. 2, *supra* note 69, at 3.

<sup>87</sup> *Id.*; *Independent Investigation of Apple Supplier, Foxconn* app. 3, FAIR LAB. ASS'N, 60 (Mar. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/appendix\\_3\\_scope\\_survey\\_data.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/appendix_3_scope_survey_data.pdf) [hereinafter *March 2012 Report* app. 3].

<sup>88</sup> *March 2012 Report* app. 3, *supra* note 87, at 61–65.

limited to permanent residents.<sup>89</sup> Nearly all the employees in the Shenzhen facilities (95%) list themselves as migrants (by Foxconn records, 99% of the workers in Shenzhen are migrants).<sup>90</sup> Fewer employees in Chengdu describe themselves as migrants (47%), but this lower number is because many have migrated from villages in Sichuan Province to its capital, Chengdu, and do not meet the technical definition of a migrant worker.<sup>91</sup>

The rural origins of the workforce contrast with the highly urbanized locations of their workplace. The Guanlan and Longhua facilities in Shenzhen lie in the Pearl River Delta of Guangdong Province. Guangdong Province's population exceeds 100 million, ranking it the third most populous sub-national unit in the world, and the Pearl River Delta is the most densely populated area in Guangdong Province, including 10 million inhabitants in Shenzhen and another 12 million in the nearby city of Guangzhou.<sup>92</sup> Chengdu is no less urbanized. The city and its immediate environs in western China have a population of 14 million, and the population of Sichuan Province exceeds 80 million.<sup>93</sup> Yet only 2% of the surveyed employees grew up in a "big city," and less than 3% come from Guangdong Province.<sup>94</sup> Forty-three percent come from Sichuan Province.<sup>95</sup>

The survey reveals that half the employees live in company dormitories (65% in Chengdu and about 30% in Shenzhen).<sup>96</sup> Asked which three items they would put on a wish list, most pick higher salaries, higher bonuses and better food, valuing them above working hours, rest days, break arrangements, living conditions in the dormitories,

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<sup>89</sup> According to the All-China Women's Federation, census data from 2010 indicated that 61 million children in rural areas—38% of the total number of children in those areas—have been "left behind" so that they could attend school after their parents migrated to urban areas for employment. He Dan & Xiang Mingchao, *No Longer at Home in Their Hometowns*, CHINA DAILY (May 30, 2013), [http://www.chinadaily.com.cn/cndy/2013-05/30/content\\_16545823.htm](http://www.chinadaily.com.cn/cndy/2013-05/30/content_16545823.htm).

<sup>90</sup> *March 2012 Report*, *supra* note 6, at 5, 9; *March 2012 Report* app. 2, *supra* note 69, at 3.

<sup>91</sup> *March 2012 Report* app. 2, *supra* note 69, at 3, 13.

<sup>92</sup> See *Overview*, SHENZHEN GOVERNMENT ONLINE, <http://english.sz.gov.cn/gi/> (last visited Aug. 22, 2013); *Guangzhou*, WIKIPEDIA, [http://en.wikipedia.org/wiki/Guangzhou#cite\\_note-7](http://en.wikipedia.org/wiki/Guangzhou#cite_note-7) (last visited Aug. 1, 2013).

<sup>93</sup> See *Chengdu*, WIKIPEDIA, <http://en.wikipedia.org/wiki/Chengdu> (last visited Aug. 1, 2013); *Sichuan 2004—A Year in Review*, CHINA.ORG.CN, <http://www.china.org.cn/english/features/ProvinceView/156637.htm> (last visited Aug. 1, 2013).

<sup>94</sup> *March 2012 Report* app. 3, *supra* note 87, at 61, 63.

<sup>95</sup> *Id.* at 63.

<sup>96</sup> *Id.* at 12; *March 2012 Report* app. 2, *supra* note 69, at 3.

cleanliness of toilets and “the way my supervisor talks to me.”<sup>97</sup> The company food earns particular disdain. Although the quantity of food is generally ok, 71% disagree that the company serves “good food,” with 45% disagreeing “completely.”<sup>98</sup>

Foxconn employees at these three facilities do not suffer from some of the abuses that sometimes occur elsewhere in China or at suppliers in other Asian countries. Wages are paid on time, the base rate exceeds the applicable minimum wage, and overtime is paid at a premium rate.<sup>99</sup> After an initial six-month probationary period, a written employment contract provides employees with a three-year term, as required by the China Labor Contract Law.<sup>100</sup> Nearly all say they received a copy of their employment contract (88%) and an employee handbook (91%) and that they were “clearly” informed at the time of hire on how their wages would be calculated (73%), the policy on working hours (65%), their production target (59%), and factory rules (62%).<sup>101</sup> Fewer (42%) thought the explanation of benefits and subsidies was clear.<sup>102</sup> The employees are represented by a union, and a written union contract exists (although its contents are nowhere described in the report).<sup>103</sup> All employees, including the migrant workers, are Chinese citizens.<sup>104</sup>

For most employees (66%), it is “absolutely true” that they have “good friends at work.”<sup>105</sup> Few count on the union. Most (65%) would talk to their supervisor if they experience a problem at work; few (14%) would talk to the worker representative.<sup>106</sup> If unhappy or stressed, most would talk to a work colleague (53%) or a family member (46%); few would speak to a supervisor (20%) and almost none to a dorm manager

<sup>97</sup> *March 2012 Report* app. 2, *supra* note 69, at 14; *March 2012 Report* app. 3, *supra* note 87, at 50–55.

<sup>98</sup> *March 2012 Report* app. 2, *supra* note 69, at 5–6; *March 2012 Report* app. 3, *supra* note 87, at 11.

<sup>99</sup> *March 2012 Report*, *supra* note 6, at 9.

<sup>100</sup> See, e.g., *Independent Investigation of Apple Supplier, Foxconn* app. 1, pt. 1, FAIR LAB. ASS’N, 1 (Mar. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/appendix\\_1.1\\_sci\\_findings\\_guanlan.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/appendix_1.1_sci_findings_guanlan.pdf) [hereinafter *March 2012 Report* app. 1.1].

<sup>101</sup> *March 2012 Report* app. 2, *supra* note 69, at 7–8; *March 2012 Report* app. 3, *supra* note 87, at 19–22, 68.

<sup>102</sup> *March 2012 Report* app. 3, *supra* note 87, at 22.

<sup>103</sup> See *March 2012 Report* app. 1.1, *supra* note 100, at 9; *Independent Investigation of Apple Supplier, Foxconn* app. 1, pt. 3, FAIR LAB. ASS’N, 8 (Mar. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/appendix\\_1.3\\_sci\\_findings\\_chengdu.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/appendix_1.3_sci_findings_chengdu.pdf) [hereinafter *March 2012 Report* app. 1.3].

<sup>104</sup> See *March 2012 Report* app. 3, *supra* note 87, at 66–67.

<sup>105</sup> *Id.* at 33; *March 2012 Report* app. 2, *supra* note 69, at 16.

<sup>106</sup> *March 2012 Report* app. 2, *supra* note 69, at 8; *March 2012 Report* app. 3, *supra* note 87, at 25–31.

(1%).<sup>107</sup> The most common ailments at the end of the workday are neck and back pain.<sup>108</sup>

The initial report tells little about the pay system. According to the report, the starting wage at the Shenzhen facilities is RMB1800 (\$286) per month, which is 20% higher than the RMB1500 (\$238) monthly minimum wage in Shenzhen, and it increases to RMB2200 (\$349) at the end of the six-month probationary period.<sup>109</sup> In U.S. dollars, workers on the production lines reported their average monthly pay as \$384; supervisors reported \$556; and management reported \$942.<sup>110</sup> Combined, the average monthly salary reported by the survey respondents was RMB2537 (about \$400).<sup>111</sup> But it varies by facility, with an average of \$358 in Chengdu, \$427 in Longhua and \$456 in Guanlan.<sup>112</sup>

Although employees are assigned piece rates, it does not appear that pay is calculated on the basis of individual production.<sup>113</sup> The report also does not attempt to identify the impact of overtime pay on employees' earnings, nor the extent to which monthly earnings fluctuate as changing production demands impact the need for overtime work. But the concern of employees over their pay is clear. About two-thirds describe their earnings as *not* meeting basic needs.<sup>114</sup> This too varies by facility, with the most unhappiness about pay in Chengdu, where 72% say it does not meet basic needs.<sup>115</sup>

The majority reported that they met company expectations: 76% said that they made "few" or nearly no mistakes, and 64% denied having to re-do their work or correct mistakes.<sup>116</sup> Nearly all of the employees answering questions about piece rates said they knew their assigned rate exactly "sometimes" or "always," and 84% of those who answered said they achieved or exceeded their piece rate.<sup>117</sup>

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<sup>107</sup> *March 2012 Report* app. 3, *supra* note 87, at 35–38.

<sup>108</sup> *Id.* at 16–19; *March 2012 Report* app. 2, *supra* note 69, at 7.

<sup>109</sup> *March 2012 Report*, *supra* note 6, at 9. Numbers are based on an exchange rate of 6.30 Chinese renminbi per 1 U.S. dollar, the exchange rate as of March 31, 2012. As of June 15, 2013, the exchange rate was 6.13 RMB/1 USD.

<sup>110</sup> *March 2012 Report* app. 2, *supra* note 69, at 5.

<sup>111</sup> *Id.* at 4.

<sup>112</sup> *March 2012 Report*, *supra* note 6, at 9.

<sup>113</sup> *March 2012 Report* app. 3, *supra* note 87, at 56.

<sup>114</sup> *Id.* at 8; *March 2012 Report* app. 2, *supra* note 69, at 5.

<sup>115</sup> *March 2012 Report* app. 2, *supra* note 69, at 5.

<sup>116</sup> *March 2012 Report* app. 3, *supra* note 87, at 57–58.

<sup>117</sup> *Id.* at 56–57.



Long hours are the norm. The average number of hours worked per week in the three months prior to the survey was 56; the most hours worked in one week in the prior three months was, on average, 61, and half the workers reported working 11 or more days in a row without an off day.<sup>118</sup> But less than 20% thought their hours were excessive, and 34% wanted more hours.<sup>119</sup> Frequent work on the night shift was reported by 67%.<sup>120</sup>

About 15% of surveyed employees did not plan to stay at the factory for the next two years, and approximately the same number planned to leave within two months.<sup>121</sup> Low wages was the most cited reason for those planning to leave.<sup>122</sup> The presence of family or friends in the workforce was the most cited reason for those intending to stay.<sup>123</sup>

### *B Analysis of the FLA Investigation*

The FLA investigation gathered an enormous amount of information about the three Foxconn facilities, as is apparent from the above description of the employees and their working conditions. Significantly, the FLA made much of the data public. The detail included in the FLA reports on Foxconn goes far beyond data previously released by either Apple or Foxconn and even exceeds the detail usually found in the FLA's assessment reports of other suppliers. Perhaps the most striking and important features of the audit are the thoroughness of the investigation and the fact that much of the information was made public.

But the FLA investigation failed to examine three important issues: the FLA did not examine data on employee turnover; it did not look into issues of sexual harassment or gender discrimination; and it failed to analyze the extensive survey data to see if answers differed by sex, tenure or job classification.

First, although the FLA recognized that high worker turnover was a significant problem at the three Foxconn facilities and identified it as a "root cause" of excessive hours that employees are required to work,<sup>124</sup> the report contains no analysis of terminations: no information as to the number of employees terminating during each of the last several years;

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<sup>118</sup> *March 2012 Report* app. 2, *supra* note 69, at 4.

<sup>119</sup> *Id.* at 4–5.

<sup>120</sup> *March 2012 Report* app. 3, *supra* note 87, at 67.

<sup>121</sup> *Id.* at 39–40, 45.

<sup>122</sup> *Id.* at 46.

<sup>123</sup> *Id.* at 40.

<sup>124</sup> *March 2012 Report*, *supra* note 6, at 2.

no breakdown of voluntary vs. involuntary terminations, no breakdown of terminations by length of service, job category (managers, engineers and workers) or gender and no analysis of whether the termination rate has changed over time. Since the 163-question survey was completed only by current employees, it also provides no information on reasons why employees voluntarily terminate their employment, where employees go after leaving Foxconn (whether to other employers in the Pearl River Delta or Chengdu, or back to their villages or towns) and to what extent their experience at Foxconn met their needs and expectations.

The March 2012 report similarly lacks hiring data, including how many applicants Foxconn receives for each opening, and it contains no description of how Foxconn recruits new employees and what selection criteria are used in hiring. Nothing in the reports, for example, indicates how many employees had prior experience at other factories. Nor does the report address promotions, including whether any production workers are ever promoted to first level manager positions.

Lacking information as to hiring, promotions or terminations, the report presents a static picture of the employment relationship, without any sense of how employees progress through the system or why they leave. This is a critical deficiency. In the absence of any information that illuminates the reasons for the high turnover rate, for example, it is impossible to assess whether any of the changes recommended by the FLA are likely to result in longer employee tenure. The failure to collect data on and analyze Foxconn's turnover rate thus handicaps future assessment efforts.

Second, the report does not address gender discrimination and sexual harassment. Both the FLA Workplace Code and Apple's Supplier Code of Conduct prohibit sexual harassment and discrimination based on gender or sexual orientation.<sup>125</sup> Yet the report makes no effort to identify whether women are fairly represented in higher paid positions or in engineering or supervisory positions, or whether female employees choose to terminate their employment sooner, or later, than their male counterparts. Surprisingly, the term sexual harassment does not appear in the FLA report. A lengthy employee survey in the United States also would surely include questions designed to reveal whether sexual harassment was perceived to be a problem. Despite growing attention to

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<sup>125</sup> *FLA Workplace Code of Conduct*, *supra* note 12; *Apple Supplier Code of Conduct*, *supra* note 26, at 2.

the prevalence of sexual harassment in Chinese workplaces,<sup>126</sup> no questions on the FLA survey probed this subject, and the audit report has no findings on this issue.

Finally, with only a couple of exceptions, the survey results are tabulated for all respondents, without showing whether the answers differ by sex, length of service or employee classification. If the responses of managers as to compensation or communication of company policies differ from those of workers, for example, the amalgamated tabulation of the responses may be misleading.

#### **IV Analysis of the FLA'S Compliance Findings And Its Proposed Remedial Measures**

The FLA findings address a number of issues that are likely to have a significant impact on working conditions of employees, such as excessive hours, health and safety standards and compensation levels. Overall, the FLA faulted the three Foxconn facilities for “serious and pressing non-compliances” with the FLA Code and PRC law.<sup>127</sup> According to the March 2012 report, the numerous deficiencies involved fifty issues, covering a wide range from the compensability of short morning meetings that occur before employees clock in for work to exit doors in dormitories operated by third-parties to the membership of union committees to eligibility of employees for social insurance under PRC law.<sup>128</sup> In devising remedial recommendations, the FLA prides itself on “go[ing] beyond identifying labor problems by uncovering the sources of these problems, and how best to resolve them.”<sup>129</sup> Many of the FLA findings are therefore supported by a “root cause analysis,” which serves as the basis for identifying remedial actions that will “effect change” and “increase the chances of sustainable improvement of working

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<sup>126</sup> See Roger Herod, Elizabeth D. MacGillivray & Deirdre Golden, *Global Diversity: Managing and Leveraging Diversity in a Global Workforce, Part IV: China—Other Issues: Gender and sexual harassment*, INTERNATIONAL HUMAN RESOURCES GUIDE § 20:31 (updated 2012); Crystal Roberts, *Far From a Harmonious Society: Employment Discrimination in China*, 52 SANTA CLARA L. REV. 1531, 1540 (2012); Timothy Webster, *Ambivalence and Activism: Employment Discrimination in China*, 44 VAND. J. TRANSNAT'L L. 643, 668 (2011); *Sexual Harassment: A Growing Social Problem*, CHINA DAILY (May 20, 2005), [http://www.chinadaily.com.cn/english/doc/2005-05/20/content\\_444316.htm](http://www.chinadaily.com.cn/english/doc/2005-05/20/content_444316.htm).

<sup>127</sup> *March 2012 Report*, *supra* note 69, at 1.

<sup>128</sup> *Id.* at 2; see generally *March 2012 Report* app. 1.1, *supra* note 100; *March 2012 Report* app. 1.2, *supra* note 134; *March 2012 Report* app. 1.3, *supra* note 103.

<sup>129</sup> *March 2012 Report*, *supra* note 6, at 1.

conditions.”<sup>130</sup> The FLA identified 360 specific remedial actions for Foxconn to undertake.<sup>131</sup>

In particular, the FLA report highlighted four problem areas: (1) working hours; (2) health and safety; (3) industrial relations and worker integration and (4) compensation and social security insurance.<sup>132</sup> The report sets forth key findings relating to each of these four problem areas, as well as findings relating to the treatment of interns.<sup>133</sup> In three separate appendices, the report describes all of the FLA findings and recommendations with respect to each facility.<sup>134</sup>

The August 2012 Status Report consists of a three-page summary, a three page appendix on changes in the intern program and a lengthy appendix for each of the three facilities at Guanlan, Longhua and Chengdu. It identifies the progress to date on 360 recommended remedial tasks, roughly one-third of which apply to each of the three facilities. The status report was based on return visits to each of the three facilities in late June and early July 2012 by the same groups that conducted the initial assessments and included a review of records and interviews with managers and workers.<sup>135</sup> The May 2013 Status Report has a five page summary and three appendices, one for each of the three facilities, which list the remaining remedial tasks and the progress observed on the basis of visits in January 2013.<sup>136</sup> According to the FLA, 98% of the recommendations had been implemented by January 2013.<sup>137</sup>

Although many of the remedial recommendations will have a direct and immediate impact on employees, some fail to take account of the realities of employment in China, including the reasons for the high turnover in the Foxconn facilities and the special role of the ACFTU, leaving uncertain the ultimate impact of the proposed reforms. The individual findings and proposed remedial actions are discussed below.

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<sup>130</sup> *Id.* at 6–7.

<sup>131</sup> *August 2012 Status Report*, *supra* note 9, at 1.

<sup>132</sup> *March 2012 Report*, *supra* note 6, at 2–3.

<sup>133</sup> *Id.* at 8–12.

<sup>134</sup> See *March 2012 Report* app. 1.1, *supra* note 100; see *Independent Investigation of Apple Supplier, Foxconn* app. 1, pt. 2, FAIR LAB. ASS’N, (Mar. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/appendix\\_1.2\\_sci\\_findings\\_longhua.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/appendix_1.2_sci_findings_longhua.pdf) [hereinafter *March 2012 Report* app. 1.2]; see *March 2012 Report* app. 1.3, *supra* note 103.

<sup>135</sup> *August 2012 Status Report*, *supra* note 9, at 1.

<sup>136</sup> See *May 2013 Status Report*, *supra* note 10.

<sup>137</sup> *Id.* at 3.

Whatever the impact of the audit on these three Foxconn facilities, the process followed by the FLA is significant. First, by applying the very detailed employment standards of the FLA's Workplace Code of Conduct, as well as the requirements of PRC law, the FLA in effect created a transnational set of employment standards. Second, the commitment of Apple and Foxconn to implement all of the FLA's recommended remedial actions, and to make public the FLA's reports on their performance in implementing the remedies, transforms the FLA audit process into a potential alternative to local enforcement of workplace regulations.

### A Four Key Findings

**Working Hours.** Excessive working hours is the first problem highlighted in the FLA report. This is not surprising. The FLA Workplace Code requires that working hours be capped at 60 hours, as does Apple's Code of Conduct.<sup>138</sup> PRC law, enacted in 2008, goes far beyond this, imposing a stringent cap of 36 overtime hours per month, equivalent to a 49-hour weekly maximum.<sup>139</sup> Further, PRC law requires one 24-hour rest day per week and a 10-15 minute ergonomic break after every two hours of work.<sup>140</sup>

Abuses of all of these requirements were common. In Chengdu, for example, the FLA found that 25% of the employees exceeded the 60-hour limit in June 2011, although only 6% exceeded it in January 2012.<sup>141</sup> In Longhua, "most" employees exceeded 60 weekly hours in early 2011, although only 8% did so in late 2011.<sup>142</sup> Foxconn employees at all three facilities responding to the survey reported to the FLA that they work an average of 56 hours per week and that their highest weekly total of hours during the prior several months was, on average, 61 hours.<sup>143</sup> It appears that Foxconn, like many other employers in China, has simply ignored the 2008 working-hour law in the absence of effective external enforcement mechanisms.

The FLA also determined that employees were frequently required to work seven or more days without a rest day (37% of the workers at

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<sup>138</sup> *March 2012 Report*, *supra* note 6, at 8; *Apple Supplier Code of Conduct*, *supra* note 26, at 2.

<sup>139</sup> *March 2012 Report*, *supra* note 6, at 8.

<sup>140</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 8.

<sup>141</sup> *March 2012 Report* app. 1.3, *supra* note 103, at 6.

<sup>142</sup> *March 2012 Report* app. 1.2, *supra* note 134, at 8.

<sup>143</sup> *March 2012 Report*, *supra* note 6, at 8; *March 2012 Report* app. 2, *supra* note 69, at 4.

Longhua, for example, worked seven or more days without a rest day at least once in a three month period) and that during the workday they were often denied the required ergonomic breaks.<sup>144</sup>

Most of these abuses, although long-standing, should be easy to fix, and the FLA required that Foxconn do so by the end of May 2012. Compliance with the 49-hour cap mandated by Chinese law presents a vexing challenge, however, as discussed further below, and the FLA gave Foxconn an extended deadline for compliance, until July 2013. The FLA did not comment that setting a July 2013 compliance date was, in effect, tolerating Foxconn's continued violation of the 49-hour cap for more than a year.

**Short-Term Fixes.** Shortly after publication of the March 2012 Report, Foxconn took a number of steps to address some of the problems related to working hours. Each of the facilities has an electronic human resources system to record hours, as would be expected in plants that pay tens of thousands of employees on an hourly basis. Yet it appears that none of the plants routinely compiled reports on each employee's weekly hours, programmed their system to prevent overtime in excess of 60 hours or flagged violations of the 60-hour limit. In response to the audit, all three facilities promptly changed their written policies on hours, now requiring that employees not exceed the 60-hour cap, mandating a weekly rest day and instructing floor managers to permit the ergonomic break.<sup>145</sup> The FLA also reported that line leaders had been trained on the policy to provide the required ergonomic breaks and that workers had been informed of the policy through posters, LED displays and training.<sup>146</sup>

All three facilities took steps by May 31, 2012 to enhance their electronic HR systems to monitor weekly hours and ensure compliance with the 60-hour limit, and to implement training programs to educate managers and workers on both the 60-hour restrictions and the weekly rest-day requirement.<sup>147</sup> Perhaps most importantly, all three facilities began to work with Apple's sourcing department to make sure that the

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<sup>144</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 8; *March 2012 Report* app. 1.2, *supra* note 134, at 8.

<sup>145</sup> See *August 2012 Status Report*, *supra* note 9, at 2.

<sup>146</sup> E.g., *Foxconn Verification Status Report* app. 2, FAIR LAB. ASS'N, K95 (Aug. 2012), [http://www.fairlabor.org/sites/default/files/documents/appendix\\_2\\_guanlan\\_verification\\_tracker.xls](http://www.fairlabor.org/sites/default/files/documents/appendix_2_guanlan_verification_tracker.xls) [hereinafter *August 2012 Status Report* app. 2].

<sup>147</sup> *August 2012 Status Report* app. 2, *supra* note 146, at K35–36; *Foxconn Verification Status Report* app. 4, FAIR LAB. ASS'N, K32 (Aug. 2012), [http://www.fairlabor.org/sites/default/files/documents/appendix\\_4\\_chengdu\\_verification\\_tracker.xls](http://www.fairlabor.org/sites/default/files/documents/appendix_4_chengdu_verification_tracker.xls) [hereinafter *August 2012 Status Report* app.4].

weekly production plan could be accomplished with their current workforce and within the 60-hour limit.<sup>148</sup>

Based on a review of records and interviews with managers and workers, the FLA determined in June 2012 that the three facilities were complying with the 60-hour limit.<sup>149</sup> In January 2013, Apple announced a worldwide “average of 92 percent compliance with a maximum 60-hour work week” and that it was tracking weekly hours at many of its suppliers so that it would be aware of any abuses of this standard on a timely basis.<sup>150</sup>

Surprisingly, however, the FLA noted in May 2013 that there had been violations of the 60-hour limit at Guanlan during three separate weeks in September and October 2012.<sup>151</sup> Despite its interest in “root causes,” the FLA did not attempt to explain how these violations occurred in the face of the steps previously taken to ensure compliance with the 60-hour limit.

Securing compliance with the 60-hour weekly limit, the weekly rest day, and the ergonomic break requirements is an important, although long-overdue, achievement that should improve working conditions. Despite years of audits by Apple, the prominence of Foxconn in its supply chain and the fact that the Longhua facility had been a target of the 2006 *Mail on Sunday* expose,<sup>152</sup> Apple had not obtained compliance with these standards before joining the FLA. Apple’s role is critical; although the report does not say so, it is likely that the reason for the long history of work hour violations is Apple’s production demands, and it is doubtful that the factories will consistently comply with the 60-hour limit unless Apple makes clear that it values such compliance, even where compliance results in failure to meet Apple’s production needs.

**Long-Term Remedies.** The FLA gave Foxconn an extended period of more than a year to comply with the 36-hour monthly cap on overtime under PRC law. A longer period for compliance with this requirement makes sense in light of at least two significant challenges facing Foxconn: how to meet production requirements with reduced overtime hours and how to address workers’ concerns about the loss of income that would result from their working fewer hours at premium

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<sup>148</sup> *August 2012 Status Report* app. 2, *supra* note 146, at K40.

<sup>149</sup> *E.g.*, *August 2012 Status Report* app. 2, *supra* note 146, at K37.

<sup>150</sup> *Supplier Progress Report 2013*, *supra* note 28, at 6.

<sup>151</sup> *May 2013 Status Report*, *supra* note 10, at 5.

<sup>152</sup> *See supra* Part I.B.

rates. But even with this extended deadline, the FLA does not provide clear solutions to enable Foxconn to meet these challenges. As a result, the FLA identified compliance with the Chinese overtime limits as the “most challenging action item” facing Foxconn.<sup>153</sup>

The FLA identified numerous “root causes” for Foxconn’s failure to comply with the overtime limits under the FLA Code and the stricter requirements under PRC law:

- High turnover rate results in decreased levels of productivity and efficiency, which in turn require workers to work more hours to be able to meet the production targets.
- Labor shortage issues in Guangdong province mean factories need to request active workers to work more overtime (Longhua and Guanlan).
- Production and capacity planning does not include safeguards to prevent workers from working more than 60 hours a week or to ensure that workers are provided a day off within a seven-day work period.
- Although the current starting wage is 20% above the legal minimum wage, workers do not feel it is high enough to meet basic needs and provide some discretionary income. As a result, workers rely on overtime hours.
- Insufficient oversight by buyer to address reasons behind overtime.
- Possible delays due to late delivery of components.
- Tight production schedule due to short lead time and late orders. (Chengdu only)
- Quality issues and reworking hours due to precision and high detail level of product. (Chengdu only)<sup>154</sup>

But it is difficult to see how addressing these “root causes”—improving product quality to reduce the need for re-work; eliminating delays caused by late delivery of components, improving efficiency by reducing employee turnover—will have more than a marginal impact on productivity.

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<sup>153</sup> *May 2013 Status Report*, *supra* note 10, at 5.

<sup>154</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 8; *March 2012 Report* app. 1.2, *supra* note 134, at 8; *March 2012 Report* app. 1.3, *supra* note 103, at 6.



Based on its root cause analysis, the FLA suggested, as one step to satisfy production targets without excessive overtime, that Foxconn might hire “a significant number of extra workers.”<sup>155</sup> The FLA’s suggestion is problematic for at least two reasons. First, hiring a significant number of new employees is no easy task. The FLA noted that it will require “an aggressive program” including the construction of “infrastructure capacities” such as apartments, canteens, recreational facilities and the like to accommodate an even larger workforce, as well as competitive wages and compensation to attract additional workers.<sup>156</sup>

Second, the FLA’s proposal does not address challenges created by fluctuating product demand. As Apple experiences significant spikes in demand for new, wildly popular products, its production requirements to meet that demand may similarly spike. In response, Foxconn may be expected to deliver high volumes of product in unreasonably short time frames, which it does by requiring massive amounts of overtime from its existing workforce. For example, with 288,000 employees working on Apple products at the three plants, the ability to increase average hours from 40 hours per week in one month to 55 hours in the next would be equivalent to adding 108,000 new employees working a 40-hour week. Hiring more employees to ensure compliance with the monthly limit of 36 overtime hours will change how flexibly Foxconn can respond to fluctuating demand. If in fact fluctuating demand is the real problem, then the key may lie in communications between Foxconn and Apple’s sourcing department, and in Apple’s limiting its expectations of product deliveries, even during periods of peak demand, to an amount that can be met with appropriate overtime hours.

The second challenge to prompt compliance with the overtime cap is the opposition of employees at the three facilities to the imposition of any cap that will result in a reduction in their total compensation. The employee surveys conducted by the FLA show that employees are far more concerned about increasing their pay than about reducing their hours, and “in *all* focus group discussions about working hours, employees raised concerns that stricter working hour regulations would lower their income.”<sup>157</sup>

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<sup>155</sup> *March 2012 Report*, *supra* note 6, at 12.

<sup>156</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 9; *March 2012 Report* app. 1.3, *supra* note 103, at 7.

<sup>157</sup> *March 2012 Report*, *supra* note 6, at 8 (emphasis added); *see also* Paul Mozur, *Foxconn Workers Say, ‘Keep Our Overtime,’* WALL ST. J. (Dec. 17, 2012), <http://online.wsj.com/article/SB10001424127887324296604578175040576532024.html>.

To alleviate this concern, the FLA secured Foxconn's agreement to come into "full legal compliance" with the requirements of Chinese law on work hours "while protecting workers' pay."<sup>158</sup> The March 2012 report did not explain how the FLA expected Foxconn to do this, although the lengthy compliance period was perhaps intended to give Foxconn time to devise a strategy for accomplishing it. The May 2013 Status Report, although noting that compliance with the 36 hour cap on overtime is perhaps the "most challenging" item for Foxconn, does not reveal whether Foxconn has devised a plan to "protect workers pay" while reducing their hours.<sup>159</sup>

Meeting the stringent restrictions on employee hours mandated by PRC law, while both protecting employee earnings and satisfying the production demands of Apple, may pose a far more significant challenge for Foxconn and Apple than even the FLA reports acknowledge.

a) *Health and Safety*

The FLA's health and safety assessment was the strongest part of its audit. The sections on health and safety issues in the three appendices on individual facilities are the longest and most detailed.<sup>160</sup> Plainly, the FLA applied an exacting set of safety standards in the audits, and Foxconn had not routinely adhered to these detailed standards. The FLA identified a very large number of safety issues during its review of the three facilities and, for the most part, secured Foxconn's immediate agreement to rectify them. Particular attention was paid to the issue of emergency exits for use in the case of fire, and the corrective efforts are still on going.<sup>161</sup> At Guanlan, this includes analyzing fire drills to identify bottle-necks, reducing the employee population density on some floors, expanding the width of emergency exits and adding cross-building bridges and an external ladder, with a focus on possible evacuation during shift turnovers when population density might be highest.<sup>162</sup> The FLA also paid close attention to the procedures relating to the cutting of

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<sup>158</sup> *March 2012 Report*, *supra* note 6, at 2.

<sup>159</sup> *Id.*; *May 2013 Status Report*, *supra* note 10, at 5.

<sup>160</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 15–30; *March 2012 Report* app. 1.2, *supra* note 134, at 15–28; *See March 2012 Report* app. 1.3, *supra* note 103, at 16–30.

<sup>161</sup> *See, e.g., August 2012 Status Report* app. 2, *supra* note 146, at rows 87–90.

<sup>162</sup> *Second Foxconn Verification Status Report* app. 1, FAIR LAB. ASS'N, T93 (May 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/guanlan\\_secondv\\_a\\_report\\_2-05-2013.xls](http://www.fairlabor.org/sites/default/files/documents/reports/guanlan_secondv_a_report_2-05-2013.xls) [hereinafter *May 2013 Status Report* app. 1].

aluminum, because of the explosion at the Chengdu facility in 2011 caused by aluminum dust.<sup>163</sup>

The FLA did not limit its health and safety review to major issues such as fire evacuation, potentially deadly explosions or structurally unsound buildings. The FLA also considered more mundane issues. For instance, at Guanlan it recorded instances of failure to wear safety shoes, inadequate lock out/tag out procedures, improper use of ear plugs, incomplete Material Safety Data Sheets, inadequate thermal comfort controls, forklift trucks with inoperable rear gear sound alarms and without speed limiting systems, inconsistent color coding of pipes and no fire detectors or sprinklers in the boiler room.<sup>164</sup> At Chengdu it noted that fire drills were performed only once per year, not twice as required by local law, that management was unaware of the benefits of ergonomic improvements, and that the Health, Safety and Environment (HS&E) committee did not meet regularly, and it identified instances where air guns were improperly connected and the production floor was slippery due to leaking lubricants.<sup>165</sup>

As a long-term solution to safety issues, the March 2012 FLA report advocated more worker involvement in developing and monitoring health and safety procedures. Worker involvement in these issues, the FLA stated, is “the first line of defense.”<sup>166</sup> Although this recommendation may accord with modern management theory, and may be especially appropriate in plants with an experienced and technically sophisticated workforce, it is difficult to see how the approach makes sense here. As the FLA acknowledged, the rate at which employees leave the Foxconn facilities “clearly complicates” this approach, for frequent departures make it “difficult to maintain participation in the health and safety committees.”<sup>167</sup> But perhaps a greater complication is that the typical employee—very young, new to the workforce and a recent emigrant from a distant village—is not well-positioned to point out inadequate lock out/tag out procedures, inconsistent color coding of pipes and other shortcomings in the safety procedures in a huge facility where 70,000 employees are assembling sophisticated technology products.

The August 2012 status report, however, makes clear that Foxconn has combined modest efforts to encourage worker involvement (ensuring

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<sup>163</sup> *March 2012 Report*, *supra* note 6, at 2, 11.

<sup>164</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 15, 19, 21, 26.

<sup>165</sup> *E.g.*, *March 2012 Report* app. 1.3, *supra* note 103, at 18, 22, 25, 28.

<sup>166</sup> *March 2012 Report*, *supra* note 6, at 2.

<sup>167</sup> *Id.* at 12.

worker participation in HS&E committees; providing safety and leadership training for such members; and including the committee in some HS&E decisions such as the selection of outside consultants) with a top-down approach. It is moving forward, for example, to update its corporate safety and maintenance policies; test fire detectors, sprinklers and emergency protective gear; and hire consultants to provide employees with health and safety training, perform risk assessments and develop the technical solutions to health and safety issues.<sup>168</sup>

Although the appendices to the March report identified a number of ergonomic improvements that should be made at each facility, and a general failure of management to appreciate the benefits of such improvements, the summary report did not highlight ergonomics as a key issue.<sup>169</sup> But ergonomic issues are important to production line employees. The employee survey revealed that neck and back pain is the most common reported ailment at the end of the workday, and the audit demonstrated that the stools or chairs made available to workers at their workstations were ergonomically deficient.<sup>170</sup> According to the March 2012 Report, the stools have no back support, and the chairs are not adjustable in height and provide inadequate back support.<sup>171</sup> Illumination varies, with some areas too dim and others too bright, and the temperature varies as well.<sup>172</sup> The workstations are poorly organized, and no thought had been given to ergonomic improvements in the tools.<sup>173</sup>

Both the August 2012 and May 2013 status reports correct this lack of emphasis by highlighting ergonomic improvements made by Foxconn, including “changing the design of workers’ equipment to guard against repetitive stress injuries,” and hiring an outside consultant to design ergonomic training, as well as ensuring that workers take the required ergonomic breaks during the workday.<sup>174</sup> Press reports have also focused

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<sup>168</sup> *August 2012 Status Report*, *supra* note 9, at 2.

<sup>169</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 23–25.

<sup>170</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 23–24; *March 2012 Report* app. 1.2, *supra* note 134, at 24; *March 2012 Report* app. 1.3, *supra* note 103, at 16–19; *March 2012 Report* app. 2, *supra* note 69, at 7.

<sup>171</sup> *March 2012 Report* app. 1.2, *supra* note 134, at 24; *March 2012 Report* app. 1.3, *supra* note 103, at 24.

<sup>172</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 23; *March 2012 Report* app. 1.2, *supra* note 134, at 24.

<sup>173</sup> *March 2012 Report* app. 1.3, *supra* note 103, at 25.

<sup>174</sup> *August 2012 Status Report*, *supra* note 9, at 2; *accord May 2013 Status Report*, *supra* note 10, at 4.

on ergonomic changes,<sup>175</sup> and Foxconn has established an ergonomic laboratory to identify other possible improvements.<sup>176</sup>

*b) Industrial Relations and Worker Integration*

An important value underlying the FLA audits is belief in the importance of worker communication, consultation and negotiation and in the independence of unions. But it is commonly understood that the ACFTU, with its monopoly on lawful representation of workers, does not operate like the independent trade unions familiar to Western democracies.<sup>177</sup> “China’s unions remain closely linked to and subject to direction of the Communist Party of China,” and other unions are illegal.<sup>178</sup> In a country where, at least in theory, the Party, the State and the state-owned enterprises all operate on behalf of the workers, the union’s role focuses more on connecting the Party and the workers.<sup>179</sup>

Not surprisingly, and in stark contrast to Apple’s own findings regarding freedom of association, the FLA found employees at the Foxconn facilities had “very limited knowledge of the structure, function and activities of the worker participation bodies” within Foxconn.<sup>180</sup> This included limited knowledge of the role of the union. As is “common” in Chinese factories where the union is present, the FLA found that most members of union committees and other worker participation bodies were members of *management*, or were nominated by management.<sup>181</sup> At the Longhua facility, for example, the chairman of the local branch of the ACFTU was the factory’s Purchasing Project Manager and the vice chairman was the Human Resources supervisor.<sup>182</sup>

The FLA’s March 2012 report recommends that Foxconn create policies that will enable workers to provide input to management; that union committees be comprised of representatives nominated and elected by workers “without management interference;” and that health and

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<sup>175</sup> Keith Bradsher & Charles Duhigg, *Signs of Changes Taking Hold in Electronics Factories in China*, N.Y. TIMES (Dec. 26, 2012), <http://www.nytimes.com/2012/12/27/business/signs-of-changes-taking-hold-in-electronics-factories-in-china.html>.

<sup>176</sup> See, e.g., *August 2012 Status Report* app. 2, *supra* note 146, at H92.

<sup>177</sup> See Sarah Biddulph, *Responding to Industrial Unrest in China: Prospects for Strengthening the Role of Collective Bargaining*, 34 SYDNEY L. REV. 35, 38 (2012).

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *March 2012 Report*, *supra* note 6, at 10.

<sup>181</sup> *March 2012 Report*, *supra* note 6, at 11, 3; *March 2012 Report* app. 1.1, *supra* note 100, at 10; *March 2012 Report* app. 1.2, *supra* note 134, at 10; *March 2012 Report* app. 1.3, *supra* note 103, at 8.

<sup>182</sup> *March 2012 Report* app. 1.2, *supra* note 134, at 10.

safety committees include elected worker representatives.<sup>183</sup> According to the FLA, these form “a detailed set of necessary remedial measures . . . to establish genuine avenues to workers to provide input on company decisions that affect their lives and livelihood.”<sup>184</sup>

Although the May 2013 status report refers to “notable increases in the participation of workers in union committees, and a corresponding decline in management participation” as a result of union elections “to increase the strength of workers representation,” the increase has been modest.<sup>185</sup> From June 2012 to January 2013, worker representation at Guanlan increased from no workers on a committee of 27 to 24 workers on a committee of 62 and Chengdu increased from six workers on a committee of 85 to 33 workers on a committee of 112.<sup>186</sup> According to the FLA, the next elections are scheduled in Chengdu in March 2014 and in Longhua and Guanlan in January 2015.<sup>187</sup>

Even with the modest steps in the direction of greater numbers of workers on union committees, neither the original FLA report nor the status reports consider whether it is realistic to think the change will bring about a fundamental alteration in the decision-making processes at the Foxconn facilities. The March 2012 Report also acknowledges that high employee turnover makes it difficult to achieve employee participation. Moreover, the FLA oddly omits from the March 2012 report the important warning note that it has routinely included when auditing companies in China: that many provisions of PRC law are contrary to “fundamental principles” of freedom of association and that “all” factories in China therefore fall short of satisfying these principles.<sup>188</sup>

Beyond the issue of union representation, two specific recommendations relating to worker participation are especially puzzling. First, the FLA recommended, and Foxconn has already agreed, that every Foxconn employee working on Apple products be given a copy of the collective bargaining agreement (CBA).<sup>189</sup> No mention is made of any information in the CBA that would be helpful to any employees;

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<sup>183</sup> *March 2012 Report*, *supra* note 6, at 3.

<sup>184</sup> *Id.* at 1.

<sup>185</sup> *May 2013 Status Report*, *supra* note 10, at 4.

<sup>186</sup> *Id.* at 4.

<sup>187</sup> *Id.* at 4.

<sup>188</sup> *See, e.g., Independent External Monitoring Report—adidas Group (2009)*, FAIR LAB. ASS’N, 9, <http://fairlabor.org/transparency/tracking-charts> (follow “adidas Group” hyperlink, then follow “530015138H\_China.pdf” hyperlink).

<sup>189</sup> *March 2012 Report*, *supra* note 6, at 3.

significantly, none of the FLA reports relies on, or even cites, a single provision of the CBA. The FLA provides no reason to think that the union would become a vibrant advocate of worker rights if only employees had access to this document. As of August 2012, Foxconn had uploaded the CBA onto its website, posted it on bulletin boards and summarized it in the employee handbook, but had not yet satisfied the odd FLA request that every employee also be given a hard copy.<sup>190</sup>

Second, the FLA recommended that the employee handbooks eliminate the current provisions stating that employees may be fired for engaging in illegal strikes.<sup>191</sup> Foxconn subsequently removed the illegal strike provision from its handbook and engaged in some training of managers on resolving work stoppages.<sup>192</sup> Although noting that strikes are not legal under PRC law, the FLA based this recommendation on the FLA Code, which prohibits such provisions.<sup>193</sup> But the FLA did not urge workers to engage in strikes. Since international standards and Chinese law are diametrically opposed, it is difficult to see how Foxconn is expected to implement the FLA recommendation that “Management should adopt rules for the treatment of workers who engage in any work stoppage ... based on international and Chinese best practices.”<sup>194</sup>

A more promising effort to encourage worker participation involves the once moribund Health Safety and Environmental Committees at each facility. At the direction of the FLA, Foxconn has involved these committees in certain decisions, such as the selection of health and safety consultants, has included workers on the committees and has provided training to the committee members on leadership and communication.<sup>195</sup> But it remains highly uncertain whether any of the efforts to ensure that workers have a voice in decisions affecting their workplace will result in meaningful change.

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<sup>190</sup> *August 2012 Status Report* app. 2, *supra* note 146, at K43; *Foxconn Verification Status Report* app. 3, FAIR LAB. ASS'N, K44 (Aug. 2012), [http://www.fairlabor.org/sites/default/files/documents/appendix\\_3\\_longhua\\_verification\\_tracker.xls](http://www.fairlabor.org/sites/default/files/documents/appendix_3_longhua_verification_tracker.xls) [hereinafter *August 2012 Status Report* app. 3]; *August 2012 Status Report* app. 4, *supra* note 147, at J–K38.

<sup>191</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 11.

<sup>192</sup> *E.g.*, *August 2012 Status Report* app. 2, *supra* note 146, at J48.

<sup>193</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 11.

<sup>194</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 12; *August 2012 Status Report* app. 2, *supra* note 146, at G48.

<sup>195</sup> *August 2012 Status Report* app. 2, *supra* note 146, at J68–69.

c) *Compensation and Social Security Insurance*

The Compensation and Social Security Insurance section of the audit report addresses four issues: low wages, overtime pay, social insurance and the treatment of interns.

**Low Wages.** The FLA survey of 35,000 employees identifies low pay as their primary concern.<sup>196</sup> Since the starting wage exceeds the applicable minimum wages in Shenzhen and Chengdu and pay exceeds the average Chinese wage, this is not a compliance issue, and the FLA's initial report does not suggest otherwise. Still, the FLA promised to "conduct a cost of living study in Shenzhen and Chengdu to assist Foxconn in determining whether worker salaries meet FLA requirements for basic needs, as well as discretionary income."<sup>197</sup> "[G]iven the concerns expressed by workers about whether wages cover their basic needs," the report "recommends a follow-up study to document spending patterns and the actual costs of the components of a basic needs wage."<sup>198</sup> Conspicuously, the report does not say whether Foxconn agrees that such a study is appropriate, or that it will grant pay increases based on input as to worker needs, much less increases designed to provide for discretionary income.

This is perhaps the boldest of the FLA's recommendations because it is plainly designed to push Foxconn (and Apple) to pay higher wages, even if increases are not required to attract workers or to satisfy union demands. Moreover, the FLA makes this push for higher compensation even as it is setting a schedule for substantial reduction in employee hours. The August 2012 and May 2013 Status Reports make no mention of this important initiative, however, and it is unclear whether the FLA has abandoned this effort.

**Overtime Pay.** The FLA found no violations by Foxconn relating to pay, except for three failures to calculate properly compensable working time.

First, *unscheduled* overtime was paid in thirty-minute increments: employees received no extra pay for twenty-nine minutes of unscheduled overtime and were paid extra for only thirty minutes if they worked

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<sup>196</sup> See *March 2012 Report*, *supra* note 6, at 14; *March 2012 Report*, app. 2, *supra* note 69, at 4–5; *March 2012 Report*, *supra* note 87, at 46, 50–55.

<sup>197</sup> *March 2012 Report*, *supra* note 6, at 3.

<sup>198</sup> *Id.* at 12.



fifty-nine minutes of unscheduled overtime.<sup>199</sup> According to FLA, this problem affected 14% of the employees and does not apply to scheduled overtime work.<sup>200</sup> Foxconn agreed to pay overtime in units of fifteen minutes.<sup>201</sup> Second, employees were not paid for required participation in team meetings before they clock in, which typically last about ten minutes. Foxconn agreed to limit these meetings to no more than ten minutes and to compensate employees for them.<sup>202</sup> Third, the FLA found that employees were not paid for required skills-testing and skills improvement training, because management believed that no pay was appropriate if the purpose of the training was to assist the employee.<sup>203</sup>

The August 2012 Status Report verifies that Foxconn corrected each of these deficiencies. This included a change in policy to calculate unscheduled overtime in fifteen-minute increments and a clear differentiation between work-related training, which is to be compensated, and life-skills training, which is both voluntary and non-compensable.<sup>204</sup> Foxconn's new policy is to schedule trainings and meetings during normal working time and to pay overtime if such meetings or trainings take place outside of those hours.<sup>205</sup> Foxconn also included revised written policies and training for both managers and workers on the new policies.<sup>206</sup>

By itself, each of these changes is modest, but the principle underlying these changes—workers should be paid for all their work—is important. In addition, the impact of these changes in conjunction with the enforcement of overtime caps will likely be that each worker has fewer productive work hours each day, further affecting Foxconn's ability to meet production requirements without fundamental changes to its operations.

**Social Insurance.** The Social Insurance Law of 2007 mandates health, accident, social security, unemployment and maternity coverage. The FLA identified a structural problem: all of these social insurance programs were both funded (through employer and employee

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<sup>199</sup> *Id.* at 3, 9.

<sup>200</sup> *Id.* at 3.

<sup>201</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 4; *March 2012 Report* app. 1.2, *supra* note 134, at 4; *March 2012 Report* app. 1.3, *supra* note 103, at 4.

<sup>202</sup> *March 2012 Report*, *supra* note 6, at 9; *March 2012 Report* app. 1.3, *supra* note 103, at 3–4.

<sup>203</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 3; *March 2012 Report* app. 1.2, *supra* note 134, at 3.

<sup>204</sup> *E.g.*, *August 2012 Status Report* app. 2, *supra* note 146, at K20.

<sup>205</sup> *E.g.*, *id.* at K18.

<sup>206</sup> *E.g.*, *id.* at K19.

contributions) and administered on a provincial or city basis. As a result, migrant employees generally cannot obtain the benefits under these programs in the province where they work because they are not residents, nor can they receive them once they return to their villages in another province, because no contributions have been made. Transportability is less of a problem at the Chengdu facility, where most workers are from Sichuan Province,<sup>207</sup> and the city of Shenzhen has taken steps to mitigate the problem: the city administers the maternity benefits program to cover migrant workers as well as Shenzhen residents,<sup>208</sup> and, effective January 1, 2013, Shenzhen began allowing all migrant workers in the city access to unemployment insurance coverage.<sup>209</sup> Nevertheless, the FLA secured Foxconn's agreement both to explore private insurance alternatives and to work with local governments to provide for transportability of benefits.<sup>210</sup>

**Interns.** The FLA noted that the treatment of interns at Chinese factories has been a major concern for external stakeholders.<sup>211</sup> Although interns in China are paid for their work (unlike in the United States, where the term "internship" is generally used to refer to an unpaid position), PRC law does not classify interns as employees and prohibits them from working more than eight hours per day, five days per week.<sup>212</sup> The Chinese Ministry of Education reports that eight million vocational students work at factories in China each year.<sup>213</sup> These interns from vocational schools often come to a plant as a group, together with a teacher.<sup>214</sup> The press and advocacy groups have reported complaints by students that their participation was coerced, including allegations that local governments shut down vocational schools to assist local factories confronting labor shortages and assertions that vocational schools receive substantial payments for funneling vocational students to factories.<sup>215</sup>

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<sup>207</sup> *March 2012 Report*, *supra* note 6, at 9.

<sup>208</sup> *Id.*

<sup>209</sup> *August 2012 Status Report*, *supra* note 9, at 2.

<sup>210</sup> *March 2012 Report*, *supra* note 6, at 12.

<sup>211</sup> *Id.* at 9.

<sup>212</sup> *Id.* at 10. The FLA noted that Guangdong Province also has regulations relating to the employment of interns but did not indicate how these regulations bear on the assessment. See *March 2012 Report* app. 1.1, *supra* note 100, at 7; *March 2012 Report* app. 1.2, *supra* note 134, at 7.

<sup>213</sup> Lucy Hornby, *Use of Student Interns Highlights China Labor Shortage*, REUTERS (Jan. 6, 2013), <http://www.reuters.com/article/2013/01/06/us-china-labour-interns-idUSBRE9050CV20130106>.

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*; *New iPhone, Old Abuses: Have Working Conditions at Foxconn in China Improved?* SACOM, 6 (Sept. 20, 2012), <http://www.scribd.com/doc/106445655/New->

According to the March 2012 report, interns account for nearly 3% of the Foxconn workplace and work an average of 3.5 months, mostly during the summer break from school.<sup>216</sup> The FLA found that Foxconn has routinely permitted interns to work overtime and on the nightshift.<sup>217</sup> But the initial FLA report sets forth no concrete remedial steps to change the internship program.

Surprisingly, however, Foxconn quickly implemented a major change in the program. In a separate appendix, the March FLA report describes the “Foxconn Internship Program Plan,” which includes a dozen general practices endorsed by Foxconn and Apple regarding internships.<sup>218</sup> These practices include ensuring that interns’ wages are fair and above minimum wage, monitoring work hours to ensure compliance with legal limits, developing procedures “so that interns do not ever feel that they are working against their will,” and providing counseling services for interns.<sup>219</sup> According to the August status report, Foxconn will not only comply with PRC law prohibiting interns from working more than 40 hours, it will ensure that in hiring interns, “their qualifications match the practical skill sets they will be acquiring during the tenure of the program.”<sup>220</sup> Foxconn also developed “a tool” to measure the interns’ skills before and after the internship.<sup>221</sup> Although no new interns have been hired since Foxconn revamped its internship program, the FLA verified that the Longhua facility has already instituted a number of improved procedures.<sup>222</sup>

Transforming the intern program at Foxconn from a relatively cheap source of temporary help to an educational experience for the students, if it in fact occurs, would be a remarkable change. But it is not clear whether the plants will scale back their employment of interns under the new program. As of January 2013, neither Chengdu nor

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iPhone-Old-Abuses; see also David Barboza & Charles Duhigg, *China Contractor Again Faces Labor Issues on iPhones*, N.Y. TIMES (Sept. 10, 2012), <http://www.nytimes.com/2012/09/11/technology/foxconn-said-to-use-forced-student-labor-to-make-iphones.html>; Ngai & Chan, *Global Capital*, *supra* note 78, 391–92 (2012).

<sup>216</sup> *March 2012 Report*, *supra* note 6, at 10.

<sup>217</sup> *Id.*

<sup>218</sup> *Independent Investigation of Apple Supplier, Foxconn* app. 5, FAIR LAB. ASS’N, (Mar. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/appendix\\_5\\_internships.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/appendix_5_internships.pdf).

<sup>219</sup> *Id.*

<sup>220</sup> *Foxconn Verification Status Report* app. 1, FAIR LAB. ASS’N, 1 (Aug. 2012), [http://www.fairlabor.org/sites/default/files/documents/reports/appendix1\\_interns\\_final.pdf](http://www.fairlabor.org/sites/default/files/documents/reports/appendix1_interns_final.pdf).

<sup>221</sup> *Id.*

<sup>222</sup> *August 2012 Status Report*, *supra* note 9, at 3.

Longhua had hired any interns since the March 2012 report; only Guanlan had done additional hiring: 400 interns in June 2012, 1000 interns in July 2012 and 17 in September 2012.<sup>223</sup>

In January 2013 Hewlett Packard announced that it too was insisting that its Chinese suppliers implement special procedures governing the employment of students, including assurances that the work be voluntary, that they have access to grievance systems, that their work “complement the primary area of study,” and that the percentage of interns and temporary employees not exceed 20% of the total working for a supplier.<sup>224</sup> This has been the first tangible indication that the FLA audit was having an effect on other multinational companies.

But even as Foxconn was making these changes in the intern programs at Longhua, Guanlan and Chengdu in 2012, the press was reporting complaints by vocational students that they had been forced to work at Foxconn facilities in Zhengzhou and Huai’an in North and East China.<sup>225</sup> Limiting its audit to only three Foxconn facilities, the FLA has not investigated the extent to which noncompliance may still exist at other locations.

### *B Analysis of Other Compliance Issues Identified by the FLA*

The FLA examined a large number of issues in addition to those encompassed by the four key problem areas. The issues included the following:

#### *a) Resignation Procedures*

The Chengdu facility required that employees complete a “complicated,” four-step approval process before they could resign.<sup>226</sup> Although management said the goal was to discourage resignations (and reduce turnover), one consequence of this requirement, not surprisingly, was that “many workers” left without giving notice, in which event they never were paid for the work they performed after their most recent pay day.<sup>227</sup> Foxconn agreed to simplify the resignation procedure,<sup>228</sup> and

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<sup>223</sup> *May 2013 Status Report*, *supra* note 10, at 5.

<sup>224</sup> Keith Bradsher & David Barboza, *Hewlett Pushes China to Limit Student Labor*, N.Y. TIMES (Feb. 7, 2013), <http://www.nytimes.com/2013/02/08/business/global/hewlett-packard-joins-push-to-limit-use-of-student-labor-in-china.html>.

<sup>225</sup> Barboza & Duhigg, *China Contractor Again Faces Labor Issues on iPhones*, *supra* note 215.

<sup>226</sup> *March 2012 Report* app. 1.3, *supra* note 103, at 15.

<sup>227</sup> *Id.*

Chengdu established a one-stop resignation booth, where employees not only complete the process electronically; they also immediately receive pay for all hours worked up to their resignation.<sup>229</sup> Although a “high percentage” of resigning employees at Chengdu forfeited their last paycheck,<sup>230</sup> the reports do not indicate whether a similar problem existed at Longhua or Guanlan.

### b) Probationary Periods

Foxconn employees have written contracts with a term of three years.<sup>231</sup> The initial probationary period is six months, as permitted by China’s Labor Contract Law. The FLA Workplace Code, however, calls for a probationary period of not more than three months. In each facility, the FLA found Foxconn in violation of FLA standards because it had not yet limited the initial probationary period to three months.<sup>232</sup>

By August 2012, Foxconn had revised its policies and contracts to limit probationary periods to three months for workers, leaving it at six months for engineering and managerial staff.<sup>233</sup> The FLA report does not say whether any employee has ever been terminated during the probationary period or why the FLA believes a probationary period of three months is better for employees than a six-month period. Although the FLA devoted considerable efforts to securing this policy change, and to describing this accomplishment, it is not clear that the policy revision will benefit the Foxconn employees.

### c) Discrimination

The FLA’s treatment of discrimination issues is bizarre. The March FLA report faults Foxconn for requiring that applicants for the position of recruiter in each of the facilities be at least twenty-four years old.<sup>234</sup> Surely this is a trivial form of discrimination, especially in facilities where the average age is twenty-three.<sup>235</sup> Such a requirement would not

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<sup>228</sup> *Id.*

<sup>229</sup> *August 2012 Status Report* app. 4, *supra* note 147, at J66.

<sup>230</sup> *March 2012 Report* app. 1.3, *supra* note 103, at 15.

<sup>231</sup> *E.g., March 2012 Report* app. 1.1, *supra* note 100, at 1.

<sup>232</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 1; *March 2012 Report* app. 1.2, *supra* note 134, at 1; *March 2012 Report* app. 1.3, *supra* note 103, at 1.

<sup>233</sup> *August 2012 Status Report* app. 2, *supra* note 146, at J10; *August 2012 Status Report* app. 3, *supra* note 190, at K10; *August 2012 Status Report* app. 4, *supra* note 147, at K10.

<sup>234</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 2; *March 2012 Report* app. 1.2, *supra* note 134, at 2; *March 2012 Report* app. 1.3, *supra* note 103, at 2.

<sup>235</sup> *See March 2012 Report* app. 2, *supra* note 146, at 3.

even be unlawful under federal law in the United States, which protects from age discrimination only persons over age forty<sup>236</sup> and, as to employees in the protected age group, does not prohibit preferences favoring older employees over younger ones.<sup>237</sup>

The FLA's remedial action for this unimportant requirement went far beyond the underlying offense: Foxconn not only changed the job description to require candidates for the recruiting position to have a certain level experience (for which the age requirement plainly had been a proxy) but also reviewed thousands of other job descriptions, ensuring that they did not contain inappropriate criteria and attempting to develop "objective criteria (such as educational achievement or work experience) to define qualifications for all job positions."<sup>238</sup> No reason is given for thinking that any employee will benefit from the inclusion of "objective criteria" in these job descriptions. Unlike the United States, where courts have spoken favorably of objective criteria as an antidote to subjective biases that are operated to exclude African Americans or women from some employment,<sup>239</sup> there is no suggestion of systematic bias against any protected group in the Foxconn facilities.

While focusing on the one very trivial instance of age discrimination, the FLA did not consider whether Foxconn systematically favors younger applicants over older ones in hiring. The FLA also arranged for Foxconn to develop special procedures and policies to protect not only juvenile and pregnant employees, but also "elderly" employees, which it defines as age 50 and above.<sup>240</sup> Special policies for the "elderly" would not be lawful in the United States, and in plants where the average age is 23, it is not clear whether any applicant or employee fits into the "elderly" category.

The FLA also pushed Foxconn to develop special policies for the employment of disabled workers, including the identification of positions in which the disabled could be employed.<sup>241</sup> This would appear to be a misguided first step, since the nature of the disability and the

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<sup>236</sup> Age Discrimination in Employment Act of 1967, 29 U.S.C. § 631(a) (2006).

<sup>237</sup> *General Dynamics Land Systems, Inc. v. Cline*, 540 U.S. 581, 590–91 (2004).

<sup>238</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 3; *March 2012 Report* app. 1.2, *supra* note 134, at 2–3; *March 2012 Report* app. 1.3, *supra* note 103, at 3.

<sup>239</sup> *See Cortez v. Wal-Mart Stores, Inc.*, 460 F.3d 1268 (10th Cir. 2006) ("unlike truly objective criteria, [a subjective factor] can be used as a tool for unlawful discrimination").

<sup>240</sup> *E.g.*, *August 2012 Status Report* app. 4, *supra* note 147, at J14.

<sup>241</sup> *See, e.g.*, *March 2012 Report* app. 1.3, *supra* note 103, at 5.

requirements of the position should determine whether it is possible to accommodate a person's disability in a particular position.

While imperfectly addressing age and disability discrimination issues, the FLA totally ignored sex discrimination concerns. Roughly 95,000 of the 288,000 employees working on Apple products at the three facilities are women. Yet the FLA did not look to see whether women were fairly treated in terms of pay and promotions, nor did it ask why the percentage of female employees at the three plants, 36%, is so much lower than at some other factories, such as those in Nike's supply chain, where 70% of the 320,000 employees are women.<sup>242</sup> Nor did the FLA ask about sexual harassment. In China, the Revised Law on the Protection of the Rights and Interests of Women, amended in 2005, makes sexual harassment of women illegal;<sup>243</sup> both the FLA Workplace Code and Apple's Code of Conduct condemn sexual harassment;<sup>244</sup> and surveys in China indicate that large numbers of women have experienced sexual harassment in the workplace and elsewhere.<sup>245</sup> The FLA gave no explanation for overlooking this issue.

#### d) *Posting of Names of Disciplined Workers*

All three facilities posted the names of employees who were subjected to disciplinary actions. According to the FLA, this practice is consistent with the local law but violates the FLA Workplace Code.<sup>246</sup> The FLA instructed factory management to stop this practice immediately, and Apple agreed to conform its Code of Conduct to the FLA standard.<sup>247</sup>

<sup>242</sup> See *Global Manufacturing*, NIKE, INC., <http://nikeinc.com/pages/manufacturing-map> (last visited Aug. 1, 2013).

<sup>243</sup> 妇女权益保障法 (2005 年修订) [Law on the Protection of Women's Rights and Interests (2005 Amendment)] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 28, 2005, effective Dec. 1, 2005) art. 40, CLI.1.59781 CHINALAWINFO.

<sup>244</sup> See *FLA Workplace Code of Conduct*, *supra* note 12; *Apple Supplier Code of Conduct*, *supra* note 26, at 2.

<sup>245</sup> Rong Jiaojiao, *Law Revised to Protect Women's Rights, China Features, Embassy of the People's Republic of China in the United Kingdom of the Great Britain and Northern Ireland* (Sept. 20, 2005), <http://www.chinese-embassy.org.uk/eng/zt/t213042.htm>.

<sup>246</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 12; *March 2012 Report* app. 1.2, *supra* note 134, at 12; *March 2012 Report* app. 1.3, *supra* note 103, at 11–12.

<sup>247</sup> *Id.*

e) *Recording Worker Names and Time of Toilet Breaks*

The FLA discovered that supervisors in one building at Chengdu were recording names and times of worker visits to the toilet. The FLA said this practice should stop, and it did.<sup>248</sup>

f) *Grievances*

The FLA found that the grievance process was poorly understood by workers (80% of interviewed workers in Chengdu did not understand the process, but only 20% in Guanlan said they did not understand it), and that some workers expressed fear that they would be pressured to resign if they lodged complaints.<sup>249</sup> The FLA recommended that elected worker representatives be placed on the grievance committees “so they can provide active worker representation and involvement on decision-making process about grievance related issues” and that steps be taken to protect workers from retaliation if they filed a grievance.<sup>250</sup> But the report provides no information as to the frequency of employee grievances, or whether any of them are resolved in favor of the worker. According to the August 2012 Status Report, 154 grievances were filed at the Guanlan facility in the period after Foxconn attempted to communicate the policy to employees, and a follow-up survey reported that 94% of the employees filing these grievances were satisfied with the manner in which they were handled.<sup>251</sup> But it is difficult to know what to make of these statistics without more detailed information regarding the subjects of the grievances or their outcome.

g) *No Retrenchment Policy*

Foxconn does not have a policy stating how employees would be selected for termination in the event of a reduction in force. Although Chinese law, like U.S. law, does not require such a policy, and factory management at all three factories said there was no need for such a policy since they had “never” experienced any downsizing,<sup>252</sup> Foxconn acquiesced in the FLA demand that it adopt a retrenchment policy at each

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<sup>248</sup> *March 2012 Report* app. 1.3, *supra* note 103, at 11–12; *August 2012 Status Report* app. 4, *supra* note 147, at J56.

<sup>249</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 13; *March 2012 Report* app. 1.2, *supra* note 134, at 13; *March 2012 Report* app. 1.3, *supra* note 103, at 13.

<sup>250</sup> *March 2012 Report* app. 1.1, *supra* note 100, at 14; *March 2012 Report* app. 1.2, *supra* note 134, at 14; *March 2012 Report* app. 1.3, *supra* note 103, at 14.

<sup>251</sup> *August 2012 Status Report* app. 2, *supra* note 146, at K59.

<sup>252</sup> *See March 2012 Report* app. 1.1, *supra* note 100, at 15; *March 2012 Report* app. 1.2, *supra* note 134, at 15; *March 2012 Report* app. 1.3, *supra* note 103, at 15.



location and communicated the policy to employees and managers through email, LED screens, internal meetings, posters and training.<sup>253</sup> The FLA reports do not describe the provisions of the retrenchment policy adopted by Foxconn, or give any indication that it reviewed the substance of the policy, as the FLA's interest is seemingly limited to the fact that such a policy exists.

## V Conclusion

The audit of Foxconn, although flawed in some ways, has important implications for labor and employment at multinational companies, many of which not be fully known for years to come. First, the audit is significant because Apple insisted that Foxconn comply with both Chinese law and the FLA standards, thus creating a new set of transnational employment protections for Foxconn workers, and because the FLA issued detailed reports on the audit results, recommendations and follow-up that were made public. This public process in effect provided an alternative enforcement mechanism to the Chinese courts and government, which have largely acquiesced in Foxconn's failure to comply with Chinese employment law. This independent and open audit process should serve as a model for multinational companies that purport to enforce corporate social responsibility codes and ensure fair working conditions among their suppliers. Consumers, advocacy groups, and workers may now put more pressure on Apple and other companies to conduct similarly thorough, public audits at other plants in China and elsewhere.

Also, by joining the FLA and commissioning such an extensive examination of Foxconn's employment practices, Apple assumed responsibility not only for enforcement of human rights standards prohibiting coerced labor but also such details as the compensability of training time and the frequency of ergonomic breaks. Apple has thus acted in a way inconsistent with "the core operating assumption" of multinational companies that their responsibility for working conditions does not extend to the workers of unaffiliated companies that serve as their suppliers. Apple assumed this responsibility even though Foxconn is an enormous, sophisticated and very successful company.

In addition, the substance of the assessment is significant. The time and effort devoted to the audit was extraordinary. The analysis properly

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<sup>253</sup> *August 2012 Status Report* app. 2, *supra* note 146, at K64; *August 2012 Status Report* app. 4, *supra* note 147, at J68.

identified important priorities, including working hours, health and safety concerns and the lack of a mechanism for employees to express their views on their employment conditions, and the auditors heard and reported the primary concern of workers regarding their low pay. The recommendations reflect an emphasis on employee training, and Foxconn appears to have taken especially strong remedial steps with respect to a key issue, ergonomics, and a particularly glaring problem, the abuse of interns. Moreover, Hewlett Packard's decision to insist on revamped student intern procedures at its suppliers reflects a positive ripple effect of the audit beyond the manufacture of Apple products. And although the audit can be criticized for postponing the date for compliance with Chinese law on overtime, that may reflect a sensible recognition of the practical difficulty of bringing about such a fundamental change in Foxconn's business model.

The delay in the compliance date with the PRC overtime law means, however, that it will be some time before we know whether Foxconn manages to comply with the strict cap on overtime hours while "protecting" employee earnings. This will be no easy task because the workers have frequently expressed their willingness to work long hours in an effort to maximize their pay and because Foxconn already has very low profit margins on the work it performs for Apple. Nor will we know for some time whether the new mix of hours and pay has any effect on employee tenure. Contrary to the FLA's expectation, it is not clear that a shorter workweek will fundamentally alter employees' view of their work experience, where they perform repetitive work alongside tens of thousands of co-workers in massive facilities far from their homes. Follow-up studies, potentially followed by revised recommendations, will be important for assessing the success of Foxconn's remedial measures.

The audit also had important flaws. The rote insistence that every FLA standard be adopted by Foxconn results in much bureaucratic busywork, such as the revision of thousands of job descriptions to express qualifications in terms of objective criteria and elaborate efforts to educate workers on retrenchment policies that, most likely, they will never experience. Requiring trivial and irrelevant changes means focusing less on the issues that matter. And the audit overlooked important issues, such as, inexplicably, sex discrimination and sexual harassment. To ensure a more comprehensive picture of working conditions and assessment of compliance with the FLA Workplace Code of Conduct, future audits—by the FLA or by Apple itself—should address these issues explicitly.

The assessment did not examine the most important dynamic at the Foxconn plants, the high turnover rate. It makes little sense to propose changes designed to increase employee tenure, as the audit does, unless there has been a detailed examination of termination data and an analysis of the reasons for the voluntary departures, which the audit has not done. Unfortunately, the failure to analyze the current high turnover rate will handicap any effort in the future to assess the effects of the remedial actions resulting from the audit.

Further, the audit failed to take account of some of the realities of China. The FLA devoted much attention to ensuring that the union representatives be selected from the ranks of workers, not management. No matter how union committees are selected, however, the reality for now is that unions in China primarily serve the interests of the state and the Communist Party. Unless the state and Party come to the view that a potentially adversarial relationship between workers and management can promote social harmony, it is improbable that modest changes in union election processes at Foxconn will yield noticeable changes in decision-making or other working conditions at the facilities. And the notion that worker involvement is the key to improving safety and health practices ignores the unique demographics of Foxconn factories, where workers are young migrants from rural China who are unlikely to remain in Foxconn's employ for more than a year or two.

Finally, the audit largely ignored the elephant in the room: why do the Foxconn workers earn so little when Apple's profits are so large? The initial report bravely raised this subject in the form of a proposed study to determine what pay is sufficient to meet "basic needs" in Chengdu and Shenzhen. Although pay is the most important issue for the workers, the subsequent reports do not pursue this topic. While the proposed study would not necessarily explain or dispel the disparity between wages and profits, sustained and public attention to the basic needs of Chinese factory workers might better illuminate that elephant for electronics consumers, whose purchasing decisions ultimately drive the market.

It remains unclear how much the audit will ultimately change work conditions, whether at the three Foxconn facilities, at other Foxconn facilities, at Apple's other suppliers or at the suppliers for other multinational companies. It has been disappointing, for example, that neither Apple nor the FLA, much less other multinational companies, has made public comparably detailed reports and underlying data in connection with subsequent audits conducted at other supplier facilities. There have been modest indications, however, that the audit will have an

impact beyond the three Foxconn facilities: Apple's rigorous monitoring of hours for a million employees of its subcontractors; the after-work education program now made available in several additional Foxconn facilities; and Hewlett Packard's new rules on student interns. But much is still unknown, including, for example, whether Foxconn intends to comply with the PRC law on overtime at all its facilities in China and whether Apple will insist that its other suppliers in China also comply with PRC law.

Over the next several years, the actions of Foxconn and Apple on these and other compliance issues will determine whether the FLA audit is seen as a genuine commitment to a new set of employment standards for Chinese workers, or as a one-time response to a particular public relations problem. Time will tell.

# **Barbarians at the Legal Gates: Examining South Korea's Pre-emptive Globalization Policies Prior to Legal Market Liberalization**

*Jasper Kim\**

## **ABSTRACT**

*Prior to the passage of the Korea-U.S. free trade agreement that would liberalize South Korea's legal services market to allow for the onshore entry of U.S. law firms for the first time in its history, domestic Korean law firms rapidly began a race-to-the-biggest strategy, trying to gauge the potential costs and benefits of merging with other law firms. The collapse by many of South Korea's law firm dominance was a tangible fear by many Korean legal professionals based on evidence of legal markets having been liberalized in such countries as Germany and France, which was subsequently followed by domination in the league tables by foreign law firms in each of their home markets. South Koreans, always fearing the potential for perceived global embarrassment—in part stemming from the country's 1910–45 occupation by Japan as well as the 1997–98 financial crisis—did not want to see its own domestic league tables dominated by non-Korean firms.*

*In response, the South Korean government put forth a set of three “pre-emptive” globalization policies to reconstitute and increase the overall competitiveness of its lawyers and legal services sector through various agencies to help the local legal services sector related to legal education and licensing of foreign legal professionals. The three pre-emptive globalization policies included (1) a mandatory course in Anglo-American law taught in English (required for all incoming new Korean lawyers under the Traditional Bar Exam); (2) the introduction of “American-style” professional graduate law schools (beginning in 2009 by converting twenty-five government-selected law programs to three-year “American-style” professional graduate law school system as well as instituting a New Bar Exam); and (3) the passage of a FLCA (allowing for foreign legal consultants to practice in South Korea).*

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*Such pre-emptive globalization policies, set forth by various entities in the legal services and education sectors, reflected the South Korean desire to stymie the possible negative effects of having foreign law firms enter its borders in a “barbarians at the gates” perceived scenario following the implementation of various free trade agreements, namely with the U.S. (but also with the EU), which effectively opened South Korea’s historically closed legal gates to foreign participants for the first time in its modern history.*

## I Introduction

The South Korean legal market now allows for the entry of foreign law firms for the first time in its modern history due to the signing of the Korea-U.S. free trade agreement. In an effort to globalize its domestic legal services sector pre-emptively in the face of an inevitable “barbarians at the gate” scenario, Asia’s fourth-largest economy unveiled three pre-emptive policies as a means by which South Korea’s legal sector could become more globally competitive in the face of such incoming foreign legal competition.

The South Korean legal markets have benefited from a history of protectionism, and thus, a natural monopoly in the local legal services market. Without foreign law firms to provide competition, local law firms were free to set the standards in terms of the depth and breadth of Korean legal services and related legal fees for the local market.<sup>1</sup> As South Korea became increasingly export-oriented during its post-War period, especially with the U.S. (one of South Korea’s largest trading partners), discussions began between the two countries to enter into a bilateral free trade agreement (FTA), in which certain designated tariffs would be eliminated or reduced on a range of goods and services. Such efforts culminated into the recent ratification of the Korea-U.S. free trade agreement<sup>2</sup> on November 22, 2011, which aimed to reduce or eliminate tariffs on designated goods and services, including legal services in South Korea.<sup>3</sup> According to the U.S. Trade Representative’s office, “For services, the FTA will provide meaningful market access commitments that

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<sup>1</sup> Such skepticism is, in part, due to Japan’s colonialization period of South Korea (1910–1945), and more recently, the 1997–98 Asian financial crisis, in which a perception existed that the cause of the Korean financial crisis was exacerbated by IMF loan conditionalities, rather than a misallocation of capital and crony capitalism.

<sup>2</sup> “Korea-U.S. free trade agreement,” “Korea-U.S. FTA,” “U.S.-Korea free trade agreement,” “U.S.-Korea FTA,” and “KORUS FTA” shall all denote the same meaning, and such terms will be used interchangeably for purposes of this article. Further, the term “Korea,” “Republic of Korea,” and “South Korea” shall also denote the same meaning, and such terms will be used interchangeably for purposes of this article.

<sup>3</sup> The U.S.-Korea FTA was ratified by the United States on October 12, 2011, and thereafter, ratified by South Korea on November 22, 2011. See KORUS Free Trade Agreement, U.S.-S. Kor., Feb. 10, 2011, Pub. L. No. 114–41 (2012). The KORUS FTA is projected to eliminate tariffs on approximately 95 percent of goods between the U.S. and South Korea, representing the second largest FTA for both South Korea (behind the Korea-EU FTA) and United States (behind NAFTA). See WHITE HOUSE, ECONOMIC VALUE OF THE U.S.-SOUTH KOREA FREE TRADE AGREEMENT: MORE AMERICAN EXPORTS, MORE AMERICAN JOBS (2012). The U.S.-Korea FTA is also projected to increase U.S. exports to South Korea by \$10–11 billion, while securing approximately 70,000 U.S. jobs. *Id.*

extend across virtually all major service sectors, including...the opening up of the Korean market for foreign legal consulting services.”<sup>4</sup>

Part of the KORUS FTA’s more prominent related provisions included the gradual but inevitable liberalization of the South Korean legal market over the course of five years from the date of the Korea-U.S. FTA’s ratification into force on November 2011 by the South Korean legislature. The KORUS FTA was met with both fierce support and criticism. The supporters heralded the agreement has a means to further boost exports to the U.S. market, in which per annum trade volume between the U.S. and South Korea was estimated at \$79 billion, while prices of imported American goods and services were also lowered.

However, the KORUS FTA also had its fair share of critics. Some of such critics believed that the opening of the local legal services market would mark the beginning of the end in terms of South Korean law firms’ market share over foreign law firms.<sup>5</sup> Fear also existed among certain South Korean circles that liberalizing South Korea’s legal services sector could lead to foreign competitors taking critical market share from domestic South Korean firms. Among those who held such view, a sizable number of South Korean law firms saw the liberalization of the South Korean legal market, with an estimated size of approximately \$3 billion (as of 2010),<sup>6</sup> as a possible major risk factor. Such perceived risk factor

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<sup>4</sup> See U.S. TRADE REPRESENTATIVE, NEW OPPORTUNITIES FOR U.S. EXPORTERS UNDER THE U.S.-KOREA TRADE AGREEMENT (2012).

<sup>5</sup> The primary domestic fear was the impact of American law firms in South Korea, despite a recently ratified Korea-EU free trade agreement allowing for European law firms (including Britain’s dominant large law firms, to enter the South Korean market). Such extreme focus on the U.S. is also linked to South Korea’s history during the Korean War (1950–53), which led to a large American military contingent in the Korean peninsula, which still exists today. See generally CARTER J. ECKERT ET AL., KOREA OLD AND NEW: A HISTORY (Cambridge Mass. 1990); See generally ALICE H. AMSDEN, ASIA’S NEXT GIANT: SOUTH KOREA AND LATE INDUSTRIALIZATION (Oxford Univ. Press 1992). With such American presence, past and present, came the influence of American culture, including products and services that are clearly visible today from Starbucks to McDonalds on street corners in and around the nation’s capital city of Seoul. *Id.* However, with such visible signs of American influence followed a backlash effect, based in part on nationalism, that South Korea should become increasingly independent of foreign influence. *Id.* This sentiment was not as extreme as seen in the *juche* (self-reliance) policy found in North Korea, but at the same time, the spirit underlying South Korea’s support for increasingly self-reliance is not entirely different. See VICTOR D. CHA, NORTH KOREA: THE IMPOSSIBLE STATE, PAST AND FUTURE (2012); See also JASPER BECKER, KIM JONG II AND THE LOOMING THREAT OF NORTH KOREA (2006).

<sup>6</sup> See H. Park et al., *South Korean Law Firms in Expansion Mode Following Legal Market Liberalization*, FIN. TIMES, Aug. 12, 2011, <http://www.ft.com/intl/cms/s/2/9a49>



was based in part on the perceived negative experiences with liberalization of the legal services sector in Germany and France, in which foreign law firms, rather than domestic law firms, later dominated the league tables of both countries.<sup>7</sup>

Thus, the question often asked within South Korea's legal circles was, "Will South Korea's legal market follow the footsteps of Germany and France, or will it meet a different fate in which South Korean law firms will be able to sufficiently compete with American and European law firms?" Cognizant of this, and bearing the lessons learned from Germany and France, Korean policymakers strategically structured the liberalization of South Korea's legal market in a way that would maximize the benefits and mitigate the risks to local law firms.

This article provides an overview of and analyzes the aforementioned historic liberalization of the South Korean legal services sector in two parts. The first part of this article will provide a general overview the Korea-U.S. FTA, specifically its unprecedented provisions requiring the opening of South Korea's legal market to American law firms. The second part of this article will overview the introduction of three "pre-emptive" policies, enacted prior to the ratification of the U.S.-Korea FTA, to globalize<sup>8</sup> South Korea's lawyers and legal services sector as well as to stymie the possible negative effects of the liberalization of the South Korean legal market, which specifically are: (1) a required Anglo-American course taught in English for all incoming Korean attorneys; (2) the introduction of South Korea's newly-created "American-style"<sup>9</sup>

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31de-c51e-11e0-ba51-00144feabdc0.html (noting the desire by many of South Korea's largest law firms to increase headcount in anticipation of free trade agreements that have or were in process of being negotiated by the South Korean government).

<sup>7</sup> In Germany's case, nine out of the country's ten largest local law firms merged with either UK or U.S. law firms following liberalization of its legal market. See 최승진 (Seung Jin Choi), "외국변호사가 온다", 국내 법률시장 초토화 우려 [*Foreign Lawyers to Arrive, Fears of Devastation of Domestic Legal Market*], NOCUTNEWS.COM, Sept. 27, 2004, <http://www.cbs.co.kr/nocut/show.asp?idx=29228>; In France's case, the dissolution of several notable local law ensued following the liberalization of its legal services sector. See Hyoung Tae Kim, *Legal Market Liberalization in South Korea: Preparation for Change*, 15 PAC. RIM L. & POL'Y J. 199, 203 (2006).

<sup>8</sup> "Globalize" shall, for purposes of this article, denote the attempt by policymakers to reach global standards. Although the term "globalize" has an extremely wide array of proffered definitions, the International Monetary Fund defines it to mean "the growing economic interdependence of countries worldwide through the increasing volume and variety of cross-border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology." IMF, *World Economic Outlook, A Survey by the Staff of the International Monetary Fund* (World Economic and Financial Surveys, 1997), at 45 (ch. 3), <http://www.imf.org/external/pubs/WEOMAY/chapter3.pdf> (last visited May 9, 2012).

<sup>9</sup> "American style" professional graduate law school system shall, for purposes of

professional graduate law school system; and (3) the passage of a Foreign Legal Consultant Act (FLCA) allowing foreign lawyers to practice law in their respective home jurisdictions in South Korea. The third and final part of this article weighs the arguments for and against the three pre-emptive globalization policies.

This article argues that the introduction of the nation's three "pre-emptive" policies noted above represented a deliberate strategic policy by the South Korean government to bolster the nation's domestic law firm and law school core competencies for what was viewed as an inevitable opening of the nation's legal services sector during a "barbarians at the gate" pre-liberalization era. By doing this, the South Korean policymakers' objective was to mitigate the risk of possible market share domination of its local legal services market by foreigners and foreign entities, which South Korea is particularly sensitive towards based on its history as a former colony of Japan from 1910 to 1945, spurring a constant sense of nationalism and desire to preserve the Korean market primarily for Koreans.<sup>10</sup>

#### A *U.S.-Korea FTA*

Until the recent entry into force of the Korea-US Free Trade Agreement by the South Korean legislature in 2011, South Korea's legal services market still largely resembled a "Hermit Kingdom"<sup>11</sup> mindset. According to a report by the European Chamber of Commerce, South Korea was the last economy to allow for partial liberalization of its domestic legal services sector to allow for foreign law firms. Even North Korea—one of the most closed countries in the world—went ahead of

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this article, be defined as a three-year professional graduate law school system that applies a Socratic pedagogical teaching method that in form and substance is substantially similar to and modeled upon the American professional graduate law school system model. For a text relating to legal education reform in both South Korea and Japan, see Tom Ginsburg, *Transforming Legal Education in Japan and Korea*, 22 PENN. ST. INT'L L. REV. 433, 434 (2004). See also Simon Chesterman, *The Evolution of Legal Education: Internationalization, Transnationalization, and Globalization*, 10 GER. L. REV. 877, 886–87 (2009).

<sup>10</sup> See BRUCE CUMINGS, *KOREA'S PLACE IN THE SUN: A MODERN HISTORY* 175 (updated 2005) (arguing that South Korea's period under Japanese colonialization from 1910–1945 led to "underdevelopment, crushed dissent and suppressed indigenous culture").

<sup>11</sup> The term "Hermit Kingdom" is often used to denote a period during South Korea's late Chosun dynasty (1392–1910) in which the nation limited its dealings with the outside world and international community. The first possible usage of the term "hermit" with Korea can reportedly be traced back to the 19th century with William E. Griffins' book. See generally COREA: WILLIAM E. GRIFFINS, *THE HERMIT NATION* (1882).

South Korea in terms of allowing for a foreign law presence within its borders before its southern neighbor.<sup>12</sup> Although the KORUS FTA would be a benefit to South Korea's vast industrial complex of exporters, given that exports account for nearly half of the South Korean economy,<sup>13</sup> local vested interests put up a lengthy challenge to the opening of the country's last bastion of historically closed legal gates to foreigners.

The language in the Korea-U.S. free trade agreement (within the agreement's annex) sets forth a three-stage liberalization process for legal services.<sup>14</sup> The first stage takes effect upon the ratification of the agreement, in which foreign law firms are allowed to set up representative offices, while U.S. lawyers are allowed to provide legal advice upon U.S. and public international law matters as foreign legal consultants. The second stage, set to take place no later than two years from the agreement's entry into force, allows for U.S. and South Korean law firms to collaborate together regarding cases involving both American and South Korean legal issues in which profits can be shared. The third and final stage, to take place no later than five years from the agreement's entry into force, allows for joint ventures between U.S. and South Korean law firms, whereby U.S. law firms would then be allowed to employ domes-

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<sup>12</sup> Andrew Salmon, *North Korea Allows Foreign Law Firm to Set up Shop*, N.Y. TIMES, Sept. 8, 2004, [http://www.nytimes.com/2004/09/08/business/worldbusiness/08iht-law\\_ed3\\_.html](http://www.nytimes.com/2004/09/08/business/worldbusiness/08iht-law_ed3_.html).

<sup>13</sup> See Robert M. Cutler, *Korea Eases Growth*, ASIA TIMES ONLINE, Apr. 21, 2012, <http://www.atimes.com/atimes/Korea/ND21Dg01.html> (noting that “[e]xports account for half of the South Korean economy, a significant proportion even for an Asian country”); see also CIA Report, *The World Factbook: South Korea Economy*, <https://www.cia.gov/library/publications/the-world-factbook/geos/ks.html> (last updated Aug. 22, 2012).

<sup>14</sup> Specifically, the relevant KORUS FTA language states: “(a) No later than the date this Agreement enters into force, Korea shall allow, subject to certain requirements consistent with this Agreement, U.S. law firms to establish representative offices (Foreign Legal Consultant offices or FLC offices) in Korea, and attorneys licensed in the United States to provide legal advisory services regarding the laws of the jurisdiction in which they are licensed and public international law as foreign legal consultants in Korea; (b) No later than two years after the date this Agreement enters into force, Korea shall allow FLC offices, subject to certain requirements consistent with this Agreement, to enter into specific cooperative agreements with Korean law firms in order to be able to jointly deal with cases where domestic and foreign legal issues are mixed, and to share profits derived from such cases; and (c) No later than five years after the date this Agreement enters into force, Korea shall allow U.S. law firms to establish, subject to certain requirements consistent with this Agreement, joint venture firms with Korean law firms. Korea may impose restrictions on the proportion of voting shares or equity interests of the joint venture firms. For greater certainty, such joint ventures may, subject to certain requirements, employ Korean-licensed lawyers as partners or associates.”

tic attorneys, including appointing South Korean lawyers as partners in U.S. law firms in Korea.<sup>15</sup>

Some of the concern in South Korea for liberalizing its legal services sector links to how different lawyers and lawyering are from its American counterparts. Historically, very few Korean lawyers exist to support its vast export-oriented economy. While the U.S. has one lawyer for approximately 268 people, England and Wales with one lawyer for approximately 513 people, and France with one lawyer for approximately 1,264 people. In contrast, South Korea has just one lawyer for every 6,100 people.<sup>16</sup>

As with other protected sectors, such scarcity has been a net benefit for the producers at the cost of consumers. With non-existent foreign competition, domestic legal fee rates have only other domestic lawyers to compete against and set prices. Thus, legal fees in South Korea, not accounting for purchasing power, can be comparable to those in the U.S., for a country where the average person, according to World Bank figures, earns 20,757 U.S. dollars per year compared to 47,199 U.S. dollars per year in the U.S.<sup>17</sup>

#### a) *In-House Counsel and Corporations as Beneficiaries*

Given the dominant export-focus of many of South Korea's corporations, the liberalization of Korea's legal services sector pursuant to the KORUS FTA meant that many of South Korea's large corporations and conglomerates would be net beneficiaries of such liberalization. This is especially the case since, based on the table below, South Korea's most prominent global corporate brands are also the most prominent domestic employers of attorneys, both Korean and foreign. The largest in-house counsel team is held by Samsung, which has a total of 174 attorneys, of which 68 are Korean lawyers and 106 are foreign lawyers.<sup>18</sup> The second

<sup>15</sup> See Ji-sookBae, *Foreign Law Firms Eye Korean Market*, KOR. TIMES, Mar. 11, 2012, <http://www.koreaherald.com/national/Detail.jsp?newsMLId=20120307001149> (noting that law firms such as Paul Hastings, Cleary Gottlieb, Ropes & Gray as well as Clifford Chance may enter the South Korean legal market following the liberalization of South Korea's legal market).

<sup>16</sup> Jasper Kim, *Socrates v. Confucius: An Analysis of South Korea's Implementation of the American Law School Model*, 10 ASIAN-PAC. L. & POL'Y J. 322, 326 (2009). [hereinafter "Socrates v. Confucius"]

<sup>17</sup> When factoring in purchasing power, legal fees in Korea can in effect be double the U.S. level. Hence, the adage holds in Korea that, "If you're rich, you're innocent, but if you're poor, you're guilty."

<sup>18</sup> 정태웅(Tae-Ung Jung), *기업법무팀에선 무슨일 할까? [What Kinds of Work Does a Department of Legal Affairs in a Corporation do?]*, HANKYUNG DAILY, Nov. 12,

largest in-house team is held by LG, which has a total of 90 attorneys, of which 15 are Korean attorneys and 75 are foreign attorneys.<sup>19</sup> The third largest in-house legal team is held by Hyundai-KIA Motors, which has a total of 59 attorneys, of which a mere four are Korean attorneys and the remaining 55 are foreign attorneys.<sup>20</sup> The number four position was SK with 26 total attorneys followed by GS with 17 total attorneys.<sup>21</sup> Interestingly, according to the data, Kumho-Asiana (the parent company for Asiana Airlines) did not report having a single Korean-licensed attorney among its in-house staff, while reporting to have six foreign attorneys.<sup>22</sup>

Table 1. In-House Legal Team Headcount (League Table–South Korea)<sup>23</sup>

<i>Ranking</i>	<i>Law Firm</i>	<i>No. of Domestic (South Korean) Lawyers</i>	<i>No. of Non-domestic (Foreign) Lawyers</i>
1	Samsung	68	106
2	LG	15	75
3	Hyundai-Kia Motors	4	55
4	SK	12	14
5	GS	7	10
6	Posco	5	8
7	Hanwha	10	1
8	Hyundai Heavy Industry	4	4
9	KT	4	2
10	Kumho-Asiana	0	6

Further, as the above table indicates, each of the five largest in-house employers also have just as many or more foreign lawyers as domestic—not entirely unexpected given the export-focus of these global firms. However, what may be slightly more surprising is the disproportionate number of foreign attorneys to domestic attorneys present in most of the top ten in-house legal teams in South Korea.<sup>24</sup>

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2007, [http://www.hankyung.com/news/app/newsview.php? type=2&aid=2007111211711&nid=910&sid=01062035](http://www.hankyung.com/news/app/newsview.php?type=2&aid=2007111211711&nid=910&sid=01062035).

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> As of this writing, it is believed that the KORUS FTA, given its relatively recent ratification, has of yet not dramatically altered the proportion of foreign lawyers to domestic South Korean lawyers. This is also due to the fact that the first graduation class of South Korea's new law schools was very recent, February 2012, thus related

Why is this case? In part, the sheer scarcity of Korean-licensed attorneys in South Korea is a contributing factor. South Korea currently has approximately 9,400 domestic licensed attorneys, according to Harvard Law School's Program on the Legal Profession.<sup>25</sup> For much of the past decade until 2012 (with the first graduating class of South Korea's new graduate law schools entering the legal market), South Korea capped the number of successful bar exam passers to approximately 1,000 each year.<sup>26</sup>

Moreover, in addition to such quantitative cap on the number of lawyers each year, the Korean bar passage rate has also been historically low prior to the introduction of South Korea's graduate law schools (and subsequently initiated new bar exam to be taken by graduates of such new law schools), averaging less than five percent, with the average successful candidate haven taken the exam three times.<sup>27</sup> Even after successfully passing South Korea's traditional bar exam, the process continues with a two-year mandatory legal training system at the Judicial Research and Training Institute (JRTI, which falls under the purview of the Supreme Court of Korea),<sup>28</sup> in which only the top graduates are able to secure jobs as state prosecutors and judges (often viewed as the most prestigious legal positions in the country, in part, due to the positions' perception of influence, power, and long-term stability). Thus, the supply of South Korean attorneys is relatively low by standards of industrialized nations.<sup>29</sup>

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information is still relatively scarce. However, as time progresses, more information and studies related to the ebb and flow of new attorney hires following the KORUS FTA should become increasingly available.

<sup>25</sup> *The Legal Profession of the Republic of South Korea* (2011), [http://www.law.harvard.edu/programs/plp/pdf/Korean\\_Legal\\_Profession.pdf](http://www.law.harvard.edu/programs/plp/pdf/Korean_Legal_Profession.pdf). See generally WILLIAM P. ALFORD ET AL., *RAISING THE BAR: THE EMERGING LEGAL PROFESSION IN EAST ASIA* (William P. Alford ed., 2007) (describing legal education reforms in China, Japan, South Korea, Malaysia, and Indonesia).

<sup>26</sup> *Id.*

<sup>27</sup> For Korean bar passage rate data, e.g., Ministry of Justice Report, *Announcement of Passing First Year Bar Examination* (Mar. 27, 2013), [http://www.moj.go.kr/HP/COM/bbs\\_03/ListShowData.do?strNbodCd=noti0005&strWrtNo=2693&strAnsNo=A&strNbodCd=noti0005&strFilePath=moj/&strRtnURL=MOJ\\_30200000&strOrgGbnCd=100000&strThisPage=1&strNbodCdGbn=](http://www.moj.go.kr/HP/COM/bbs_03/ListShowData.do?strNbodCd=noti0005&strWrtNo=2693&strAnsNo=A&strNbodCd=noti0005&strFilePath=moj/&strRtnURL=MOJ_30200000&strOrgGbnCd=100000&strThisPage=1&strNbodCdGbn=)

<sup>28</sup> 제 1 회 변호사시험 합격자 발표 [*Announcement of the First Bar Exam*], MINISTRY OF JUSTICE (Mar. 27, 2012), [http://www.moj.go.kr/HP/COM/bbs\\_03/ListShowData.do?strNbodCd=noti0005&strWrtNo=2693&strAnsNo=A&strNbodCd=noti0005&strFilePath=moj/&strRtnURL=MOJ\\_30200000&strOrgGbnCd=100000&strThisPage=1&strNbodCdGbn=](http://www.moj.go.kr/HP/COM/bbs_03/ListShowData.do?strNbodCd=noti0005&strWrtNo=2693&strAnsNo=A&strNbodCd=noti0005&strFilePath=moj/&strRtnURL=MOJ_30200000&strOrgGbnCd=100000&strThisPage=1&strNbodCdGbn=) (Mar. 27, 2012).

<sup>29</sup> What may be striking is that in-house legal departments in South Korea typically have very few Korean-licensed attorneys. Most of the legal needs of domestic corporations are done by the *buhp-mu* (in-house legal) team, which in effect, often act as an

b) *Domestic Law Firms in an Era of Greater Competition*

With the KORUS FTA, the monopoly over South Korea's legal talent may become even more competitive, with competition from not only top law firms like Kim & Chang (with nearly 400 domestic lawyers and foreign legal consultants), but also large U.S. law firms (that can offer entry-level legal associates a starting salary of \$160,000–170,000 per year with the possibility of an additional year-end performance bonus).<sup>30</sup> Such rates are significantly higher level than many current local law firm rates. Further, such rates do not even factor working environment factors in which senior attorneys demand strict obedience far beyond that seen in U.S. law firms—a vestige of the male-dominated working culture—whereby all Korean male citizens undergo a compulsory two-year military service. Many of the larger South Korean law firms also offer an incentive for young associates in which a year of full-

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in-house team of a small number of Korean qualified attorneys working in conjunction with a larger number of corporate legal assistants and paralegals. Often, such non-law licensed personnel are undergraduate law majors, who either had no interest in dedicating scarce time and resources towards preparing for the notoriously “difficult” Korean bar exam, or who have in fact attempted but failed to pass the traditional Korean bar exam. At the same time, a certain percentage of such personnel who possess a certain level of requisite English language proficiency, may aspire to study for a LL.M. program and subsequently sit for a U.S. state bar examination to become a U.S.-qualified attorney (as a proxy for, or in addition to, becoming a Korean-licensed attorney). In such position, although formally qualified to opine on matters of U.S. law, having an undergraduate law background in Korean law, would arguably increase the career potential of a person holding such qualifications; The perceived prestige of working as an in-house attorney, although highly sought after in the U.S., is viewed with less prestige in South Korea. This is linked to the perception that any person working for a company, even lawyers, become company workers (which is generally perceived to rank below the echelons of an attorney within South Korea's unique socio-economic hierarchy), rather than as a *byeonhosa*, the Korean term for “attorney” (which carries with it, a clear connotation of being part of an elite socio-economic class historically perceived as a more prestigious position compared to that of a company worker, referred to as *jihkwon*).

<sup>30</sup> *How Much Do Law Firms Pay New Associates? A 16-Year Retrospective*, NALP BULLETIN (Oct. 2011), [http://www.nalp.org/new\\_associate\\_sal\\_oct2011](http://www.nalp.org/new_associate_sal_oct2011) (noting that average starting associate salaries for law firms with 251 or more attorneys in large metropolitan areas of Chicago, Los Angeles, New York, and Washington DC could be as high as \$160,000 per year without year-end bonus as of 2011). See also Debra Cassens Weiss, *Average Starting Pay for Law Grads Is on Downward Shift; Drop Is Largest for Law Firm Jobs*, ABA J. (July 2011), [http://www.abajournal.com/news/article/average\\_starting\\_pay\\_for\\_law\\_grads\\_is\\_on\\_downward\\_shift\\_drop\\_is\\_largest\\_for](http://www.abajournal.com/news/article/average_starting_pay_for_law_grads_is_on_downward_shift_drop_is_largest_for) (noting the general downward trend of legal job starting salaries, including law firm salaries as of 2011).

ly-subsidized legal education is offered, allowing for time and funding to cover a year-long LL.M. program.<sup>31</sup>

Table 2. Law Firm Headcount (League Table – South Korea)<sup>32</sup>

<i>Ranking</i>	<i>Law Firm</i>	<i>No. of Domestic (South Korean) Lawyers</i>	<i>No. of Non-domestic (Foreign) Lawyers</i>
1	Kim & Chang	315	80
2	Bae, Kim & Lee	176	34
3	Lee & Ko	176	30
4	Shin & Kim	160	31
5	Yoon, Yang, Kim, Shin & Yu	156	23
6	Yulchon	116	29
7	Jisung Horizon	103	20
8	AJU International Group	80	25
9	Barun Law	84	9
10	Hwang, Mok & Park	66	8

Based on the table above, Kim & Chang is the largest and arguably the most prestigious law firm in South Korea with over 400 domestic and foreign attorneys in total. The second largest South Korean law firm in terms of headcount is Bae, Kim & Lee followed by Lee & Ko, each with approximately over 200 attorneys. The remaining top five positions are occupied by Shin & Kim and Yoon Yang Kim Shin & Yu, each with slightly less than 200 total attorneys. Thereafter, the sizes of the remaining top ten law firms in terms of total attorneys employed decrease notably with Hwang Mok Park employing less than one hundred total attorneys.

Unlike the domestic-to-foreign composition imbalance seen with South Korea's largest in-house legal counsel teams, South Korea's largest law firm composition is predominated by domestic-licensed Korean attorneys. At the same time, the number of foreign attorneys within South Korea's largest law firms is significant. It may also hold the key in terms of how sustainable its business model may be in terms of preserving

<sup>31</sup> This system is primarily geared towards young associates who show a good deal of future potential, and is aimed for top U.S. LL.M. programs, with the understanding that the sent associate would then sit and pass a U.S. state bar exam (such as New York or California).

<sup>32</sup> Kyungho Choi, *Korean Foreign Legal Consults Act: Legal Profession of American Lawyers in South Korea*, 11 ASIAN PAC. AM. L.J. 100, 111–12 (2009).



South Korea's market share in the domestic legal services market with the liberalization of the local legal services market.<sup>33</sup>

*c) KORUS FTA Motivators: Globalization, Competitiveness and Economics*

With the beginning of negotiations with the United States and the EU for free trade agreements several years ago,<sup>34</sup> the question became an issue of “when” rather than “if” the legal services market would be opened to foreign competitors. That is, the view was that the opening of the domestic legal services market would be inevitable. Increased trade, especially with larger industrialized economies, meant the need for not merely more legal contracts, but also an awareness of the terms and conditions of increasingly complex contracts, particularly in English, the language in which many cross-border contracts are drafted. Moreover, domestic South Korean lawyers became increasingly exposed to the practices and standards of foreign attorneys and foreign clients, especially during the legal negotiation and contract drafting processes, in which bargaining and contracting styles differed leading to possible suboptimal, non-pareto efficient outcomes on the South Korean side (from the perspective of some South Korean parties).<sup>35</sup> Thus, it was concluded that it

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<sup>33</sup> The liberalization of the South Korean legal services market was viewed with great anxiety, but it did not come as a surprise. In fact, South Korea's post-1953 economic strategy has been to export products primarily to major export markets like the United States, while still preserving a relatively protectionist domestic market in which major producers were shielded from foreign competition. *See generally* BYUNG-NAK SONG, *THE RISE OF THE KOREAN ECONOMY* (Oxford Univ. Press 3rd ed. 2003); *see generally* JASPER KIM, *KOREAN BUSINESS LAW: THE LEGAL LANDSCAPE AND BEYOND* (2010) (noting the deregulatory trends in the South Korean economy following the 1997–98 Asian financial crisis) and JASPER KIM, *CRISIS AND CHANGE: SOUTH KOREA IN A POST-1997 NEW ERA* (2005) (overviewing the reconstitution of South Korea's legal and economic infrastructure during the post-1997 period).

<sup>34</sup> Negotiations related to the U.S.-Korea FTA were announced in early 2006. Negotiations were concluded on April 2007. The FTA was first signed on June 30, 2007. The treaty was subsequently renegotiated, with the renegotiated FTA signed on December 2010. *See* KORUS FTA, *supra* note 3. For an overview on the possible economic effects of the KORUS FTA, *see* U.S. INT'L TRADE COMM'N, *U.S.-KOREA FREE TRADE AGREEMENT: POTENTIAL ECONOMY-WIDE AND SELECTED SECTORAL EFFECTS* (2007). For a view critical of the KORUS FTA regarding labor issues, *see* Jennifer John, *Proposed Korea-U.S. FTA Bad for Both Countries*, UNITED AUTO WORKERS, <http://www.uaw.org/story/proposed-korea-us-fta-bad-both-countries> (last visited May 6, 2012).

<sup>35</sup> For instance, historically, most South Korean corporations did not have a lawyer present during negotiations with foreign counterparties, which placed South Korea's corporations at a relative disadvantage, especially related to negotiating and understanding the material terms and conditions of a particular cross-border transaction in goods and/or services between the two sides. Such historical “attorney gap” has led

would be in the best *economic* self-interest of the South Korean government—separate, but related to, the seeking of global standards through globalization for the appearance to the international community of appearing liberalized and globalized—that served as a significant incentive to implement policies that would bolster the domestic competitiveness of the South Korean legal services market.<sup>36</sup>

One perceived risk as viewed by some South Korean legal service providers and lawyers was that foreign law firms would have a larger number of foreign qualified attorneys as part of their headcount and legal arsenal. Further, although such foreign attorneys would not be able to provide legal opinions based on Korean law, they would however be able to opine on issues outside of the purview of Korean law, namely U.S. law, and to a certain extent, specific domestic law under the greater umbrella of EU law.<sup>37</sup> In response, the South Korean government effectively im-

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many of South Korea's largest firms to hire a large number of both domestic and foreign attorneys in recent years to seek competitive advantage.

<sup>36</sup> At the same time, some political pressure also existed to liberalize South Korea's legal services sector by virtue of being a signatory state to international organizations, such as the United Nations (UN), World Trade Organization (WTO), and the OECD, to name a few. However, the dominant motivator was economic, not political factors.

<sup>37</sup> Another perceived risk by South Korean regulatory officials before the opening of the domestic legal services market was the competitiveness of domestic South Korean lawyers in terms of the sheer breadth and depth of skill sets and services that could be offered. The training of most South Korean lawyers under the traditional law school system was one of self-study to pass the notoriously difficult South Korean bar examination, which is highly predicated on sheer rote memorization of domestic codes and regulations. See Jasper Kim, *Socrates vs. Confucius*, *supra* note 16, at 325; see also Ministry of Justice Report, *Qualification for Taking Bar Exam*, [www.moj.go.kr/HP/BA\\_R/bar\\_10/bar\\_1030/bar\\_103010.jsp](http://www.moj.go.kr/HP/BA_R/bar_10/bar_1030/bar_103010.jsp) (last visited May 12, 2012) (noting that formal requirements to sit for the Traditional Bar Exam). Moreover, within South Korea's traditional legal education infrastructure, relatively little focus was given to the ability to "think like a lawyer" as would be the case in many, if not most, U.S. law schools (whereby the thinking process underlying the black letter law is often viewed as just as important if not more than the memorization of U.S. laws itself). *Id.* Thus, in contrast to the South Korea's traditional educational system (especially prior to the introduction of the nation's new graduate law schools), the U.S. law school system is and has been highly predicated on teaching law through the "Socratic" method, although some criticism of the American law school model has arisen due to such things as high student indebtedness, lack of employment prospects, and the ability to produce globally-minded lawyers. See Jill Schachner Chanen, *Re-engineering the JD: Schools across the Country Are Teaching Less about the Law and More about Lawyering*, A.B.A. J., July 1, 2007, [http://abajournal.com/magazine/re\\_engineering\\_the\\_jd/](http://abajournal.com/magazine/re_engineering_the_jd/). For example, Harvard Law School's 1L "Langdellian" curriculum, which as existed relatively untouched for over a century, has been reconstituted such that 1L students will be offered three new classes, one of which being problem-solving skills." *Id.* Further, Stanford Law School has also doubled its elective offerings, while the University of Pennsylvania Law School is taking a more interdisciplinary approach to its legal education. *Id.* Further, many U.S. state bar examinations have a more reasonable bar passage rate, which could provide more academic security to focus more on U.S. law school courses (i.e., the "means" to be-

plemented three “pre-emptive” policies to bolster, globalize, and increase the overall competitiveness of the local legal services market prior to the ratification of the Korea-U.S. FTA (and EU-Korea FTA), which the next section will further discuss.

*B Pre-FTA “Pre-emptive” Globalization Policies (For South Korea’s Lawyers and Legal Profession)*

This section will describe some of the more relevant factors relating to three pre-emptive policies—the requirement at the JRTI of a compulsory Anglo-American course in English, implementation of the new “American-style” graduate law schools in South Korea, and passage the Foreign Legal Consultant Act—that represented an effort by South Korean policymakers to globalize South Korea’s legal services sector in anticipation of the opening of the local legal market.

The specific pre-emptive globalization policies are:

(1) Anglo-American Law Required Course at the JRTI beginning from 2005: required for those who already passed the traditional South Korean bar examination by requiring a one-year course on Anglo-American law offered in the first year, a course taught entirely in English by primarily U.S. licensed legal professionals.

(2) Introduction of “American-style” Professional Graduate Law Schools (beginning in the fall academic semester of 2009): mandating that future applicants to sit for the Korean bar exam must be a graduate from one of the twenty-five three-year new professional graduate law schools in South Korea.

(3) Foreign Legal Consultants Act (FLCA) passed on March 3, 2009: allowing for greater numbers of foreign attorneys to work for South Korean law firms.<sup>38</sup>

The aforementioned combined pre-emptive policies each represented efforts by different institutions and agencies to bolster South Korea’s legal sector capabilities and core competencies. Although the approach and methodology was different among the pre-emptive policies,

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coming a lawyer) than spending a disproportionately high amount of time and resources on the passage of a particular U.S. state bar examination (e.g., the “ends” to the means in becoming a lawyer).

<sup>38</sup> For an overview of the FLCA by the U.S. Library of Congress, see Sayuri Umeda, *Foreign Legal Consultants Law*, LIBRARY OF CONGRESS (May 1, 2009), [http://www.loc.gov/lawweb/servlet/lloc\\_news?disp3\\_1205401259\\_text](http://www.loc.gov/lawweb/servlet/lloc_news?disp3_1205401259_text).

the common nexus binding the three policies was an implicit understanding that the status quo was no longer a viable option regarding South Korea's legal services sector, and that action rather than inaction was needed.

Related policymakers calculated that implementing such initiatives proactively and pre-emptively—rather than reactively subsequent to the ratification of the Korea-U.S. free trade agreement—would allow for the time needed to produce the intended results of a more competitive local legal services industry. Such pre-emptive approach would also allow for possible adjustments to such initiatives prior to the FTA's ratification. However, one negative aspect of such timing strategy is that although the three pre-emptive policies were enacted prior to the FTA's ratification, relatively little time existed between the implementation of such pre-emptive policies and the KORUS FTA's ratification itself. Further, although in form and appearance, the three pre-emptive policies appear as viable policy approaches to create a wall of defense against foreign legal actors and institutions, which were met with both successes and failures in cases outside of South Korea, the actual sustainable impact of such pre-emptive policies applied specifically to the South Korean legal services markets would be and still is untested and unprecedented.

*a) Pre-emptive Policy 1: An Analysis of the JRTI Anglo-American Law Course (mandatory for all new attorneys)*

As an initial pre-emptive globalization policy, South Korea's JRTI—a two-year legal training institute under the purview of the Supreme Court of Korea required for all traditional Korean bar exam passers—mandated that all of its first-year trainees<sup>39</sup> take a required year-long (two semester) course entitled “Anglo-American” law. This was the first time in the JRTI's history that a U.S. law course would be designated as a required course. Just as significant, the mandatory Anglo-American course was a full academic year in length, that is, the course involved two consecutive semesters in the first year (of the two-year total) JRTI legal training period. It was also a mandatory course in which English would be the main language of instruction taught by mostly non-Korean faculty (who were mostly foreign attorneys), which was unprecedented. On the other hand, the vast majority of JRTI law courses were taught in the Korean language by Korean faculty (usually

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<sup>39</sup> The term “trainees” (yeonsu-seng) is a term used to denote those individuals who, after passing the traditional Korean bar exam, attended mandatory subsequent judicial training at the JRTI. Upon entering the JRTI's two-year legal training period, JRTI trainees become part of the state as recognized government officials.

judges or prosecutors, who are often rotated in two-year intervals to different positions, including for some, to the JRTI).

Because most of the JRTI teaching faculty for the newly-required Anglo American course was and would be taught by foreign faculty (all fluent in English, but many of whom not fluent in the Korean language), in addition to language issues, a contrast in pedagogical issues often existed.<sup>40</sup> This phenomenon may have existed because most of the foreign faculty received their legal training from U.S. law schools, within a Socratic teaching environment, whereby in contrast, the JRTI's teaching environment is often akin to a relatively conservative "Confucian" environment heavily based on rote memorization rather than constant in-class professor-student discourse. One objective with the Anglo-American required course is that having foreign faculty to teach the content would also help increase the global competitiveness of Korea's future attorneys in preparation for the opening of the local legal services market.<sup>41</sup>

However, the two-hour length course was primarily, if not entirely, taught through the use of PowerPoint slides (and printouts of such slides) that were given and therefore used by all instructors for the course. The PowerPoint slides often varied in length, but were generally long given the two-hour time duration of the course. The net effect being that little or no time was left to explain the meaning behind the PowerPoint slide concepts, above and beyond the time required to read each of the slides' substantive contents. As a direct result, little or no time existed to apply the Socratic Method, even if it would be a teaching system compatible with the legal trainees at the JRTI, the next generation of Korea's lawyers, judges, and prosecutors. When time did allow for questions from students, few, if any, questions were typically asked.<sup>42</sup>

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<sup>40</sup> For an analysis on German legal training, in contrast to the U.S. legal training method, see Hariolf Wenzler & Kasia Kwietniewska, *Educating the Global Lawyer: The German Experience*, 61 J. LEGAL EDUC. 462, 464–67 (2012). For an analysis focusing on one specific U.S. law school training method, see Tonya Krause-Phelan et al., *Using a Faculty Inquiry Process To Examine Student Responsibility for Learning*, 61 J. LEGAL EDUC. 280, 283–95 (2011).

<sup>41</sup> For full disclosure, the author participated as one of the first foreign faculty to teach the Anglo-American course at the JRTI from the course's inception.

<sup>42</sup> Several reasons could exist for such lack of participation. First, traditionally in South Korea, it has not been the norm for a student to ask a professor a direct question for fear of a perception of possibly challenging the professor's noted authority (within the lens of Korean culture, teachers, including professors, held a status equivalent to the very highest level of society due to the country's focus on education and test taking). Second, a language and/or cultural barrier could have existed since most of those in the JRTI Anglo-American course were not fluent or highly proficient in the English language, especially given the complexities and subtlest underlying legal jargon in English.

Thus, viewed critically, the required Anglo American course could be seen as one that was too heavy in content given the highly compressed time periods given for the covered lecture material. On the other hand, viewed positively, having the experience of taking the JRTI Anglo-American course taught in English by foreign faculty (many or all having significant work experience as attorneys), could only help the global competitiveness of Korea's next generation of legal professionals in preparation of the opening of the Korean legal services sector.

At the same time, the JRTI Anglo-American course was not exactly flawless and without its weaknesses. Several pedagogical changes could be instituted to reconstitute the learning environment to an even better, more effective educational ecosystem. Specifically, if the objective of the pre-emptive globalization policies is to, in fact, produce a globalized legal profession and workforce, then the following could be suggested. First, the PowerPoint slides currently used and relied upon, would be better served if used for a partial, but not entire, part of the two-hour mandatory course. This is suggested since PowerPoint slides create a general proclivity towards passive, rather than a proactive, Socratic-based method. It is most likely that the PowerPoint-driven course materials were purposely done in this way, given that the JRTI trainees' English language capability varies from relatively weak to relatively strong. Thus, by relying primarily on PowerPoint slides, a comfort zone is created since its contents can be easily read and understood, relative to a lecture-based approach with less reliance on PowerPoint slides. However, although a linguistic comfort zone may be created, its benefits can be outweighed by its costs because the JRTI trainees are not brought out of their respective comfort zones. After all, law school training is based on new methods in terms of both pedagogical style and substance<sup>43</sup>, which by definition brings law students outside their comfort zones.

Second, more implementation of presentations and Socratic-based teaching methods should be used in the mandatory Anglo-American course. In doing so, given the primarily Confucian-based learning envi-

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However, even in Korean law courses taught entirely in Korean, few if any questions are generally asked. Third, the sheer amount of content in the course, especially in the English language—covering a major 1L-type topic within just one two-hour lecture (e.g., Torts one week, followed by Criminal Law the next week)—could have overwhelmed the class (as would any course on foreign law taught in a foreign language might be for many U.S. law students, if the roles were reversed).

<sup>43</sup> "Style" is interpreted for purposes of this article to mean the Socratic teaching method used in a law school setting. "Substance" is interpreted for purposes of this article to mean the law school curricula, generally, and the black letter law and cases used, specifically, in a law school setting.

ronment in South Korea, generally, and the JRTI, specifically, the course cannot fully rely on the Socratic-based teaching method alone. As such, the suggestion here is for the Socratic teaching method to complement, rather than replace, the existing slides used in the course.

In terms of presentations, the suggestion is for the JRTI trainees to do either individual or team-based presentations, selected and organized in advance of the presentation day itself, perhaps based on a related legal concept and/or case, in English. By allowing for such structure, the JRTI trainees would see the process as less burdensome and perhaps even more of an opportunity to showcase one's legal knowledge in an individual or team context to his or her academic peers in the lecture room. This would also create an education ecosystem that is, in essence, a two-way (rather than a one-way, top-down) street, in which the course trainees learn through participation rather than rote memorization, enriching the pedagogical process, in the spirit of the Socratic teaching method.<sup>44</sup>

The next section analyzes the introduction of a radical reconstitution of South Korea's education training ecosystem with the introduction of "American-style" graduate law schools beginning in 2009. Previous to 2009, under the traditional bar exam ("Traditional Bar Exam") that existed prior to the introduction of the nation's graduate law schools, relatively few requirements existed for a person to qualify to sit for the examination so long as a certain number of law-related courses were taken beforehand (but ostensibly falling short of requiring an undergraduate degree of any kind as a requirement). However, from 2009 under the new bar exam system ("New Bar Exam"), only graduates from one of South Korea's new graduate law schools would be qualified to sit for the new bar exam, which required the graduation from one of South Korea's twenty-five graduate law schools.<sup>45</sup>

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<sup>44</sup> The suggested implementation of presentations by JRTI trainees could be of various lengths, while it is noted that most trainees would likely prefer short presentations given the different substance and style of the Anglo-American course. At the same time, this would compel the trainees to focus more on the book upon which the PowerPoint slides are loosely centered upon, which is (at the time of this writing), Law 101. See generally JAY M. FEINMAN, *LAW 101: Everything YOU NEED TO KNOW ABOUT AMERICAN LAW* (Oxford Univ. Press 3rd ed. 2010).

<sup>45</sup> Unlike the Traditional Bar Exam with exceptionally low passage rates the New Bar Exam would in many ways emulate the U.S. state bar exam model by striving for passage rates of approximately fifty percent). For New York State Bar passage rates (a common destination for Korean attorneys), see NYS Bar Exam Report, *Bar Exam Results*, <http://www.nybarexam.org/press/press.htm> (last visited May 6, 2012). For an empirical legal educational survey for those who failed a U.S. state bar examination, see Jane Yakowitz, *Marooned: An Empirical Investigation of Law School Graduates Who Fail the Bar Exam*, 60 J. LEGAL EDUC. 3, 11–31 (2010).

b) *Pre-emptive Policy 2: “American Style” Professional Graduate Law Schools*

On July 27, 2007, South Korea passed landmark legislation in the form of the Graduate Law School Act (GLSA), which introduced a new legal educational system to replace its traditional four-year undergraduate bachelor’s in letters-in-law (“LLB”) system to the U.S.-style three-year, JD-prototyped graduate law school program beginning in the fall academic term of 2009.<sup>46</sup> Separate from the shift from legal education to the graduate level (from the undergraduate level), the new South Korean graduate law schools are substantially distinguishable from the former system in several ways.<sup>47</sup>

First, under the GLSA, to sit for the New Bar Exam and to become a qualified lawyer<sup>48</sup>, an applicant must be a graduate of one of the new Korean graduate law schools, which opened their doors in 2008.<sup>49</sup> Second, to be accepted into a Korean Law School, a law school entrance exam, known as the Law School Education Entrance Test (LEET), is required,<sup>50</sup> compared to no such exam under the Traditional Bar Exam. Third, only graduates from one of the twenty-five government-approved Korean Law Schools can sit for the New Bar Exam.<sup>51</sup> Fourth, the Korean

<sup>46</sup> See 법학전문대학원 설치 및 운영에 관한 법률[Graduate Law School Act], Act. No. 8852, Feb. 29, 2008, art. 22 (S. Kor.) (emphasizing the need for an undergraduate degree or its equivalent prior to admissions). [hereinafter GLSA]

<sup>47</sup> Prior to the passage of the Graduate Law School Act, the Korean legal education system was composed of primarily academic (rather than professionally-focused) graduate and undergraduate programs. Jasper Kim, *Socrates v. Confucius*, *supra* note 16, at 325. The undergraduate degree was effectively the equivalent of a four-year Bachelor’s in the Letter of the Law (LLB) degree. At the graduate level, two primary options exist: the two-year Master’s in Law degree (LLM), and the Doctor of Philosophy in Law (PhD) degree. *Id.* Throughout all levels, both graduate and undergraduate, South Korea’s legal education system was based on the Confucian-based top-down lecture and rote-memorization teaching method as opposed to the relatively flatter and more confrontational Socratic method applied in American law schools. *Id.*

<sup>48</sup> The first New Bar Exam pursuant to the GLSA was administered in 2011.

<sup>49</sup> The Traditional Bar Exam does not contain any express requirement for an undergraduate degree or higher to sit for the Korean bar examination, known as the *sahbuhp-goshi*. See Ministry of Justice Report, *Qualification for Taking Bar Exam*, *supra* note 38. A requirement does exist, however, for 35 credits of “law-related” courses to sit for the Traditional Bar Examination. *Id.*

<sup>50</sup> See GLSA, *supra* note 47, art. 24 (relating to the discussion of a new entrance examination for the South Korea’s new graduate law schools).

<sup>51</sup> The twenty-five (25) selected law schools along with the number of students allowed for such law school (in brackets) are: Seoul National University (150), Korea University (120), Yonsei University (120), Sungkyunkwan University (120), Hanyang University (100), Ewha Womans University (100), Kyunghee University (60), Chungang University (50), Hankuk University of Foreign Studies (50), University of Seoul (50), Ajou University (50), Inha University (50), Konkuk University (40), Sogang



Law School faculty composition under the GLSA must now consist of a minimum number of former legal practitioners (compared to no such requirement for Korean university law departments prior to the GLSA).<sup>52</sup> Fifth, in terms of admissions into the Korean graduate law schools, English language proficiency (separate from other possible foreign languages) are now be emphasized in the admissions process in terms of demonstrated evidence of English ability, such as the TOEIC/TOEFL (compared to no such formal emphasis in the current system).<sup>53</sup> Sixth, the number of newly-admitted Korean lawyers will presumably increase significantly (from approximately 1,000 in 2008 to a figure ranging anywhere from 1,500 to 2,000 newly-admitted Korean lawyers from 2012, the first graduating class year under the new system).<sup>54</sup>

One notable objective by Korean policymakers in passing the GLSA was to create “practical” Korean lawyers. For example, GLSA article 4 states the need for “professional training” and both “theory and practice” as it relates to Korea’s new legal education.<sup>55</sup> Further, the explicit requirement exists of a bachelor’s degree<sup>56</sup> or its equivalent to enter the Korean graduate law schools, which is distinguishable from no such requirement of any undergraduate degree for the Traditional Bar Exam.<sup>57</sup>

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University (40), Gangwon University (40), Pusan National University (120), Dong-A University (80), Kyungpook National University (120), Yeungnam University (70), Chonnam University (80), Chonbuk University (80), Wonkwang University (60), Cheju National University (40), Chungnam National University (100), and Chungbuk National University (70). The total number of students expected to be enrolled in all the above 25 law schools is 2000. See the Korean Ministry of Education and Human Resources Development Website, [http://www.mest.go.kr/ms\\_kor/news/notice/broadcast/\\_icsFiles/afieldfile/2008/05/20/1199535\\_01.hwp](http://www.mest.go.kr/ms_kor/news/notice/broadcast/_icsFiles/afieldfile/2008/05/20/1199535_01.hwp) (last visited Aug. 25, 2008).

<sup>52</sup> See GLSA, *supra* note 47, art. 16(3) (which requires that at least 20 percent of the Korean Law School faculty to consist of former practitioners, who have five years or more of relevant legal experience).

<sup>53</sup> Although subject to the admissions criteria of each institution, it is generally expected that many, if not all, of the Korean graduate law schools, will require the submission of a TOEFL/TOEIC English proficiency examination.

<sup>54</sup> 로스쿨 정원 첫해 1500명 확정...대학들 강력반발 [Law school first year starts with 1,500 freshmen... and strong opposition from undergraduate schools], HERALD (Apr. 4, 2010), [http://news.heraldcorp.com/view.php?ud=200710170141&md=20100404211705\\_AT](http://news.heraldcorp.com/view.php?ud=200710170141&md=20100404211705_AT).

<sup>55</sup> See GLSA, *supra* note 47, art. 4.

<sup>56</sup> Further, under GLSA articles 1–3, one-third or more of new law school entrants should already possess a bachelor’s degree from a different university from that being matriculating into. This is to avoid academic over-representation among a cluster of the top-tiered Korean universities, especially within Korea’s so-called elite “SKY” universities (Seoul National University, Korea University, and Yonsei University). See GLSA, *supra* note 47, arts. 1–3.

<sup>57</sup> See GLSA, *supra* note 47, art. 22.

The GLSA also mandates that at least one-fifth of all Korea's graduate law school faculty must be qualified lawyers,<sup>58</sup> either in Korea or elsewhere, who have at least five years of professional experience in a law-related field.<sup>59</sup> As a result, the approach to law teaching in Korea has been very academic rather than practical prior to the GLSA, which Article 16(3) attempts to resolve. Second, the 20 percent or greater practitioner-faculty requirement is progressive in nature in that either Korean or non-Korean practitioners may qualify. This indicates an acute awareness that practitioners with international experience are needed to increase the likelihood of achieving the GLSA objectives.<sup>60</sup>

Articles 22 and 23 of the GLSA relate to student selection. Article 22 states that applicants must possess an undergraduate bachelor's degree or its equivalent.<sup>61</sup> Pursuant to Article 23, the criteria that the Korean graduate law schools can use to select students are as follows: (a) undergraduate GPA; (b) LEET score<sup>62</sup>; (c) language abilities; and (d) social or volunteer activities.<sup>63</sup> Of the above factors, only the undergraduate GPA

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<sup>58</sup> This is also noteworthy since most law professors in Korea, even at the most "elite" universities, have a majority law faculty who are not Korean-licensed lawyers. For instance, as of 2008 when the new graduate law schools were first introduced, Seoul National University (the so-called "Harvard of Korea") has approximately 41 percent (18 out of 44) of its faculty who have passed the Korean bar examination, while Kyunghee University has just 32 percent (11 out of 34) of its law faculty who have passed the Traditional Bar Exam.

<sup>59</sup> See GLSA, *supra* note 47, art. 16(3).

<sup>60</sup> GLSA article 2 sets forth the "educational philosophy" of the new law schools, which includes the mission to educate people of "various ideologies" who can then as lawyers "provide a wealth of quality legal services...to resolve disputes efficiently, professionally, and with the knowledge, skills, and training of such a lawyer." The degree conferred upon graduation from the Korean graduate law schools is effectively a professional master's degree, unlike the Juris Doctor (J.D.) degree issued by U.S. law schools, which is effectively a professional doctorate degree. The two degrees, however, are similar in that both programs are professional legal graduate degrees. The language in GLSA article 2 is relevant for several reasons. First, the "various ideologies" language when seeking future legal professional candidates links to GLSA article 26, the latter requiring that at least one-third of new entrants not be law majors. The presumptive intent is to have a majority of new law school students who already possess a non-law undergraduate academic degree, similar to the American law school model. This language also exists to help create Korean lawyers who can assist in their "specialty areas" as based in part on their non-law undergraduate major, in areas such as intellectual property, banking, business, and trade, which was perceived as lacking (both domestically and internationally) with today's current supply of Korean practitioner lawyers. GLSA, *supra* note 47, art. 2.

<sup>61</sup> GLSA, *supra* note 47, art. 22.

<sup>62</sup> The first LEET exam was offered in Korea on August 24, 2008 in the following seven South Korean cities: Seoul, Busan, Daegu, Gwangju, Daejeon, Chuncheon, and Jeju. See MEST of South Korea, [http://www.mest.go.kr/ms\\_kor/news/notice/broadcast/\\_icsFiles/afieldfile/2008/06/02/1205400\\_01.hwp](http://www.mest.go.kr/ms_kor/news/notice/broadcast/_icsFiles/afieldfile/2008/06/02/1205400_01.hwp) (last visited Apr. 25, 2012). See also LEET, <http://www.leet.or.kr> (last visited Apr. 26, 2008).

<sup>63</sup> GLSA, *supra* note 47, art. 23(1)-(3).

would be considered for admission in the previous undergraduate system. The LEET was a newly-created standardized law school admissions exam largely inspired by the Law School Admission Test (LSAT) used by U.S. law schools, in which questions were primarily non-law based in an effort to measure analytical thinking rather than the amassing and resuscitation of known facts and legal codes. The other factors, such as language and extracurricular activities, were also added components in the new law school admissions system in an effort to admit a more “well-balanced” applicant interested in greater social concerns who could also be effective communicators in an international setting.

Many of the challenges that exist for the aforementioned JRTI Anglo-American course exist for South Korea’s graduate law school system. Specifically, that—despite modeling itself after the American law school system and the Socratic-style teaching method—the pedagogical structure still in many instances defaults to the lecture-based, rote memorization mind-set focused on “teaching to the test.” This makes sense from a local context since one of the most commonly-cited metric by which a law school’s success is measured is the passage rate of the new Korean bar examination (which was approximately 80 percent for the first graduating class of the new law school graduates).

When the topic, generally, and this view, specifically, is raised, often the counterargument is that the teaching method is Socratic or near Socratic since students are able to ask questions to professors. But merely being afforded the opportunity to ask questions in a law school lecture is distinguishable from using the Socratic teaching method in its purest form, in which the professor assumes a highly inquisitorial role with one or more students, in the process, asking a series of real or hypothetical questions to mirror a courtroom or other similar scenario. In other words, it would be a spirited academic, adversarial-based debate between the professor and student.

As such, due to the Confucian culture embedded within South Korean students—such as a strong deference to one’s teacher, including law school professors, and senior authority figures—creating and fostering such a spirited academic, adversarial-based debate between a perceived senior figure (the professor) with a junior figure (the student) would be challenging. This is not to say that such Confucian constraint cannot be

overcome, but such change will take time and a concerted effort by both the law school professors as well as students.<sup>64</sup>

*c) Pre-emptive Policy 3: Foreign Legal Consultant Act*

South Korea's law firms are primarily composed of Korean lawyers, as one would expect. However, a growing number of non-Korean lawyers also constitute part of South Korea's domestic law firm workforce as "Foreign Legal Consultants" pursuant to the FLCA. The FLCA allowed for South Korean law firms to recruit non-Korean attorneys, mostly notably, U.S.-qualified attorneys, as a pre-emptive means increase the scale and scope of legal services offered by domestic law firms. The timing of the FLCA's introduction on March 2, 2009 is also notable in that it was passed during a period in which a seminal free trade agreement between the U.S. and South Korea—the Korea-U.S. free trade agreement—was nearing completion. In effect, the FLCA gave local Korean law firms needed lead time to recruit its foreign law personnel to prepare for the perceived penetration of the local markets by foreigners and foreign entities.

The FLCA provided for a partial liberalization of the South Korean legal services market previous to the KORUS FTA by allowing for certain qualified foreign legal consultants to practice law in South Korea ("Foreign Legal Consultants" or "FLCs"), upon receiving approval from Ministry of Justice<sup>65</sup> and registering with the Korean Bar Association.<sup>66</sup> To qualify as a Foreign Legal Consultant, certain criteria must be satisfied, including having at least three years of legal work experience in the individual's home jurisdiction.<sup>67</sup> This provision in effect made null and void a previous Korean law under Article 109 of the Korean Attorney-in-Law Act, which prohibited foreign attorneys from practicing law

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<sup>64</sup> The three pre-emptive globalization policies are generally viewed as separate but related to South Korea's new graduate law school system. This is due to several factors. First, different branches of the South Korean government were connected to each of the pre-emptive policies (i.e., Ministry of Education, Ministry of Justice, Korean Bar Association). Second, due to the first issues, the timing of the pre-emptive globalization policies were staggered and thus not unified due to the lack of coordination of the policies. And third, as it stands now, the JRTI and graduate law school system are two separate means upon which to qualify as a South Korean attorney until approximately 2017, whereupon the JRTI system will be reconstituted, thus making the graduate law school system the sole means upon which to become a South Korean attorney.

<sup>65</sup> 외국법자문사법 [Foreign Legal Consultant Act], Act No. 10629, May 19, 2011, art. 6 (S. Kor.) [hereinafter FLCA].

<sup>66</sup> FLCA, *supra* note 66, art. 10.

<sup>67</sup> FLCA, *supra* note 66, art. 4(3).

in South Korea. The FLCA applies to U.S. attorneys as well as EU attorneys.

FLCs in South Korea can practice law in three ways. First, by providing legal representation on matters of the FLC's home jurisdiction in which he or she is a licensed attorney.<sup>68</sup> Second, by providing legal representation on issues related to an international treaty relating to South Korea and the FLC's home jurisdiction in which he or she is a licensed attorney.<sup>69</sup> Third, and finally, the FLC can represent clients in South Korea related to international arbitration issues.<sup>70</sup>

Originally, earlier drafts of the FLCA reflected an internal debate among domestic legislators in terms of whether the term "lawyer" could be used by FLCs. Domestically, the Korean term for lawyer, *byeonhosa*, carried with it a significant cachet and level of prestige linked, in part, to the low passage rate of the traditional Korean bar exam as well as the relatively few number of total licensed Korean legal professionals. What domestic policymakers did not want was the risk of confusion between terms denoting Korean attorneys and foreign attorneys. Ultimately, a compromise of sorts was struck in which the term "[foreign legal] consultant" (*jahmunsa*)—which is clearly distinguishable from the term for lawyer in Korean, *byeonhosa* (albeit also viewed with less cachet and prestige from a domestic Korean perspective)—could also be used alongside the term "lawyer" if associated with the FLC's home jurisdiction in which he or she is licensed to practice law (e.g., "U.S. lawyer" or in Romanized Korean, *MigukByeonhosa*).

The net effect of the FLCA was to allow for a greater number of qualified foreign attorneys, including certain U.S. and EU attorneys, to be registered Foreign Legal Consultants in South Korean law firms. The main benefit of the FLCA was to increase and bolster the number of foreign attorneys, in particular U.S. attorneys, within the ranks of many South Korean law firms and organizations. The increased number of foreign attorneys within Korea's law firms and other organizations was a purposely pre-emptive and strategic move to increase the competitiveness of such domestic institutions to prepare for the inevitable coming era of the liberalization of the local legal services sector that would necessitate the introduction of foreign law firms and foreign lawyers into South Korea. That is, the passage of the FLCA was in essence South Korea's strategy of "fighting fire with fire."

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<sup>68</sup> FLCA, *supra* note 66, art. 24(1).

<sup>69</sup> FLCA, *supra* note 66, art. 24(2).

<sup>70</sup> FLCA, *supra* note 66, art. 24(3).

At the same time, the title of “FLC” or “Foreign Legal Consultant” in many ways represent the very upper limit of legal advice and representation that can be given to a foreign-licensed attorney working in South Korea, even with the KORUS FTA having been enacted and ratified. Viewed negatively, this barrier was constructed purposely given South Korea’s historical suspicion of outsiders and foreigners, given its history and long vivid memory of Japan’s occupation period from 1910–45. However, the perspective of FLCs from local legal interest groups should be one of opportunity rather than suspicion or fear, as is the apparent perception. Instead, much like with other bar associations in Northeast Asia, foreign licensed attorneys in South Korea should be afforded the opportunity to be formally recognized by the Korean Bar Association, or a related organization thereof.<sup>71</sup> This would create a bridge rather than a barrier between FLCs and South Korea’s twenty-first century legal profession, creating a synergistic effect that could be mutually beneficial, especially in a globalized era.

*d) South Korea’s “Pre-emptive Policies” to Liberalization of its Legal Gates: Arguments For and Against*

Regarding the JRTI required course, some participants who were required to take the course (the “JRTI trainees”) argued that the JRTI should focus on Korean law matters only, and not matters pertaining to other domestic jurisdictions, including the Anglo-American law issues. Such view may have been exacerbated by the fact that an academic grade was given for the Anglo-American course, which in turn, would affect the ability to become future state prosecutors and judges.<sup>72</sup> The counter-argument to this position was that the understanding of U.S. law linked with the passing of several FTAs—most notably the KORUS

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<sup>71</sup> The Hong Kong Bar Association allows for foreign licensed attorneys to become members. Overseas barristers may, having at least three years' experience, take the Barristers Qualification Examination to officially become a Hong Kong barrister. Moreover, lawyers who have at least three years' qualified experience may apply to switch membership of either the HKBA or the Law Society of Hong Kong. However, one may not enjoy membership of both entities at once. See Hong Kong Bar Association Website, <http://www.hkba.org>. The Japan Federation of Bar Associations also has a history of allowing foreign lawyers within its ranks. Before World War II, attorneys qualified in foreign countries could join a Japanese bar with special permission from the Supreme Court (referred to as quasi-members (準会員 *junkaiin*) of the bar. The quasi-membership was abolished by judicial reforms in 1955, and was replaced by the attorney at foreign law (外国法事務弁護士 *gaikokuhō jimū bengoshi*) in 1986. As of 1 March 2011, there are 354 attorneys at foreign law in Japan. See Japan Federation of Bar Associations Website, <http://www.nichibenren.or.jp/en/>.

<sup>72</sup> Generally, only the top 20 percent of a particular JRTI class can become state prosecutors or judges.

FTA—necessarily warranted understanding aspects of Anglo-American law.

The arguments against the FLCA were relatively more muted than the criticism against the JRTI Anglo-American course. Some domestic Korean attorneys could view the influx of foreign attorneys as possibly leading to a greater oversupply of total lawyers in the Korean legal marketplace. Further, the argument existed that not all U.S. state bars allow for FLC status, but with Korea's case, the passage of the FLCA would in effect be an "all-or-nothing" proposition that would apply to all or none of qualified attorneys in South Korea. However, it was noted that FLCs under the FLCA are allowed to opine on non-Korean law matters only. Therefore, most Korean attorneys saw FLCs as complementary to the area of Korean law and Korean lawyers.

Unlike the initial two pre-emptive policies described earlier in this section—the required Anglo-American law course and the FLCA—the greatest and most vocal opposition existed to the introduction of American-style law schools into South Korea. The opponents against the Korean Law Schools (and the GLSA) argue that this broad-sweeping shift has already been done in nearby Japan, and that such attempt was a clear and foreseeable failure.<sup>73</sup> The opponents, especially those from the various local bar associations, also argued that the GLSA will severely damage the reputation of the current members of the current Korean judiciary for several reasons. First, the GLSA is linked to increasing the number of Korean lawyers substantially above the approximately 1,000 new members allowed per year, which represented the capped number of new attorneys allowed before the introduction of the new Korean graduate law schools. Thus, according to such opponents, the new Korean graduate law schools would certainly lead to an "oversupply" of lawyers into the labor markets (in the range of nearly 1,500 new lawyers in 2012 alone under the New Bar Exam), which would in turn lead to a decrease in lawyers' average wages and possible reputational standing.<sup>74</sup> But from

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<sup>73</sup> Specifically, opponents cited the perceived failure by many in the Korean legal community of the Japan law school reforms, whereby the filtering of students to become Japanese lawyers (*bengoshi*) was effectively at the time of the Japanese bar examination—exactly the problem that the legal reforms were meant to abolish.

<sup>74</sup> The argument also existed that such effect will also lead to a diminishment of the traditionally high reputation for South Korean lawyers, and would also lead to the end of the historically protected labor markets for Korean lawyers. See Tae-jong Kim, *Law School Act Faces Opposition*, KOR. TIMES, Aug. 27, 2007, [http://www.koreatimes.co.kr/www/news/nation/2012/04/117\\_9043.html](http://www.koreatimes.co.kr/www/news/nation/2012/04/117_9043.html). For an article focusing on the challenge of job placement in South Korea's legal services market with the New Bar Exam, see Sarah Kim, *First law school grads face trial over jobs*, KOR. JOONANG DAILY, Jan. 11, 2012, <http://korea JoongAng daily.joinsmsn.com/news/article/article.aspx?aid=2946913>.

another perspective, even assuming that an increase in the number of Korean qualified attorneys has led to downward pressure on lawyer's wages, this is not a net negative in and of itself. Lower per hour rates for legal advice would make legal representation more affordable, and thus, accessible for the general population. The larger number of Korean lawyers would, admittedly, lead to greater competition for legal (and non-legal) careers, in which one's law degree and license could be leveraged. However, such larger number of licensed professionals would also incentivize such talent to specialize or create niche areas for the betterment of the industry and economy.

Opponents also existed from within the Korean law school constituency for several reasons. First, the GLSA mandates that a total of no more than twenty-five Korean Law Schools be selected (out of many more law schools which requested to be selected as a designated Korean graduate law school). However, the administration which drafted the GLSA (under the relatively liberal administration under former president Roh Moo-hyun) also mandated that at least ten of the twenty-five new Korean graduate law schools designated exist outside the Seoul metropolitan area.<sup>75</sup> This may not seem controversial from the U.S. perspective, since many, if not most such law schools are located outside of large metropolitan areas like New York, Chicago, and Los Angeles, however, in Korea, universities and their law school departments located outside of Seoul are generally considered as *de facto* second-tier universities.<sup>76</sup> Second, such a unique local *de facto* law school ranking process relates to the fact that many Seoul-area universities, which have historically been ranked higher than many universities outside of Seoul (colloquially referred to as *jibangdehs*"), were being treated unfairly due to the liberal-progressive political policies of former Korean President Roh Moo-hyun (2002–2008).<sup>77</sup>

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<sup>75</sup> See the Korean Ministry of Education and Human Resources Development Website, [http://www.mest.go.kr/ms\\_kor/news/notice/broadcast/\\_icsFiles/afieldfile/2008/05/20/1199535\\_01.hwp](http://www.mest.go.kr/ms_kor/news/notice/broadcast/_icsFiles/afieldfile/2008/05/20/1199535_01.hwp) (last visited August 25, 2008). See also the Korean Ministry of Education, Education, and Science Website, [http://www.mest.go.kr/ms\\_kor/news/notice/broadcast/1199498\\_8083.jsp](http://www.mest.go.kr/ms_kor/news/notice/broadcast/1199498_8083.jsp) (last visited August 26, 2011).

<sup>76</sup> Further, opponents may also argue that despite the apparent efforts to benchmark the U.S. law school model, the end-result may still be Korean graduate law schools that are notably distinguishable from its U.S. law school counterpart in which Korean students will still be primarily focused on passing the state bar examination.

<sup>77</sup> See Yon-se Kim, *Roh to Keep Balance in Law School Quota*, KOR. TIMES, Oct. 24, 2007, [http://www.koreatimes.co.kr/www/news/nation/2007/10/113\\_12473.html](http://www.koreatimes.co.kr/www/news/nation/2007/10/113_12473.html) (quoting the former Korean President Roh as stating, "The government will mainly focus on balanced regional development in the selection of the law schools").



Conversely, given FTAs ratified with the U.S., EU, and Chile, proponents in South Korea argued that the South Korean legal market will increasingly be opened and liberalized, which will in turn, lead to greater competition from foreign law firms in South Korea.<sup>78</sup> Currently, as evidenced in this article, the domestic Korean legal market is effectively dominated in terms of market share by several large and dominant Korean law firms, a virtual oligopoly of legal services.<sup>79</sup> Other proponents, among others,<sup>80</sup> also come from the business sector, which views the increased supply of Korean lawyers, as a net benefit.<sup>81</sup> The presumption is that a greater supply of Korean lawyers may result relative to before, which would then lead to the highest quality of Korean lawyers for the lowest price—a benefit to consumers in the legal services market in an economy that is nearly 60 percent driven by exports (and thus, purchases of South Korean products and services by foreign entities and consumers).<sup>82</sup>

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<sup>78</sup> Regarding the implementation of a possible “phased” opening of the Korean legal market relating to the passage of the U.S.-Korea Free Trade Agreement, see Tong-hyung Kim, ‘US Invasion’ Not Likely in Korean Law Market, KOR. TIMES, Apr. 15, 2007, [http://www.koreatimes.co.kr/www/news/special/2008/07/206\\_837.html](http://www.koreatimes.co.kr/www/news/special/2008/07/206_837.html).

<sup>79</sup> Such oligopolistic structure also mirrors the economic landscape of a few large corporate conglomerates constituting a large percentage of total economic output with firms such as Samsung, Hyundai, and LG. Further, although one might assume that lawyers in foreign law firms may opine only on matters of law not directly pertaining to South Korea, the apprehension is stemmed from the fact that such foreign law firm branches in South Korea may unduly attract some of the best Korean legal talent, who in the past, may have automatically gone to work for one of the larger Korean law firms, if for anything else, lack of outside competition, as in Japan with foreign law firms. Further, foreign law firm branches may most likely also offer higher compensation relative to many Korean law firms. Thus, by instituting the GLSA, the South Korean legal market is taking a pre-emptive strike in terms of preparing now for possible future competition to its domestic legal market in the future.

<sup>80</sup> One more sector that would benefit from the GLSA are the private education institutes, known as *hagwons* that are nearly omnipresent in South Korea. From a local cultural perspective, South Korea places a strong emphasis, some would argue too much so, on education, which has become so severe that the catchphrase “education fever” (교육열) was created to encapsulate this phenomenon. Such high demand has led to a commensurate supply of private institutions in Korea that prepares students from things like college entrance examinations to becoming air flight attendants.

<sup>81</sup> 97.3 percent of Korea’s business sector, according to Lexis/Nexis and the Korean Economic Daily, view local law firms as “below the world standard.” See Sean Hayes, *Dismal Legal Education*, KOR. TIMES, Nov. 20, 2007, [http://www.koreatimes.co.kr/www/news/opinion/2007/11/137\\_14\\_065.html](http://www.koreatimes.co.kr/www/news/opinion/2007/11/137_14_065.html).

<sup>82</sup> Thus, the working assumption under this argument is that the South Korean markets do not have enough Korean lawyers, most notably, specialized legal practitioners. This is, in part, due to the fact that Korean lawyers historically had undergraduate concentrations in law (rather than non-law fields such as economics, politics, and so forth, under the U.S. system) since professional graduate legal training had not existed until their accreditation in 2008 by the South Korean government. With the new graduate law schools, Korean lawyers on paper will possess two skillsets, the

With the recent graduation of the first class of Korea's new professional graduate law schools in 2012, the issue of whether South Korea has sufficiently prepared its domestic educational and law firm infrastructure to reach or come close to global competitiveness as its legal service sector is liberalized, will be best determined as further data is compiled regarding the movement and employment-related details of Korean lawyers in the legal marketplace in the future. The new law school system would also benefit from instituting a greater amount of workshops and externships, thus implementing more practical aspects of legal education into the general curriculum, as well as allowing for students to become actively involved with the local community by providing pro bono or low-cost legal services (under the supervision of a law professor and/or attorney). A greater focus on law journals would also be a way for students to further refine and calibrate one's legal research and writing skills, thus providing a more value-added product, the law student and his or her legal skill sets, and allowing for the law student to focus on a particular area of his or her academic interests. At the same time, greater use of the Korean law journal system would provide a clear signal to future employers as to exactly which students represent the upper echelons of a particular law school class, especially when grade distribution is fairly liberal relative to U.S. law school standards.

What is more clear is that the three pre-emptive policy efforts initiated by the Korean government in preparation for the opening of South Korea's legal market constituted, individually and as a whole, an unprecedented national effort to globalize its lawyers and legal profession as well as to stymie the possible negative effects of foreign law firms penetrating into South Korea's historically closed domestic legal market.

## II Conclusion

Prior to the passage of the Korea-U.S. free trade agreement that would liberalize South Korea's legal services market to allow for the onshore entry of U.S. law firms for the first time in its history, domestic Korean law firms rapidly began a race-to-the-biggest strategy, trying to gauge the potential costs and benefits of merging with other law firms. The working assumption by domestic South Korean entities was that the

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legal skillset (from the Korean law school) and the undergraduate skillset (presuming that the undergraduate degree will in most cases be unrelated to law), similar to the case with U.S. lawyers. This, in theory, could lead to a group of relatively specialized Korean lawyers in areas, such as intellectual property (copyrights, trademarks, and patents), finance, business, and human rights, to name a few. See Jasper Kim, *Wanted: value-added lawyers*, KOR. HERALD, Oct. 23, 2007, at 7.

best way to compete with incoming U.S. law firms would be by force of sheer size. Thus, under this thinking, the larger the domestic firm, the less likely it was to fall by the wayside to U.S. law firms. The collapse by many of South Korea's law firm dominance was a tangible fear by many Korean legal professionals based on evidence of legal markets having been liberalized in such countries as Germany and France,<sup>83</sup> which was subsequently followed by domination in the league tables by foreign law firms in each of their home markets. South Koreans, always fearing the potential for perceived global embarrassment—in part stemming from the country's 1910–45 occupation by Japan as well as the 1997–98 financial crisis—did not want to see its own domestic league tables dominated by non-Korean firms.

In response, the South Korean government put forth a set of three “pre-emptive” globalization policies to reconstitute and increase the overall competitiveness of its lawyers and legal services sector through various agencies to help the local legal services sector, specifically: 1) a mandatory course in Anglo-American law taught in English (required for all incoming new Korean lawyers under the Traditional Bar Exam); 2) the introduction of “American-style” professional graduate law schools (beginning in 2009 by converting twenty-five government-selected law programs to three-year “American-style” professional graduate law school system as well as instituting a New Bar Exam); and 3) the passage of a FLCA (allowing for foreign legal consultants to practice in South Korea).

Such pre-emptive globalization policies, set forth by various entities in the legal services and education sectors, reflected the South Korean desire to stymie the possible negative effects of having foreign law firms enter its borders in a “barbarians at the gates” perceived scenario following the implementation of various free trade agreements, namely with the U.S. and EU, which effectively opened South Korea's historically closed legal gates to foreign participants for the first time in its modern history. However, in an effort to accomplish its objectives, the pre-emptive policies also included some shortcomings, such as the fact that the JRTI required course in English as well as the American-style graduate law school system were still taught in a “teaching to the test” in which standardized tests and rote memorization, rather than the learning process of “thinking like a lawyer,” often took precedent.

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<sup>83</sup> See *supra* note 7.

At the same time, much needed progress has been made in the local legal services sector due to the three pre-emptive policies initiated by South Korea's policymakers in a relatively short time period. As it stands today, the verdict is still yet to be determined in terms of whether South Korea's pre-emptive policies will ultimately be judged as a success or failure from the purview of legal scholars, law students, and practitioners inside and outside the Republic of Korea.

# In the Face of Crisis— Input Legitimacy, Output Legitimacy and the Political Messianism of European Integration

*Joseph H. H. Weiler \**

## I Prologue

Beauty is famously, or infamously, in the eyes of the beholder.

For some, Maastricht was finally the ushering forth of “real” European Integration. No longer merely the marketplace, but veritable economic and monetary union, the upgrading of the European Parliament (finally democracy!), human rights and the environment in the Treaty *expressis verbis* with the expectation of more than mere words to come, and European citizenship, no less. Even the old-fashioned “Community” was upgraded to First with a term redolent with gravitas: “Union.”

For others Maastricht was a shill game, smoke and mirrors: A half-baked monetary union (“What will they do when the first asymmetric shock hits?” Marty Feldstein of Harvard warned at the time), an ever yawning democracy “deficit” with the power shift to the EU not matched by veritable accountability and citizen impact, a vacuous concept of citizenship, with no duties and empty rights and an abandonment of the original and humane concept of Community for the hackneyed Union, a term recently vacated by the Soviets.

Citizens, let us remind ourselves “were not amused.” Maastricht was greeted by the typical indifference with which the elite driven European construct was habitually met. Those who took an interest—the Danes and the French in whose countries commendably citizens were

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This essay is part of an ongoing exploration of the political and legal “DNA” of European integration. A slightly modified version was given as the Keynote Speech at the Opening of the XXV 2012 FIDE Congress in Tallinn. It develops some ideas first explored in *The Political and Legal Culture of European Integration: An Exploratory Essay in ICON*, 9 INT’L J. CONST. L. 678, 678–94 (2011).

consulted—rejected it in one case, and barely passed it, with a wafer thin majority in the other.<sup>1</sup>

That, indeed, has always been the Achilles Heel of the European construct—the question whether the undoubtedly noble project enjoys popular legitimacy.

The structure of this essay is as follows. I will first outline the manner in which I plan to use the concept of legitimacy. Typically European legitimacy discourse employs two principal concepts: Input (process) legitimacy and Output (result) legitimacy. I will add a third, less explored, but in my view central legitimating feature of Europe—Political Messianism. I will explore, in turn, each of these forms of legitimacy in their European context, and in relation to each show why, in my view, they are exhausted, inoperable in the current circumstance. My conclusion is also simple enough. The crisis of Europe will require European solutions. But if these are to be successfully adopted, they will require an employment of legitimacy resources to be found with national communities, the Member States, in some ways a very European outcome.

## II On Two Genres and Three Types of Legitimacy

Legitimacy is a notoriously elusive term, over used and under specified. So the first thing I will do is to explain the sense in which I plan to use Legitimacy in this essay. Do not, please, argue with me and say: “That is not legitimacy! It means something else!”<sup>2</sup> It is how I plan to use it, and I hope to convince you that it is a useful way for articulating something terribly important about the present crisis and the current state of European integration.

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<sup>1</sup> The Brussels Mandarins like to wave (though not recently) Eurobarometer results as evidence of widespread support for Europe. But careful examination of the data seems to suggest that Europeans typically support that which Europe promises to do, not that which it actually does. Cf. ANAND MENON & MARTIN A. SCHAIN, *COMPARATIVE FEDERALISM: THE EUROPEAN UNION AND THE UNITED STATES IN COMPARATIVE PERSPECTIVE* 9–10 (2006).

<sup>2</sup> I found the following most useful, also as a demonstration of the breadth of the concept: Cathryn Johnson, Timothy J. Dowd & Cecilia L. Ridgeway, *Legitimacy as a Social Process*, 32 ANN. REV. SOC. 53, 53–78 (Aug. 2006); Barry B. Levine, *Legitimacy and the Process by Which It Is Pursued* (Jens Beckert & Milan Zafirovski eds., 2005) (prepared for Encyclopedia of Economic Sociology); Wojciech Sadurski, *Constitutional Courts in Transition Processes: Legitimacy and Democratization* (Sydney Law Sch. Research Paper No. 11/53), <http://ssrn.com/abstract=1919363>; Fabienne Peter, *Political Legitimacy*, in STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., 2010), <http://plato.stanford.edu/archives/sum2010/entries/legitimacy/>.

There are two basic genres—languages, vocabularies—of Legitimacy: Normative and Social. The vocabulary of normative legitimacy is moral, ethical and it is informed by political theory. It is an objective measure even though there will be obvious ideological differences as to what should be considered as legitimate governance. Social legitimacy is empirical, assessed or measured with the tools of social science. It is a subjective measure, reflecting social attitudes. It is not a measurement of popularity, but of a deeper form of acceptance of the political regime.

The two types of legitimacy often inform each other and may even conflate, but not necessarily so. A series of examples will clarify. By our liberal pluralist normative yardstick, German National Socialism of the 30s and 40s was a horrible aberration, with the negation of legitimate governance. Yet, socially and empirically, for most Germans almost until the defeat in 1945 it was not only popular but considered deeply legitimate leadership. By contrast, Weimar Democracy would pass our normative test of legitimate government, yet for a very large number of Germans it was not merely unpopular, but considered illegitimate leadership, a betrayal of Germany.

However, in less extreme situations we do expect some measure of conflation between the two. One hopes that if a regime is normatively legitimate, because, say, it practices constitutional democracy, it will enjoy widespread social legitimacy, and that the opposite will be true too: In a regime that fails the normative tests, one hopes that the social legitimacy will be low too. One can imagine complicated permutations of these parameters.

Legitimacy, normative or social, should not be conflated with legality. Forbidding blacks to sit in the front of the bus was perfectly legal, but would fail many a test of normative legitimacy, and with time lost its social legitimacy as well. There are illegal measures that are considered, normatively and/or socially as legitimate, and legal measures that are considered illegitimate.

For the purpose of this essay, it is worth exploring briefly the relationship between popularity and legitimacy. If I am a lifelong adherent of the Labor party in the UK, I might be appalled by the election of the Tories and abhor every single measure adopted by the Government of the Tory Prime Minister. But it would never enter my mind to consider such measures as “illegitimate.” In fact, and this is critical for one of the principal propositions of this essay, the deeper the legitimacy resources of a

regime, the better able it is to adopt *unpopular* measures critical in the time of crisis where exactly such measures may be necessary.

There is something peculiar about the current crisis. Even if there are big differences between the Austerity and Immediate Growth camps<sup>3</sup>, everyone knows that a solution has to be European, within a European framework. And yet, it has become self-evident, that crafting a European solution has become so difficult, that the Institutions and the Union decision making process do not seem to be engaging satisfactorily and effectively with the crisis, even when employing the intergovernmental methodology, and that it is governments, national leaders, of a small club, who seem to be calling the shots. The problem is European, but Europe as such is finding it difficult to craft the remedies.

I would like to argue that in the present circumstance, the legitimacy resources of the European Union—referring here mostly to social legitimacy—are depleted, and that is why the Union has had to turn to the Member States for salvation. Solutions will still have to be Europe wide, but they will not be ideated, designed and crafted using the classical “Community Method” but will be negotiated among and validated by the Member States. They will require the legitimacy resources of the Member States—in many countries close to depletion too—in order to gain valid acceptance in Europe.

Alan Milward famously and convincingly wrote in the *European Rescue of the Member State*.<sup>4</sup> The pendulum has swung and in the present crisis it will be the Nation State rescue of the European Union.

Moving from the genres of legitimacy to a typology I would like to suggest the three most important types or forms of legitimacy, which have been central to the discussion of European integration. The most ubiquitous have been various variations on the theme of input and output legitimacy.<sup>5</sup>

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<sup>3</sup> Monhamed El-Erian, *Beyond the False Growth vs Austerity Debate*, FINANCIAL TIMES (June 24, 2010, 11:29 PM), <http://www.ft.com/cms/s/0/2f50ef78-7fcb-11df-91b4-00144feabdc0.html>.

<sup>4</sup> ALAN MILWARD, *THE EUROPEAN RESCUE OF THE NATION-STATE* (Routledge, 2nd ed. 2000).

<sup>5</sup> See generally M. Boedeltje & J. Cornips, *Input and Output Legitimacy in Interactive Governance* (Oct. 2004); Karl-Oskar Lindgren & Thomas Persson, *Input and Output Legitimacy: Synergy or Trade-off? Empirical Evidence from an EU Survey*, 17 J. EUR. PUB. POL'Y., no. 4, 449 (2010).



Process (or input) Legitimacy—which in the current circumstance can be, with some simplification, be synonymized with democracy. It is easier put in the negative: To the extent that the European mode of governance departs from the habits and practices of democracy as understood in the Member States, its legitimacy, in this case both normative and social will be compromised.

Result (or output) Legitimacy—which, again simplifying somewhat, would be all modern versions of Bread and Circus. As long as the Union delivers “the goods” —prosperity, stability, security—it will enjoy a legitimacy that derives from a subtle combination of success *per se*, of success in realizing its objectives and of contentment with those results. There is no better way to legitimate a war than win it. This variant of legitimacy is part of the very ethos of the Commission.

Telos Legitimacy or Political Messianism whereby legitimacy is gained neither by process nor output but by promise, the promise of an attractive Promised Land. I will elaborate on this below.

I will now try and illustrate the collapse of all three forms of legitimacy in the current European circumstance.

### III Europe, the Current Circumstances

This is an interesting time to be reflecting on the European construct. Europe is at a nadir which one cannot remember for many decades and which, various brave or pompous or self-serving statements notwithstanding<sup>6</sup>, the Treaty of Lisbon has not been able to redress. The surface manifestations of crisis are with us every day on the front pages: The Euro crisis<sup>7</sup> being the most current. Beneath this surface, at the structural level, lurk more profound and long-term signs of enduring challenge and

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<sup>6</sup> See, e.g., Plenary session of the European Parliament, Strasbourg: Treaty of Lisbon (Feb. 20, 2008) (including various statements from the members of the European Parliament, Janez Lenarcic, President of the Council and Margot Wallström, Vice-President of the European Commission); see also European Parliament Resolution of 20 February 2008 on the Treaty of Lisbon, Feb. 20, 2008, 2009 O.J. (C 184) 25; Brussels European Council 14 Dec. 2007, Brussels, 14 Feb. 2008, 16616/1/07 REV 1 (including the EU declaration on globalization); European Commission, *Your Guide to the Lisbon Treaty*, <http://ec.europa.eu/publications/booklets/others/84/en.pdf>; José Manuel Durao Barroso, President of Eur. Comm'n, The European Union after the Lisbon Treaty, Address at the 4th Joint Parliamentary Meeting on the Future of Europe, Brussels (Dec. 4, 2007), in SPEECH/07/793 (Dec.7, 2007).

<sup>7</sup> D. Dinan, *Governance and Institutions: Implementing the Lisbon Treaty in the Shadow of the Euro Crisis*, 49 J. COMMON MKT. STUD., no. S1, 2011, at 103.

even dysfunction and malaise. Let us refract them through the lens of legitimacy.<sup>8</sup>

First, as regards process legitimacy, there is the persistent, chronic, troubling Democracy Deficit, which cannot be talked away. The manifestations of the so-called Democracy Deficit are persistent and no endless repetition of the powers of the European Parliament will remove them. In essence it is the inability of the Union to develop structures and processes that adequately replicate or, “translate,”<sup>9</sup> at the Union level even the imperfect habits of governmental control, parliamentary accountability and administrative responsibility that are practiced with different modalities in the various Member States. Make no mistake: It is perfectly understood that the Union is not a State, but it is in the business of governance and has taken over extensive areas previously in the hands of the Member States. In some critical areas, such as the interface of the Union with the international trading system, the competences of the Union are exclusive. In others they are dominant. Democracy is not about States. Democracy is about the exercise of public power—and the Union exercises a huge amount of public power. We live by the credo that any exercise of public power has to be legitimated democratically and it is exactly here that process legitimacy fails.

In essence, the two primordial features of any functioning democracy are missing—the grand principles of accountability and representation.<sup>10</sup>

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<sup>8</sup> The literature is rich. Here is a partial sample of some truly helpful studies: THE LEGITIMACY OF THE EUROPEAN UNION AFTER ENLARGEMENT (Jacques Thomassen ed., 2009); JACQUES THOMASSEN & HERMANN SCHMITT, *Introduction: Political Legitimacy and Representation in the European Union*, in POLITICAL REPRESENTATION AND LEGITIMACY IN THE EUROPEAN UNION 3–21 (1999); DAVID BEETHAM & CHRISTOPHER LORD, LEGITIMACY AND THE EUROPEAN UNION (1998); Max Haller, *Is the European Union Legitimate? To What Extent?* 60 INT’L SOC. SCI. J. no. 196, 2009, at 223; Andrew Moravcsik, *Reassessing Legitimacy in the European Union*, 40 J. COMMON MKT. STUD., 2002, at 603; Barbara Guastaferrero & Manuela Moschella, *The EU, the IMF, and the Representative Turn: Addressing the Challenge of Legitimacy*, 18 SWISS POL. SCI. REV. 199 (2012).

<sup>9</sup> Neil Walker, *Postnational Constitutionalism and the Problem of Translation*, in EUROPEAN CONSTITUTIONALISM BEYOND THE STATE 29 (J.H.H. Weiler & Marlene Wind eds., 2003).

<sup>10</sup> DEMOCRACY, ACCOUNTABILITY AND REPRESENTATION (Adam Przeworski, Susan C. Stokes & Bernard Manin eds., 1999); Philippe C. Schmitter & Terry L. Karl, *What Democracy Is... and Is Not*, 2 J. DEMOCR., no. 3, 67 (Summer 1991); Peter Mair, *Popular Democracy and the European Union Policy* (European Governance Papers No. C-05-03, 2005), <http://www.connex-network.org/eurogov/pdf/epg-connex-C-05-03.pdf>.

Regarding accountability,<sup>11</sup> even the basic condition of representative democracy that at election time the citizens "... can throw the scoundrels out,"<sup>12</sup> that is to replace the Government, does not operate in Europe.<sup>13</sup> The form of European governance,<sup>14</sup> governance without Government, is, and will remain for considerable time, perhaps forever such that there is no "Government" to throw out. Dismissing the Commission by Parliament (or approving the appointment of the Commission President) is not quite the same, not even remotely so.

Startlingly, but not surprisingly, political accountability of Europe is remarkably weak. There have been some spectacular political failures of European governance. The embarrassing Copenhagen climate fiasco<sup>15</sup>; the weak (at best) realization of the much-touted Lisbon Agenda (also known as Lisbon Strategy or Lisbon Process),<sup>16</sup> the very story of the defunct "Constitution,"<sup>17</sup> to mention but three. It is hard to point in these instances to any measure of political accountability, of someone paying a political price as would be the case in national politics. In fact it is difficult to point to a single instance of accountability for political failure as distinct from personal accountability for misconduct in the annals of European integration. This is not, decidedly not, a story of corruption or malfeasance.<sup>18</sup> My argument is that this failure is rooted in the very structure of European governance. It is not designed for political accountability. In similar vein, it is impossible to link in any meaningful way the results of elections to the European Parliament to the performance of the Political Groups within the preceding parliamentary session, in the way that is part of the mainstay of political accountability within

<sup>11</sup> CAROL HARLOW, *ACCOUNTABILITY IN THE EUROPEAN UNION* (2003).

<sup>12</sup> IAN SHAPIRO, *DEMOCRACY'S PLACE* 96 (1996); J.H.H. Weiler, *To be a European Citizen: Eros and Civilization*, in *THE CONSTITUTION OF EUROPE* "DO THE NEW CLOTHES HAVE AN EMPEROR?" 329 (1999).

<sup>13</sup> Renaud Dehousse, *Constitutional Reform in the European Community: Are there Alternatives to the Majoritarian Avenue?* in *THE CRISIS OF REPRESENTATION IN EUROPE*, 118, 123 (Jack Hayward ed., 1995).

<sup>14</sup> Philip Allott, *European Governance and the Re-branding of Democracy*, 27 *EUR. L. REV.* no. 1, 60 (2002).

<sup>15</sup> See Resolution on the Outcome of the Copenhagen Conference on Climate Change (COP 15), *EUR. PARL. DOC. P78TA(2010)0019* (Feb. 10, 2010) (especially points 5–6).

<sup>16</sup> Iain Begg, *Is There a Convincing Rationale for the Lisbon Strategy?*, 46 *J. COMMON MKT. STU.* no. 2, 427 (2008); Wim Kok et al., *Facing the Challenge—The Lisbon Strategy for Growth and Employment*, Report from the High Level Group (Nov. 2004).

<sup>17</sup> Ian Ward, *Bill and the Fall of the Constitutional Treaty*, 13 *EUR. PUB. L.* no. 3, 461 (2007); Editorial Comments, *What Should Replace the Constitutional Treaty?*, 44 *COMMON MKT L. REV.* 561 (2007).

<sup>18</sup> See also Veith Mehde, *Responsibility and Accountability in the European Commission*, 40 *COMMON MRK L. REV.* 423 (2003).

the Member States.<sup>19</sup> Structurally, dissatisfaction with “Europe,” when it exists, has no channel to affect, at the European level, the agents of European governance.

Likewise, at the most primitive level of democracy, there is simply no moment in the civic calendar of Europe where the citizen can influence directly the outcome of any policy choice facing the Community and Union in the way that citizens can when choosing between parties which offer sharply distinct programs at the national level. The political colour of the European Parliament only very weakly gets translated into the legislative and administrative output of the Union.<sup>20</sup>

The Political Deficit, to use the felicitous phrase of Renaud Dehousse<sup>21</sup> is at the core of the Democracy Deficit. The Commission, by its self-understanding linked to its very ontology, cannot be “partisan” in a right-left sense, neither can the Council, by virtue of the haphazard political nature of its composition. Democracy normally must have some meaningful mechanism for expression of voter preference predicated on choice among options, typically informed by stronger or weaker ideological orientation.<sup>22</sup> That is an indispensable component of politics. Democracy without Politics is an oxymoron.<sup>23</sup> And yet that is not only Europe, but it is a feature of Europe—the “non-partisan” nature of the Commission—which is celebrated. The stock phrase found in endless student text books and the like, that the Supranational Commission vindicates the European Interest, whereas the intergovernmental Council is a clearing house for Member State interest, is, at best, naïve. Does the

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<sup>19</sup> Julian Priestley, *European Political Parties: the Missing Link*, NOTRE EUROPE (Oct. 22, 2010), <http://www.eng.notre-europe.eu/011-2247-European-political-parties-the-missing-link.html>; Francisco Roa Bastos, “Des partis politiques au niveau européen?” *Etat des lieux à la veille des élections européennes de juin 2009* [“Political Parties at European Level?”] *The Situation on the Eve of the European Elections in June 2009*, ETUDES ET RECHERCHES [STUDIES AND RESEARCH] 71 (2009); O. Audeoud, *Les partis politiques au niveau européen. Fédérations de partis nationaux* [Political Parties at European Level, Federations of National Parties] LES CAHIERS DU GERSE [THE GERSE PAPER] (Feb. 3, 1999).

<sup>20</sup> Vernon Bogdanor, *Legitimacy, Accountability and Democracy in the European Union*, A FEDERAL TRUST REPORT 7–8 (2007); Andreas Follesdal & Simon Hix, *Why There is a Democratic Deficit in the EU: A Response to Majone and Moravcsik*, 44 J. COMMON MKT, STUD. no. 3, 533, 545 (2006).

<sup>21</sup> Dehousse, *supra* note 13, at 124; see also JEAN-MARC FERRY & PAUL THIBAUD, DISCUSSION SUR L’EUROPE (1992).

<sup>22</sup> Follesdal & Hix, *supra* note 20.

<sup>23</sup> See PIERRE MANENT, LA RAISON DES NATIONS, REFLEXIONS SUR LA DEMOCRATIE EN EUROPE [THE REASON OF NATIONS THOUGHTS ON DEMOCRACY IN EUROPE], 59 (2006).

“European Interest” not necessarily involve political and ideological choices? At times explicit, but always implicit?

Thus the two most primordial norms of democracy, the principle of accountability and the principle of representation are compromised in the very structure and process of the Union.

The second manifestation of the current European circumstance is evident in a continued slide in the legitimacy and mobilizing force of the European construct and its institutions. I pass over some of the uglier manifestations of European “solidarity” both at governmental and popular level as regards the Euro-crisis or the near abandonment of Italy to deal with the influx of migrants from North Africa as if this was an Italian problem and not a problem for Europe as a whole. I look instead at two deeper and longer-term trends. The first is the extraordinary decline in voter participation in elections for the European Parliament. In Europe as a whole the rate of participation is below 45 per cent, with several countries, notably in the East, with a rate below 30 per cent.<sup>24</sup> The correct comparison is, of course, with political elections to national parliaments where the numbers are considerably higher.<sup>25</sup> What is striking about these figures is that the decline coincides with a continuous shift in powers to the European Parliament, which today is a veritable co-legislator with the Council. The more powers the European Parliament, supposedly the *Vox Populi*, has gained, the greater popular indifference to it seems to have developed.<sup>26</sup> It is sobering but not surprising to note the absence of the European Parliament as a major player in the current crisis. But the Institutional crisis runs deeper. The Commission has excelled as a creative secretariat and implementer and monitor, but neither as the sources of ideas or veritable political leadership. It has been faithful and effective as His Master’s Voice. But most striking has been the disappearing act of the Council. It is no longer the proud leader of Europe according to the Giscardian design, but an elaborate rubber stamp to the Union’s two Presidents—Merkel and Sarkozy. It is a failure of institu-

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<sup>24</sup> *Post-Electoral Survey 2009 Report of the Directorate-General for Communication of the European Commission*, EUR. COMM’N, 22 (Nov. 2009), [http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_320\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_320_en.pdf).

<sup>25</sup> Anand Menon & John Peet, *Beyond the European Parliament: Rethinking the EU’s Democratic Legitimacy*, in CENTER FOR EUROPEAN REFORM ESSAYS (2010); Paul Magnette, *European Governance and Civic Participation: Can the European Union be Politicised?* (Jean Monnet Working Paper No. 6/01, 2001).

<sup>26</sup> Jerzy Buzek, *State of the Union: Three Cheers for the Lisbon Treaty and Two Warnings for Political Parties*, 49 J. COMMON MKT STUD. no. S1, 7, 15 (2011); see also Joseph Weiler, *To Be a European Citizen: Eros and Civilization*, in THE CONSTITUTION OF EUROPE ‘DO THE NEW CLOTHES HAVE AN EMPEROR?’ AND OTHER ESSAYS ON EUROPEAN INTEGRATION 266 (1999).

tional legitimacy, of Parliament and Council, of Supranationalism and Intergovernmentalism. The resort to an extra-Union Treaty as a centerpiece of the reconstruction, is but the poignant legal manifestation of this political reality.

The critique of the Democracy Deficit of the Union has itself been subjected to two types of critique itself. The first has simply contested the reality of the Democracy Deficit by essentially claiming that wrong criteria have been applied to the Union.<sup>27</sup> The lines of debate are well known.<sup>28</sup> For what it is worth, I have staked my position above. But I am more interested in the second type of critique, which implicitly is an invocation of Result or Output Legitimacy. Since the Union, not being a state, cannot replicate or adequately translate the habits and practices of national democratic governance, its legitimacy may be found elsewhere.<sup>29</sup>

In analyzing the legitimacy (and mobilizing force) of the European Union, in particular against the background of its persistent Democracy Deficit, political and social science has indeed long used the distinction between process legitimacy and outcome legitimacy (also known as input/output, process/result etc.).<sup>30</sup> The legitimacy of the Union more generally and the Commission more specifically, even if suffering from deficiencies in the state democratic sense, are said to rest on the results achieved—in the economic, social and, ultimately, political realms.<sup>31</sup> The idea hearkens back to the most classic functionalist and neo-functionalist theories.<sup>32</sup>

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<sup>27</sup> Joseph Weiler, *Does Europe Need a Constitution? Demos, Telos and the German Maastricht Decision*, 1 EUR. L.J. 219, 225 (1995).

<sup>28</sup> Paul Craig, *The Nature of the Community: Integration, Democracy, and Legitimacy*, in THE EVOLUTION OF EU LAW 25 (Paul Craig & G. de Búrca eds., 1999).

<sup>29</sup> Neil MacCormick, *Democracy, Subsidiarity, and Citizenship in the "European Commonwealth"*, 16 L. & PHIL. 331, 331–56 (1997).

<sup>30</sup> See, e.g., CHARLES. R. BEITZ, POLITICAL EQUALITY: AN ESSAY IN DEMOCRATIC THEORY 31–96 (1990); ROBERT ALAN DAHL, DEMOCRACY AND ITS CRITICS 163 (1991); see also REGULATING EUROPE (GIANDOMENICO MAJONE ed., 1996); FRITZ WILHELM SCHARPF, GOVERNING IN EUROPE: EFFECTIVE AND DEMOCRATIC? 7 (1999).

<sup>31</sup> Kevin Featherstone, *Jean Monnet and the Democratic Deficit in the European Union*, 32 J. COMMON MKT STUD. no. 2, 149, 150 (1994).

<sup>32</sup> *Id.* at 155; Charles Pentland, *Political Theories of European Integration: Between Science and Ideology*, in THE EUROPEAN COMMUNITIES IN ACTION 545, 550 (Lasok & Soldatos eds., 1981); BEN ROSAMOND, THEORIES OF EUROPEAN INTEGRATION 20 (2000); see generally DAVID MITRANY, A WORKING PEACE SYSTEM (1966); ERNEST B. HAAS, THE UNITING OF EUROPE (1958); Ernest B. Haas, *Turbulent Fields and the Theory of Regional Integration*, 30 INT'L ORG. no. 2, 173 (1976); LEON N. LINDBERG, THE POLITICAL DYNAMICS OF EUROPEAN ECONOMIC INTEGRATION (1963); REGIONAL INTEGRATION: THEORY AND RESEARCH (LINDBERG & SCHEINGOLD eds., 1971).

I do not want to take issue with the implied normativity of this position—a latter day *Panem et circenses* approach to democracy, which at some level at least could be considered quite troubling. It is with its empirical reality that I want to take some issue. I do not think that outcome legitimacy explains all or perhaps even most of the mobilizing force of the European construct, but whatever role it played it is dependent on the Panem. Rightly or wrongly, the economic woes of Europe, which are manifest in the Euro crisis, are attributed to the European construct. Therefore, when there suddenly is no bread, and certainly no cake, we are treated to a different kind of circus whereby the citizens' growing indifference is turning to hostility and the ability of Europe to act as a political mobilizing force seems not only spent, but even reversed. The worst way to legitimate a war is to lose it, and Europe is suddenly seen not as an icon of success but as an emblem of austerity, thus in terms of its promise of prosperity, failure. If success breeds legitimacy, failure, even if wrongly allocated, leads to the opposite.

Thus, not surprisingly there is a seemingly contagious spread of "Anti-Europeanism" in national politics.<sup>33</sup> What was once in the province of fringe parties on the far right and left has inched its way to more central political forces. The "Question of Europe" as a central issue in political discourse was for long regarded as an 'English disease.' There is a growing contagion in Member States in North and South, East and West, where political capital is to be made among non-fringe parties by anti-European advocacy.<sup>34</sup> The spill-over effect of this phenomenon is the shift of mainstream parties in this direction as a way of countering the gains at their flanks. If we are surprised by this it is only because we seem to have air brushed out of our historical consciousness the rejection of the so-called European Constitution, an understandable amnesia since it represented a defeat of the collective political class in Europe by the *vox populi*,<sup>35</sup> albeit not speaking through, but instead giving a slap in the face to, the European Institutions.<sup>36</sup>

#### IV Europe as Political "Messianism"

<sup>33</sup> CÉCILE. LECONTE, UNDERSTANDING EUROSCEPTICISM (2010).

<sup>34</sup> EUROSCEPTICISM: PARTY POLITICS, NATIONAL IDENTITY AND EUROPEAN INTEGRATION 13 (Harmsen & Spiering eds., 2005); ALEKS. SZCZERBIAK & PAUL A. TAGGART, OPPOSING EUROPE? (Vol. I & II, 2008).

<sup>35</sup> NEIL FLIGSTEIN, EUROCLASH: THE EU, EUROPEAN IDENTITY, AND THE FUTURE OF EUROPE (2008).

<sup>36</sup> See, e.g., Joseph Weiler, U.R. Haltern & F.C. Mayer, *European Democracy and Its Critique*, in THE CRISIS OF REPRESENTATION IN EUROPE 4 (Hayward ed., 1995).

At some level the same could have been said ten and even twenty years ago.<sup>37</sup> The Democracy Deficit is not new—it is enduring. How did Europe legitimate itself before it scored its great successes of the first decades?

As I hinted above, at the conceptual level there is a third type of legitimation which, in my view, played for a long time a much larger role than is currently acknowledged. In fact, in my view, it has been decisive to the legitimacy of Europe and to the positive response of both the political class and citizens at large. I will also argue that it is a key to a crucial element in the Union's political culture. It is a legitimacy rooted in the "*politically messianic*."

In political 'messianism', the justification for action and its mobilizing force, derive not from process, as in classical democracy, or from result and success, but from the ideal pursued, the destiny to be achieved, the 'Promised Land' waiting at the end of the road. Indeed, in messianic visions the end always trumps the means.

Mark Mazower, in his brilliant and original history and historiography of 20<sup>th</sup>-century Europe,<sup>38</sup> insightfully shows how the Europe of monarchs and emperors that entered World War I was often rooted in a political messianic narrative in various states (in Germany, and Italy, and Russia and even Britain and France). It then oscillated after the War towards new democratic orders, to process legitimacy, which then oscillated back into new forms of political messianism in fascism and communism. As the tale is usually told, after World War II, Europe of the West was said to oscillate back to democracy and process legitimacy. It is here that I want to point to an interesting quirk, not often noted.

On the one hand, the Western states, which were later to become the Member States of the European Union, became resolutely democratic, their patriotism rooted in their new constitutional values, narratives of glory abandoned and even ridiculed, and messianic notions of the state

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<sup>37</sup> See, e.g., Commission White Paper on European Governance, COM (2001) 428 final (July 25, 2001); Vernon Bogdanor & Woodcock, *The European Community and Sovereignty*, 44 PARLIAM. AFF. 481, 492 (1991) ("The shortcomings of the Community lie in the feelings of remoteness and lack of influence and involvement on the part of many of its citizens"); Dieter Grimm, *Does Europe Need a Constitution?*, 1 EUR. L.J. no. 3, 282, 291 (1995); Christopher Hill, *European Foreign Policy: Power Bloc, Civilian Power—or Flop? in THE EVOLUTION OF AN INTERNATIONAL ACTOR—WESTERN EUROPE'S NEW ASSERTIVENESS* 35 (Rummel ed., 1990).

<sup>38</sup> MARK MAZOWER, *DARK CONTINENT—EUROPE'S TWENTIETH CENTURY* (1998).



losing all appeal. Famously, former empires, once defended with repression and blood, were now abandoned with zeal.<sup>39</sup>

And yet, their common venture, European integration, was in my reading a political messianic venture *par excellence*, the messianic becoming a central feature of its original and enduring political culture. The mobilizing force and principal legitimating feature was the vision offered, the dream dreamt, the promise of a better future. It is this feature that explains not only the persistent mobilizing force (especially among elites and youth) but also key structural and institutional choices made. It will also give more depth to explanations of the current circumstance of Europe.

Since, unlike the Democracy Deficit, which has been discussed and debated *ad nauseam* and *ad tedium*, Political Messianism is a feature of European legitimacy, which has received less attention, I think it may be justified if I pay to it some more attention.

## V The Schuman Declaration as a Manifesto of Political Messianism

The Schuman declaration is somewhat akin to Europe's "Declaration of Independence" in its combination of vision and blueprint. Notably, much of its text found its way into the preamble of the Treaty of Paris, the substance of which was informed by its ideas. It is interesting to re-read the declaration through the conceptual prism of political messianism. The hallmarks are easily detected as we would expect in its constitutive, magisterial document. It is manifest in what is in the Declaration and, no less importantly, in what is not therein. *Nota bene*: European integration is nothing like its European messianic predecessors – that of monarchies and empire and later fascism and communism. It is liberal and noble, but politically messianic it is nonetheless.

The messianic feature is notable in both its rhetoric and substance. Note, first, the language used—ceremonial and “sermonial” with plenty of pathos (and bathos).

*World peace cannot be safeguarded without the making of creative efforts proportionate to the dangers which threaten it....*

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<sup>39</sup> Justine Lacroix, *For A European Constitutional Patriotism*, 50 POL. STUD. no. 5, 944, 949 (2002).

*The contribution which an organised and living Europe can bring to civilization is indispensable ...*

*...a first step in the federation of Europe [which] will change the destinies of those regions which have long been devoted to the manufacture of munitions of war...*

*[A]ny war between France and Germany becomes not merely unthinkable, but materially impossible.*

*This production will be offered to the world as a whole without distinction or exception...*

*[I]t may be the leaven from which may grow a wider and deeper community between countries long opposed to one another by sanguinary divisions.*

It is grand, inspiring, Churchillian one might even say with a tad of irony. Some old habits, such as the White Man's Burden and the missionary tradition, die hard:

*With increased resources Europe will be able to pursue the achievement of one of its essential tasks, namely, the development of the African continent.*

But it is not just the rhetoric. The substance itself is messianic: A compelling vision which has animated now at least three generations of European idealists where the 'ever closer union among the people of Europe', with peace and prosperity an icing on the cake, constituting the beckoning promised land.<sup>40</sup>

It is worth exploring further the mobilizing force of this new plan for Europe. At the level of the surface language it is its straightforward pragmatic objective of consolidating peace and reconstructing European prosperity, but there is much more within the deep structure of the plan.

Peace, at all times an attractive desideratum, would have had its appeal in purely utilitarian terms. Yet, it is readily apparent that in the historical context in which the Schumann Plan was put forward the notion of peace as an ideal probes a far deeper stratum than simple Swords

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<sup>40</sup> Franco Piodi, *From the Schuman Declaration to the Birth of the ECSC: the Role of Jean Monnet* (May 2010), [http://www.europarl.europa.eu/pdf/cardoc/24663-5531\\_EN-CARDOC\\_JOURNALS\\_No6-complet\\_low\\_res.pdf](http://www.europarl.europa.eu/pdf/cardoc/24663-5531_EN-CARDOC_JOURNALS_No6-complet_low_res.pdf); Thomas Hoerber, *The Nature of the Beast: the Past and Future Purpose of European Integration*, 1 L'EUROPE EN FORMATION 17 (2006); Joseph Weiler, *To be a European Citizen: Eros and Civilization*, in THE CONSTITUTION OF EUROPE 'DO THE NEW CLOTHES HAVE AN EMPEROR?' AND OTHER ESSAYS ON EUROPEAN INTEGRATION 8 (1999) (*Introduction: We Will Do, and Hearken*).

into Ploughshares, Sitting under ones' Vines and Fig Trees, Lambs and Wolves—the classic Biblical metaphor for peace. The dilemma posed was an acute example of the alleged tension between Grace and Justice which has taxed philosophers and theologians through the ages—from William of Ockham (pre-modern), Friedrich Nietzsche (modernist) and the repugnant but profound Martin Heidegger (post-modern).

These were, after all, the early 50s with the horrors of War still fresh in the mind and, in particular, the memory of the unspeakable savagery of German occupation. It would take many years for the hatred in countries such as the Netherlands, Denmark or France to subside fully. The idea, then, in 1950, of a Community of Equals as providing the structural underpinning for long-term peace among yesterday's enemies, represented more than the wise counsel of experienced statesmen.

It was, first, a “peace of the brave” requiring courage and audacity. At a deeper level it managed to tap into the two civilizational pillars of Europe: The Enlightenment and the heritage of the French Revolution and the European Christian tradition.<sup>41</sup>

Liberty was already achieved with the defeat of Nazi Germany – and Germans (like their Austrian brethren-in-crime) embraced with zeal the notion that they, too, were liberated from National Socialism. But here was a project, encapsulated in the Schuman Declaration, which added to the transnational level both Equality and Fraternity. The Post WWI Versailles version of Peace was to take yesterday's enemy, diminish him and keep his neck firmly under one's heel, with, of course, disastrous results. Here, instead was a vision in which yesteryear's enemy was regarded as an equal—Germany was to be treated as a full and equal partner in the venture—and engaged in a fraternal inter-dependent lock that, indeed, the thought of resolving future disputes would become unthinkable.<sup>42</sup> This was, in fact, the project of the enlightenment taken to

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<sup>41</sup> See, e.g., Jürgen Habermas & Jacques Derrida, *February 15, or What Binds Europeans Together: A Plea for a Common Foreign Policy, Beginning in the Core of Europe*, in OLD EUROPE, NEW EUROPE, CORE EUROPE: TRANSATLANTIC RELATIONS AFTER THE IRAQ WAR 5, 10–12 (D. Levy ed., 2005); ALAIN FINKIELKRAUT, LA DÉFAITE DE LA PENSÉE [THE DEFEAT OF THOUGHT] (1987); JOSEPH WEILER, L'EUROPE CHRÉTIENNE: UNE EXCURSION [THE CHRISTIAN EUROPE: AN EXCURSION] (2007); JEAN-MARC FERRY, LA RÉPUBLIQUE CRÉPUSCULAIRE: COMPRENDRE LE PROJET EUROPÉEN IN SENSU COSMOPOLITICO [THE TWILIGHT REPUBLIC: UNDERSTANDING THE EUROPEAN PROJECT IN SENSU COSMOPOLITAN] (2010); ROBERT SCHUMAN, POUR L'EUROPE [FOR EUROPE] 55 (1986).

<sup>42</sup> Angeles Munoz, *L'Engagement Européen de Robert Schuman [The Robert Schuman European Commitment]*, in ROBERT SCHUMAN ET LES PERES DE L'EUROPE:

the international level as the Kant himself had dreamt. To embrace the Schuman Plan was to tap into one of the most powerful idealistic seams in Europe's civilizational mines.

The Schuman Plan was also a call for forgiveness, a challenge to overcome an understandable hatred. In that particular historical context the Schumannian notion of Peace resonated with, was evocative of, the distinct teaching, imagery and values of the Christian call for forgiving one's enemies, for Love, for Grace—values so recently consecrated in their wholesale breach. The Schuman plan was in this sense, evocative of both Confession and Expiation, and redolent with the Christian belief in the power of repentance and renewal and the ultimate goodness of humankind. This evocation is not particularly astonishing given the personal backgrounds of the Founding Fathers—Adenauer, De Gaspari, Schumann, Monnet himself—all seriously committed Catholics.<sup>43</sup>

The mobilizing force, especially among elites, the Political Classes who felt more directly responsible for the calamities of which Europe was just exiting, is not surprising given the remarkable subterranean appeal to the two most potent visions of the idyllic “Kingdom”—the humanist and religious combined in one project.<sup>44</sup> This also explains how,

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CULTURES POLITIQUES ET ANNEES DE FORMATION [ROBERT SCHUMAN AND FATHERS OF EUROPE: POLITICAL CULTURE AND YEARS OF TRAINING] 39, 44 (Schirmann ed., 2008).

<sup>43</sup> Fimister, *Integral Humanism and the Re-unification of Europe*, in ROBERT SCHUMAN ET LES PERES DE L'EUROPE: CULTURES POLITIQUES ET ANNEES DE FORMATION [ROBERT SCHUMAN AND FATHERS OF EUROPE: POLITICAL CULTURE AND YEARS OF TRAINING] 25 (Schirmann ed., 2008) (“Schuman was an ardent Roman Catholic, and his views about the desirability of political unity in Western Europe owed much to the idea that it was above all the continent's Christian heritage which gave consistence and meaning to the identity of European civilization. And the Europe he knew and loved best was the Carolingian Europe that accorded with his religious faith and his experience of French and German cultures”); Mauleon Sutton, *Chapter 1: Before the Schuman Plan*, in FRANCE AND THE CONSTRUCTION OF EUROPE, 1944–2007: THE GEOPOLITICAL IMPERATIVE 34 (2007); Alcide De Gasperi, Address at the Consultative Assembly of the Council of Europe in Strasbourg (Sept. 1952) (“It is with deep faith in our cause that I speak to you, and I am confident that through the will of our free peoples, with your support and with God's help, a new era for Europe will soon begin”).

<sup>44</sup> One should add that the transnational reach of the Schuman plan served, as one would expect, a powerful internal interest the discussion of which even today meets with resistance. The challenge of “fraternity” and the need for forgiveness, love and grace was even more pressing internally than internationally. For each one of the original Member States was seriously compromised internally. In post war Germany, to put it bluntly, neither State nor society could function if all those complicit in National Socialism were to be excluded. In the other five, though ostensibly and in a real sense victim of German aggression, important social forces became complicit and were morally compromised. This was obviously true of Fascist Italy and Vichy France. But even the little Luxembourg contributed one of the most criminally notorious units to the German army and Belgium distinguished itself as the country with the highest number

for the most part, both Right and Left, conservative and progressive, could embrace the project.

It is the messianic model that explains (in part) why for so long the Union could operate without a veritable commitment to the principles it demanded of its aspiring members—democracy and human rights. Aspirant states had to become members of the European Convention of Human Rights, but the Union itself did not. They had to prove their democratic credentials, but the Union itself did not—two anomalies that hardly raised eyebrows.

Note however, that its messianic features are reflected not only in the flowery rhetoric. In its original and unedited version, the declaration is quite elaborate in operational detail, but you will find neither the word democracy nor human rights, a thunderous silence. It's a "Lets-Just-Do-It" type of programme animated by great idealism (and a goodly measure of good old state interest, as a whole generation of historians such as Alan Milward<sup>45</sup> and Charles Maier<sup>46</sup> among others have demonstrated).

The European double helix has from its inception been Commission and Council: an international (supposedly) a-political transnational administration/executive (the Commission) collaborating not, as we habitually say, with the Member States (Council) but with the governments, the executive branch of the Member States, which for years and years had a forum that escaped in day-to-day matters the scrutiny of any parliament, European or national. Democracy is simply not part of the original vision of European integration.<sup>47</sup>

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of indigenous volunteers to the occupying German forces. The betrayal of Anna Frank and her family by their good Dutch neighbors was not an exception but emblematic of Dutch society and government who tidily handed over their entire Jewish citizenry for deportation and death. All these societies had a serious interest in "moving on" and putting that compromised past behind them. If one were to forgive and embrace the external enemy, to turn one's back to the past and put one's faith in a better future, how much more so, how much easier, to do the same within one's own nation, society even family.

<sup>45</sup> ALAN MILWARD, *THE EUROPEAN RESCUE OF THE MEMBER STATE* (Routledge, 2nd ed. 2000).

<sup>46</sup> See generally *THE MARSHALL PLAN AND GERMANY: WEST GERMAN DEVELOPMENT WITHIN THE FRAMEWORK OF THE EUROPEAN RECOVERY PROGRAM* (Maier & Bischof eds., 1991).

<sup>47</sup> Kevin Featherstone, *Jean Monnet and the Democratic Deficit in the European Union*, 32 *J. COMMON MKT STUD.* no. 2, 149, 150 (1994); see generally Jacques Delors, *Independent* (July 1993).

This observation is hardly shocking or even radical. Is it altogether fanciful to tell the narrative of Europe as one in which ‘doers and believers’ (notably the most original of its institutions, the Commission, coupled with an empowered executive branch of the Member States in the guise of the Council and COREPER), an elitist (if well-paid) vanguard, were the self-appointed leaders from whom grudgingly, over decades, power had to be arrested by the European Parliament? And even the European Parliament has been a strange *vox populi*. For hasn’t it been, for most of its life, a champion of European integration, so that to the extent that, inevitably, when the Union and European integration inspired fear and caution among citizens, (only natural in such a radical transformation of European politics) the European Parliament did not feel the place citizens would go to express those fears and concerns?

The political messianic was offered not only for the sake of conceptual clarification but also as an explanation of the formidable past success of European integration in mobilizing support. They produced a culture of praxis, achievement, ever-expanding agendas. Given the noble dimensions of European integration one ought to see and acknowledge their virtuous facets.

But that is only part of the story. They also explain some of the story of decline in European legitimacy and mobilizing pull, which is so obvious in the current circumstance. *Part of the very phenomenology of political messianism is that it always collapses as a mechanism for mobilization and legitimation.* It obviously collapses when the messianic project fails, when the revolution does not come. Interestingly, and more germane to the narrative of European Integration, even when successful it sows its seeds of collapse. At one level the collapse is an inevitable part of the very phenomenology of messianic project. Reality is always more complicated, challenging, banal and ultimately less satisfying than the dream which preceded it. The result is not only absence of mobilization and legitimation, but actual rancor.

The original Promised Land, Canaan, was a very different proposition, challenging and hostile, to the dream which preceded it. Independent India, or Kenya, or even the USA were very different to the dreams which preceded them and their like. Individually this is the story of many a courtship and love affair. The honeymoon is always better than the reality of marriage. Just as paradise becomes such, only when lost, the land itself, always falls short of the promise. It is part of the ontology of the messianic.

The emblematic manifestation of this in the context of European integration is the difference between the 868 inspiring words of the Schumann dream and the 154,183 very real words of the (defunct) European Constitution now reinvented in the Treaty of Lisbon.

In the case of Europe, there are additional contingent factors, which the collapse of the messianic narrative as a mobilizing and legitimizing factor. At one level Europe is a victim of its own success. The passage of time coupled with the consolidation of peace, the internalization of the alternative inter-state discourse which Europe presented, has been so successful that to new generations of Europeans, both the pragmatic and idealist appeal of the Schuman vision seem simply incomprehensible. The reality against which their appeal was so powerful—the age old enmity between France and Germany and all that—is no longer a living memory, a live civilizational wire, a wonderful state of affairs in some considerable measure also owed to the European constructs.

At another level, much has changed in societal mores. Europe in large part has become a post-Christian society. The profound commitment to the individual and his or her rights, relentlessly (and in many respects laudably) placing the individual in the center of political attention, has contributed to the emergence of the self-centered individuals. Social mobilization in Europe is at strongest when the direct interest of the individual are at stake and at their weakest when it requires tending to the needs of the other, as the recent Euro crisis, immigrant crisis and other such instances will readily attest. So part of the explanation of the loss of mobilizing force of the Schuman Vision is in the fact that what it offers either seems irrelevant or does not appeal to the very different idealistic sensibility of contemporary European society.

The result is that if political messianism is not rapidly anchored in the legitimation that comes from popular ownership, it rapidly becomes alienating and, like the Golem, turns on its creators.

Democracy was not part of the original DNA of European Integration. It still feels like a foreign implant. With the collapse of its original political messianism, the alienation we are now witnessing is only to be expected. And thus, when failure hits as in the Euro crisis, when the Panem is gone, all sources of legitimacy suddenly, simultaneously collapse.

This collapse comes at an inopportune moment, at the very moment when Europe of the Union would need all its legitimacy resources. The

problems are European and the solution has to be at the European level. But for that solution to be perceived as legitimate, for the next phase in European integration not to be driven by resentful fear, the architects will not be able to rely, sadly, on the decisional process of the Union itself. They will have to dip heavily into the political structure and decisional process of the Member States. It will be national parliaments, national judiciaries, national media and national governments who will have to lend their legitimacy to a solution which inevitably will involve yet a higher degree of integration. It will be an entirely European phenomenon that at what will have to be a decisive moment in the evolution of the European construct, the importance, even primacy of the national communities as the deepest source of legitimacy of the integration project will be affirmed yet again.



# 危难面前——欧洲共同体的输入正当性， 输出正当性与政治弥赛亚主义

(美) 约瑟夫·韦勒\*

## I 序言

俗话说，情人眼里出西施。

对一些人来说，马斯特里赫特（Maastricht）协议推动了“真正的”欧洲一体化。它不再仅仅是市场的联合，而是真正的经济与货币的联盟，欧洲议会的升级（终于实现了民主！），协议中对人权和环境的表述（*expresis verbis*）带有对实际行动的期待，当然还有欧洲公民身份。连那过去古板的“共同体”字眼都被升级为具有庄严韵味的“联盟”。

对另一些人而言，马斯特里赫特协议则只是一个愚人游戏，布满了烟雾弹和镜花水月：一个半生不熟的货币联盟（“当第一次不对称冲击来袭时他们能做什么呢？”哈佛的马丁·费尔德斯坦（Marty Feldstein）当时就如此警告过），不断扩大的民主“赤字”——把权力转移至欧盟，却没有相应的问责制度和公民影响力，无意义的公民身份既没有义务也没有权利，还抛弃了原有的人性化概念“社区”，选择了陈腐的“联盟”，一个刚刚被苏联腾出来的概念。

公民们，让我们再提醒自己一下，欧洲一体化并不是一个笑话。迎接马斯特里赫特协议的，是由精英驱动的欧洲建构所常见的、典型的漠不关心。而那些感兴趣的人——丹麦人和法国人，他们的国家就此事与其值得

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This essay is part of an ongoing exploration of the political and legal “DNA” of European integration. A slightly modified version was given as the Keynote Speech at the Opening of the XXV 2012 FIDE Congress in Tallinn. It develops some ideas first explored in *The Political and Legal Culture of European Integration: An Exploratory Essay* in *ICON*, 9 *INT'L J. CONST. L.* 678, 678–94 (2011).

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称颂的公民进行了协商——一个拒绝了它，而另一个仅以微薄的优势勉强通过了它。<sup>1</sup>

这始终是欧洲建构的阿克琉斯之踵（Achilles Heel）——即这个无疑非常高尚的事业到底是否享有大众正当性。

本文的结构如下：首先，我将概述我准备如何使用正当性这个概念。通常关于欧洲正当性的论述会提到两个核心概念：输入（过程）正当性和输出（结果）正当性。我将加入第三种，较少被讨论的但在我看来却对欧洲正当性至关重要的特点——政治弥赛亚主义。我将逐一探讨，欧洲的大背景下这些正当性的表现形式，并解释为何依我看这些表现形式已经被穷尽，无法在当前的环境下得到运用。我的结论也很简单：欧洲的危机需要用欧洲的方法来解决。然而如果要成功采取这些方法，就要运用在民族国家，即欧盟成员国中才能找到的正当性资源，在某些方面来讲，这是一个非常欧洲化的结果。

## II 两种派系、三种类型的正当性

正当性以其莫测的含义而著名，它被过度地使用且又不够具体。所以，首先我将阐明本文中我所赋予正当性的含义。请不要急着与我争论：“不，那不是正当性！正当性意味着其他东西。”<sup>2</sup> 这是我所计划的用法，我希望能让大家相信，这种定义对于清楚地阐述当前危机和欧洲一体化现状有着至关重要的作用。

目前大致有两种正当性的派系，用语或词汇：规范化正当性和社会化正当性。规范化正当性的用语是伦理道德，来自于政治理论。它是一个客观的评判标准，尽管对于何谓正当治理仍会有明显的意识形态上的分歧。

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<sup>1</sup> The Brussels Mandarins like to wave (though not recently) Eurobarometer results as evidence of widespread support for Europe. But careful examination of the data seems to suggest that Europeans typically support that which Europe promises to do, not that which it actually does. Cf. ANAND MENON & MARTIN A. SCHAIN, *COMPARATIVE FEDERALISM: THE EUROPEAN UNION AND THE UNITED STATES IN COMPARATIVE PERSPECTIVE* 9–10 (2006).

<sup>2</sup> I found the following most useful, also as a demonstration of the breadth of the concept: Cathryn Johnson, Timothy J. Dowd & Cecilia L. Ridgeway, *Legitimacy as a Social Process*, 32 ANN. REV. SOC. 53, 53–78 (Aug. 2006); Barry B. Levine, *Legitimacy and the Process by Which It Is Pursued* (Jens Beckert & Milan Zafirovski eds., 2005) (prepared for Encyclopedia of Economic Sociology); Wojciech Sadurski, *Constitutional Courts in Transition Processes: Legitimacy and Democratization* (Sydney Law Sch. Research Paper No. 11/53), <http://ssrn.com/abstract=1919363>; Fabienne Peter, *Political Legitimacy*, in STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed., 2010), <http://plato.stanford.edu/archives/sum2010/entries/legitimacy/>.

社会化的正当性是来自经验的，通过社会科学的工具进行评估和考量。它是主观的评判标准，反映社会的态度。它不是对民意，而是对更深层次的政权接受度的考量。

这两种派系的正当性往往互为佐证甚至可以合并，但并不必然如此。有一系列的例子可以澄清这一点。以自由主义多元化的规范性标准来看，上个世纪三四十年代时的德国国家社会主义是一种可怕的变异，否定了正当性治理。然而，从社会学角度和经验上来说，直到 1945 年战败之前，对大部分德国人而言，该统治不仅广受拥护且被视为极具正当性的领导。与此相反，魏玛民主（Weimar Democracy）符合各种正当性政府的评判标准，但对很多德国人而言，它不仅仅不受欢迎，且不具有正当性的领导，是对德国的背叛。

当然，在此种极端以外的情况下，我们确实期待这两种正当性在某些方面合二为一。人们期待，如果一个政权由于依宪政民主治理而具有规范化的正当性，它就应当享有广泛的社会正当性。反之亦然：一个不符合规范化正当性标准的政权，应当享有同样低微的社会正当性。当然，这些参数也可能通过不同排列形成更加复杂情况。

正当性，不论是从规范标准或是社会标准，都不应与合法性混同。譬如禁止黑人坐在公交车的前方座位曾一度是合法的，但却不符合很多规范化的正当性标准，并且随着时间的推移也失去了其社会化的正当性。有一些违法的手段，不论是从规范标准去判断或是从社会标准评判都被视为是正当的，而一些合法的手段则被视为是不正当的。

从本文主旨出发，有必要在此简要地探讨一下民意与正当性的关系。如果我终身都是英国工党的追随者，我也许会被王党保守派的当政所惊骇并且痛恨保王派首相所发布任何一项命令，但是我却从来都不会认为这些命令本身是“不正当的”。事实上，对于本文的一个核心论述非常重要的一点是，一个政权的正当性资源越深入，它也就越能采取那些在危机中至关重要却不得民心的措施，而这些措施往往又是不可或缺的。

当前的危机有一点特别之处。尽管在财政紧缩和刺激增长两阵营中存在非常大的分歧，<sup>3</sup>每个人都知道我们必须在一个欧洲的框架内、采用一个欧洲式的解决方法。然而，不言自明的是，创造出一个欧洲式的解决方法

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<sup>3</sup> Monhamed El-Erian, *Beyond the False Growth vs Austerity Debate*, FINANCIAL TIMES (June 24, 2010, 11:29 PM), <http://www.ft.com/cms/s/0/2f50ef78-7fcb-11df-91b4-00144feabdc0.html>.

变得非常困难，机构和联盟的决议过程无法有效且令人满意地解决这个危机，甚至连政府间的方案都无法奏效，真正做决策的只是一小部分的政府，国家首脑。问题是欧洲的问题，但如今的欧洲却无力补救。

我想提出的是，在这种情况下，欧盟的正当性资源，这里主要是指社会化的正当性，已经千疮百孔了，这就是为何联盟不得不向成员国寻求救赎。解决方案仍然需要是一个覆盖全欧的方案，但却不会用传统的“社区方案”来设想、设计与创造，而是将通过成员国之间的谈判和确认生效。这将需要动用成员国的正当性资源——有些国家的正当性资源也已趋向穷尽——才能在欧洲取得有效的认同。

艾伦·米尔沃德（Alan Milward）在《成员国的欧洲式拯救》中令人信服的名言是，<sup>4</sup>“风水轮流转，在当前的危急中，轮到成员国来拯救欧盟了。”

从正当性的派系谈到类型，我想提出三种最重要的正当性类型，它们都对欧洲一体化至关重要。影响最广泛的就是对输入正当性和输出正当性这一主题的种种延伸、变化地讨论。<sup>5</sup>

过程（或输入）正当性——在现有情况下，简单地说，可与民主同一而论。从反面来说就是，欧洲式治理在一定程度上偏离了其成员国所一贯理解的民主的习惯和习俗，而这也在同等程度上损害了其正当性——既包括规范化也包括社会化的正当性。

结果（或输出）正当性——同样，简单地说，就是现代版的“面包与马戏团”。只要联盟能提供“商品”——繁荣、稳定、安全——它就能享受成功本身（*per se*）、成功地实现其目标、以及对其结果的满意的微妙结合而衍化出的正当性。战胜是将一场战争正当化的最佳理由。这种衍化出的正当性正是联盟使命精神的一部分。

在终极正当性（*Telos Legitimacy*）或政治弥撒亚主义（*Political Messianism*）中，正当性既不是通过过程也不是通过结果取得的，而是通过承诺，一个令人心向往之的领土的承诺。我接下来会详细阐述。

现在，我要试着解释这三种正当性在如今的欧洲情景下的崩塌。

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<sup>4</sup> ALAN MILWARD, *THE EUROPEAN RESCUE OF THE NATION-STATE* (Routledge, 2nd ed. 2000).

<sup>5</sup> See generally M. Boedeltje & J. Cornips, *Input and Output Legitimacy in Interactive Governance* (Oct. 2004); Karl-Oskar Lindgren & Thomas Persson, *Input and Output Legitimacy: Synergy or Trade-off? Empirical Evidence from an EU Survey*, 17 J. EUR. PUB. POL'Y., no. 4, 449 (2010).

### III 欧洲现状

此时是一个反省欧洲共同体的有趣时机。欧洲正处于几十年来都不曾经历的低谷，不论人们说了多少豪言壮语，尝试了多少自救的努力，<sup>6</sup>里斯本公约（Treaty of Lisbon）都没能挽救这种颓势。危机最浅层的表现每天都在新闻头版上摊开在我们面前：欧元危机<sup>7</sup>正是最近的一个。表象之下，在其结构层面，却蛰伏着深刻的、长期的，预示着持久的挑战，甚至失灵和萎靡的迹象。就让我们通过正当性这个透视镜来审视他们。<sup>8</sup>

首先，就过程正义来说，三言两语无法解决那执着而持久的，慢性发展的，令人困扰的民主赤字（Democracy Deficit）。所谓的民主赤字的表现持久不退，就是那无数次的欧盟议会的权力重申也无法驱除它。本质上，它是联盟无力在联盟层面发展出能充分复制或“转化”<sup>9</sup>各成员国以不同模式实行的，哪怕并不完美的关于政府控制、议会问责和行政责任的结构和流程的体现。别误会：很显然联盟不是一个国家，但它确实在进行治理并在很多领域接管了曾属于成员国的职能。在一些重要领域，比如联盟与国际贸易系统的交接，欧盟行使着排他的权能。而在其他一些领域，它则占据主导地位。民主与国家无关。民主的要义是公权力的行使——联盟行使着

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<sup>6</sup> See, e.g., Plenary session of the European Parliament, Strasbourg: Treaty of Lisbon (Feb. 20, 2008) (including various statements from the members of the European Parliament, Janez Lenarcic, President of the Council and Margot Wallström, Vice-President of the European Commission); see also European Parliament Resolution of 20 February 2008 on the Treaty of Lisbon, Feb. 20, 2008, 2009 O.J. (C 184) 25; Brussels European Council 14 Dec. 2007, Brussels, 14 Feb. 2008, 16616/1/07 REV 1 (including the EU declaration on globalization); European Commission, *Your Guide to the Lisbon Treaty*, <http://ec.europa.eu/publications/booklets/others/84/en.pdf>; José Manuel Durao Barroso, President of Eur. Comm'n, The European Union after the Lisbon Treaty, Address at the 4th Joint Parliamentary Meeting on the Future of Europe, Brussels (Dec. 4, 2007), in SPEECH/07/793 (Dec. 7, 2007).

<sup>7</sup> D. Dinan, *Governance and Institutions: Implementing the Lisbon Treaty in the Shadow of the Euro Crisis*, 49 J. COMMON MKT. STUD., no. S1, 2011, at 103.

<sup>8</sup> The literature is rich. Here is a partial sample of some truly helpful studies: THE LEGITIMACY OF THE EUROPEAN UNION AFTER ENLARGEMENT (Jacques Thomassen ed., 2009); JACQUES THOMASSEN & HERMANN SCHMITT, *Introduction: Political Legitimacy and Representation in the European Union*, in POLITICAL REPRESENTATION AND LEGITIMACY IN THE EUROPEAN UNION 3–21 (1999); DAVID BEETHAM & CHRISTOPHER LORD, LEGITIMACY AND THE EUROPEAN UNION (1998); Max Haller, *Is the European Union Legitimate? To What Extent?* 60 INT'L SOC. SCI. J. no. 196, 2009, at 223; Andrew Moravcsik, *Reassessing Legitimacy in the European Union*, 40 J. COMMON MKT. STUD., 2002, at 603; Barbara Guastaferrro & Manuela Moschella, *The EU, the IMF, and the Representative Turn: Addressing the Challenge of Legitimacy*, 18 SWISS POL. SCI. REV 199 (2012).

<sup>9</sup> Neil Walker, *Postnational Constitutionalism and the Problem of Translation*, in EUROPEAN CONSTITUTIONALISM BEYOND THE STATE 29 (J.H.H. Weiler & Marlene Wind eds., 2003).

大量的公权力。我们赖以维生的信条是任何公权力的行使都必须以民主的方式正当化，而这正是过程正当性的失败之处。

本质上，任何起作用的民主所具有的最原始的两个特点是缺失的——伟大的问责原则和代表原则。<sup>10</sup>

就问责原则<sup>11</sup>来说，即便是代议民主最基本的条件，即在选举时公民“可以将恶棍推下台”<sup>12</sup>——即推翻政府权利——都无法在欧洲实施。<sup>13</sup>欧洲的无政府治理的治理模式<sup>14</sup>，现在、将来很长一段时间、有可能永远都是如此，以至于没有可以让人推翻的“政府”。令议会解散欧盟委员会（或通提案指定一位委员会主席）都与问责远不相同。

令人咋舌却不意外的是政治问责原则在欧洲非常薄弱。欧洲的治理中曾有一些严重的政治败局。尴尬的哥本哈根气候会议上的惨败；<sup>15</sup>曾被交口称赞的里斯本议程的（也称里斯本战略或里斯本进程）差强人意（说的好听些）的实现，<sup>16</sup>还有过时的“宪法”的故事，<sup>17</sup>这些仅是诸多惨败中的三个。——很难在这些事件中找到任何政治问责原则的体现，没有人像在国内政坛中那样付出政治代价。事实上，在欧洲一体化的史册里，连一个区别于个人对不当行为负责的对政治失败负责的例子都找不出来。这不是，绝不

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<sup>10</sup> DEMOCRACY, ACCOUNTABILITY AND REPRESENTATION (Adam Przeworski, Susan C. Stokes & Bernard Manin eds., 1999); Philippe C. Schmitter & Terry L. Karl, *What Democracy Is... and Is Not*, 2 J. DEMOCR., no. 3, 67 (Summer 1991); Peter Mair, *Popular Democracy and the European Union Policy* (European Governance Papers No. C-05-03, 2005), <http://www.connex-network.org/eurogov/pdf/epg-connex-C-05-03.pdf>.

<sup>11</sup> CAROL HARLOW, ACCOUNTABILITY IN THE EUROPEAN UNION (2003).

<sup>12</sup> IAN SHAPIRO, DEMOCRACY'S PLACE 96 (1996); J.H.H. Weiler, *To be a European Citizen: Eros and Civilization*, in THE CONSTITUTION OF EUROPE "DO THE NEW CLOTHES HAVE AN EMPEROR?" 329 (1999).

<sup>13</sup> Renaud Dehousse, *Constitutional Reform in the European Community: Are there Alternatives to the Majoritarian Avenue?* in THE CRISIS OF REPRESENTATION IN EUROPE, 118, 123 (Jack Hayward ed., 1995).

<sup>14</sup> Philip Allott, *European Governance and the Re-branding of Democracy*, 27 EUR. L. REV. no. 1, 60 (2002).

<sup>15</sup> See Resolution on the Outcome of the Copenhagen Conference on Climate Change (COP 15), EUR. PARL. DOC. P78TA(2010)0019 (Feb. 10, 2010) (especially points 5–6).

<sup>16</sup> Iain Begg, *Is There a Convincing Rationale for the Lisbon Strategy?*, 46 J. COMMON MKT. STU. no. 2, 427 (2008); Wim Kok et al., *Facing the Challenge—The Lisbon Strategy for Growth and Employment*, Report from the High Level Group (Nov. 2004).

<sup>17</sup> Ian Ward, *Bill and the Fall of the Constitutional Treaty*, 13 EUR. PUB. L. no. 3, 461 (2007); Editorial Comments, *What Should Replace the Constitutional Treaty?*, 44 COMMON MKT L. REV 561 (2007).

是，因为腐败或其他非法行为。<sup>18</sup>我认为，这种失败根植于欧洲治理结构。这种治理结构根本不是为政治问责原则而设的。同样，想要把欧洲议会选举结果与前任议会中政治团体的表现联系起来，正如在成员国问责制度的中所体现的那样，也是徒劳的。<sup>19</sup>在结构上，当“欧洲”存在时，对它的的不同无法通过任何途径可以在欧洲层面上影响其所承担的治理功能。

同样的，民主的最基础层面，公民们在国内层面上面对众多党派所提供的多元的政策有着政治选择权，但在欧洲联盟社区中，没有任何一种渠道能让公民们直接左右欧盟的政治选择。欧洲议会的政治色彩仅能微乎其微的转化到联盟的立法和行政结果中。<sup>20</sup>

用雷诺·德乌斯（Renaud Dehousse）<sup>21</sup>的妙语来说，政治赤字（Political Deficit）是民主赤字的核心。根据这一本体论形成的自我认知，欧盟委员会和理事会都不是一个左翼或右派的政党，因为其政治组成杂乱无章。民主通常都能有效的体现选民选择的机制，他们在多种选项中作出选择往往来自于或强或弱的理念目标。<sup>22</sup>这在政治中不可或缺。没有政治的民主本身就是一个矛盾的命题。<sup>23</sup>然而这不仅是欧洲的表现，而恰是欧洲的特点——欧盟委员会被广为称颂的“无党派”本质。学生课本里那些老套的说法，如超国家委员会（Supranational Commission），是欧洲利益的维护者，而政府间的委员会则是成员国利益的清道夫——最好可称为天真。难道“欧洲利益”不包括政治和理念上有时明示通常默示的选择吗？

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<sup>18</sup> See also Veith Mehde, *Responsibility and Accountability in the European Commission*, 40 COMMON MRK L. REV. 423 (2003).

<sup>19</sup> Julian Priestley, *European Political Parties: the Missing Link*, NOTRE EUROPE (Oct. 22, 2010), <http://www.eng.notre-europe.eu/011-2247-European-political-parties-the-missing-link.html>; Francisco Roa Bastos, “Des partis politiques au niveau européen?” *Etat des lieux à la veille des élections européennes de juin 2009* [“Political Parties at European Level?”] *The Situation on the Eve of the European Elections in June 2009*, ETUDES ET RECHERCHES [STUDIES AND RESEARCH] 71 (2009); O. Audeoud, *Les partis politiques au niveau européen. Fédérations de partis nationaux* [Political Parties at European Level, Federations of National Parties] LES CAHIERS DU GERSE [THE GERSE PAPER] (Feb. 3, 1999).

<sup>20</sup> Vernon Bogdanor, *Legitimacy, Accountability and Democracy in the European Union*, A FEDERAL TRUST REPORT 7–8 (2007); Andreas Follesdal & Simon Hix, *Why There is a Democratic Deficit in the EU: A Response to Majone and Moravcsik*, 44 J. COMMON MKT, STUD. no. 3, 533, 545 (2006).

<sup>21</sup> Dehousse, *supra* note 13, at 124; see also JEAN-MARC FERRY & PAUL THIBAUD, DISCUSSION SUR L’EUROPE (1992).

<sup>22</sup> Follesdal & Hix, *supra* note 20.

<sup>23</sup> See PIERRE MANENT, LA RAISON DES NATIONS, REFLEXIONS SUR LA DEMOCRATIE EN EUROPE [THE REASON OF NATIONS THOUGHTS ON DEMOCRACY IN EUROPE], 59 (2006).

因此，民主最重要的两个原则，问责原则和代表原则，都在联盟本身的结构和流程中受到了危及。

当前欧洲情况的第二个表现是欧洲建构及其机构中持续下滑的正当性和驱动力。欧元危机，对意大利涌入大量北非移民问题的置之不理，仿佛那只是意大利的问题与欧洲无关，对于欧洲政府和民众层面这些“团结一心”的丑陋表现我不想多谈。我要谈的是两个更深层也更长远的趋势。首先，是选民对欧洲议会的选举参与显著降低。欧洲整体的参加率低于 45%，尤其是有些在东部的国家的参加率低于 30%。<sup>24</sup>正确的对比对象当然是国家议会的政治选举，其参与率明显更高。<sup>25</sup>这些数据的引人注目之处在于，这种下滑与权力向欧洲议会的持续转移同时发生，而欧洲议会如今正是理事会事实上的共同立法者。欧洲议会，所谓的民意代表（*Vox Populi*），其所获得的权力越大，民众似乎越漠视它。<sup>26</sup>令人深思却又不意外的是，欧洲议会作为一个主要成员在当前危机中的缺席。而机构化层面的危机影响还更深。委员会是优秀的有创意的秘书、执行者及监督者，但却既不是理念的源泉也不是政治的领导者。它忠实而高效的执行着他的主人（*His Master*）的指令。但最发人深省的是消失了了的欧盟理事会的行为。它不再是吉斯卡尔一派（*Giscardian*）所打造的欧洲骄傲的领导者，而是欧盟两位主席，默克尔和萨科齐，手中的橡皮印章。这是机构化正当性的失败，是议会和理事会的失败，是超国家主义（*Supranationalism*）和政府间主义（*Intergovernmentalism*）的失败。求助于欧盟之外的公约来作为重建的核心不过是这种政治现实的心酸表现而已。

对于联盟的民主赤字的批判本身又会受到两种批判。第一种只是质疑民主赤字的现状，认为用于评价联盟的标准是错误的。<sup>27</sup>这一系列争论众所周知。<sup>28</sup>就这种争论前面我已明示了我的立场。但我更感兴趣的是第二种批

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<sup>24</sup> *Post-Electoral Survey 2009 Report of the Directorate-General for Communication of the European Commission*, EUR. COMM'N, 22 (Nov. 2009), [http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_320\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_320_en.pdf).

<sup>25</sup> Anand Menon & John Peet, *Beyond the European Parliament: Rethinking the EU's Democratic Legitimacy*, in CENTER FOR EUROPEAN REFORM ESSAYS (2010); Paul Magnette, *European Governance and Civic Participation: Can the European Union be Politicised?* (Jean Monnet Working Paper No. 6/01, 2001).

<sup>26</sup> Jerzy Buzek, *State of the Union: Three Cheers for the Lisbon Treaty and Two Warnings for Political Parties*, 49 J. COMMON MKT STUD. no. S1, 7, 15 (2011); see also Joseph Weiler, *To Be a European Citizen: Eros and Civilization*, in THE CONSTITUTION OF EUROPE 'DO THE NEW CLOTHES HAVE AN EMPEROR?' AND OTHER ESSAYS ON EUROPEAN INTEGRATION 266 (1999).

<sup>27</sup> Joseph Weiler, *Does Europe Need a Constitution? Demos, Telos and the German Maastricht Decision*, 1 EUR. L.J. 219, 225 (1995).

<sup>28</sup> Paul Craig, *The Nature of the Community: Integration, Democracy, and Legitimacy*, in THE EVOLUTION OF EU LAW 25 (Paul Craig & G. de Búrca eds., 1999).



判，它实际上暗示着对结果或输出正当性的祈求。既然联盟不是一个国家，也不能复制或充分地转化国内政府的惯例和实践，它的正当性或许能从别处探索。<sup>29</sup>

在分析欧盟的正当性（及驱动力）时，尤其是针对其持久的民主赤字的背景时，政治及社会科学确实长久以来都在使用过程正当性和结果正当性（也称为输入/输出，过程/结果）的区分。<sup>30</sup>总的联盟和具体到委员会的正当性，尽管受到缺少国内民主的困扰，仍取决于其所取得的成果——在经济、社会、以及最终政治领域。<sup>31</sup>这种观点回归到了最经典的功能主义和新功能主义。<sup>32</sup>

我不想挑战这个立场所隐含的规范性——一个后期的“面包与马戏团”（*Panem et circenses*）的民主方式，这个方式在某些层面至少很麻烦。我想挑战的是其经验主义事实。我不认为结果正当性能解释所有的或大部分欧洲建构的驱动力，但是，不管它的角色是什么它都依赖于“面包”（*Panem*）。对错与否，表现为欧元危机的欧洲的经济灾难来自于欧洲建构。因此，当突然面包没有了，当然蛋糕也没有了的时候，我们得到了另一种“马戏团”的对待，于是公民渐长的漠视转为了敌视，欧洲作为政治驱动力的能力不仅消失，甚至逆转。正当化一场战争的最差方式就是输掉它，而欧洲忽然间不再被视为成功的楷模，而成为了紧缩的象征，也就是对其所承诺的繁荣追逐的失败。如果成功孕育正当性，那么失败，即使错误地归责，则指向其反面。

因此，毫不意外的，一股似乎具有传染性的“反欧洲主义”在各国政坛蔓延。<sup>33</sup>曾经属于极左和极右派边缘政党的理念逐渐地向中央政治力量挺

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<sup>29</sup> Neil MacCormick, *Democracy, Subsidiarity, and Citizenship in the "European Commonwealth"*, 16 L. & PHIL. 331, 331–56 (1997).

<sup>30</sup> See, e.g., CHARLES R. BEITZ, *POLITICAL EQUALITY: AN ESSAY IN DEMOCRATIC THEORY* 31–96 (1990); ROBERT ALAN DAHL, *DEMOCRACY AND ITS CRITICS* 163 (1991); see also REGULATING EUROPE (GIANDOMENICO MAJONE ed., 1996); FRITZ WILHELM SCHARPF, *GOVERNING IN EUROPE: EFFECTIVE AND DEMOCRATIC?* 7 (1999).

<sup>31</sup> Kevin Featherstone, *Jean Monnet and the Democratic Deficit in the European Union*, 32 J. COMMON MKT STUD. no. 2, 149, 150 (1994).

<sup>32</sup> *Id.* at 155; Charles Pentland, *Political Theories of European Integration: Between Science and Ideology*, in *THE EUROPEAN COMMUNITIES IN ACTION* 545, 550 (Lasok & Soldatos eds., 1981); BEN ROSAMOND, *THEORIES OF EUROPEAN INTEGRATION* 20 (2000); see generally DAVID MITRANY, *A WORKING PEACE SYSTEM* (1966); ERNEST B. HAAS, *THE UNITING OF EUROPE* (1958); Ernest B. Haas, *Turbulent Fields and the Theory of Regional Integration*, 30 INT'L ORG. no. 2, 173 (1976); LEON N. LINDBERG, *THE POLITICAL DYNAMICS OF EUROPEAN ECONOMIC INTEGRATION* (1963); REGIONAL INTEGRATION: THEORY AND RESEARCH (LINDBERG & SCHEINGOLD eds., 1971).

<sup>33</sup> CÉCILE. LECONTE, *UNDERSTANDING EUROSCEPTICISM* (2010).

进。“欧洲问题”作为政治对话的一个核心问题，长久以来被认为是“英国式疾病”，蔓延于东南西北的各成员国，在这些国家，非边缘党派都将反欧洲的主张作为其政治资本。<sup>34</sup>这种现象的连锁反应就是主流政党也向这个方向发展，以对抗左右翼政党因此得来的收益。如果我们对这种现象感到讶异，只不过是因为我们似乎已经忘记我们历史上对所谓的欧洲宪法（European Constitution）的抗拒意识了，这是一种可理解的健忘，因为它本身就代表着舆论民意<sup>35</sup>对欧洲集体政治阶级的战胜，纵然没有明言，却在面上打了欧盟机构一个耳光。<sup>36</sup>

#### IV 政治“弥赛亚主义”在欧洲

在某种程度上讲，同样的说法可以说在十年甚至是二十年前就已经提出过了。<sup>37</sup>这种“民主赤字”并非刚刚萌芽——它已经持续存在很久了。那么欧洲究竟如何在其取得前几十年的巨大成功之前，对自己做出正当性辩护呢？

正如我在上文中提示的一样，在概念层面上存在第三种正当化。这种正当化，在我看来，长期扮演着比现在人们所认知到的更重要的作用。事实上，我认为它对欧洲的正当性和取得政治阶层和广大公民的积极回应起着决定性的作用。我还认为它是构成欧盟政治文化的核心元素的关键。这是一种植根于“政治上的弥撒亚”的正当性。

在政治“弥赛亚”主义中，其行为正当性和驱动力并非像在古典民主制度那样来自于过程，也并非来自于结果和自身的成功，而是来源于其所追求的理想，要实现的命运，道路尽头的“应许之地”。的确，在弥赛亚的愿景中，目标永远比手段重要。

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<sup>34</sup> EUROSCEPTICISM: PARTY POLITICS, NATIONAL IDENTITY AND EUROPEAN INTEGRATION 13 (Harmsen & Spiering eds., 2005); ALEKS. SZCZERBIAK & PAUL A. TAGGART, OPPOSING EUROPE? (Vol. I & II, 2008).

<sup>35</sup> NEIL FLIGSTEIN, EUROCLASH: THE EU, EUROPEAN IDENTITY, AND THE FUTURE OF EUROPE (2008).

<sup>36</sup> See, e.g., Joseph Weiler, U.R. Haltern & F.C. Mayer, *European Democracy and Its Critique*, in THE CRISIS OF REPRESENTATION IN EUROPE 4 (Hayward ed., 1995).

<sup>37</sup> See, e.g., Commission White Paper on European Governance, COM (2001) 428 final (July 25, 2001); Vernon Bogdanor & Woodcock, *The European Community and Sovereignty*, 44 PARLIAM. AFF. 481, 492 (1991) (“The shortcomings of the Community lie in the feelings of remoteness and lack of influence and involvement on the part of many of its citizens”); Dieter Grimm, *Does Europe Need a Constitution?*, 1 EUR. L.J. no. 3, 282, 291 (1995); Christopher Hill, *European Foreign Policy: Power Bloc, Civilian Power—or Flop?* in THE EVOLUTION OF AN INTERNATIONAL ACTOR—WESTERN EUROPE’S NEW ASSERTIVENESS 35 (Rummel ed., 1990).

马克·马佐尔 (Mark Mazower) 在其精彩绝伦的对 20 世纪欧洲历史的记载和编纂中<sup>38</sup>极具有前瞻性地展示了由加入第一次世界大战的君主和帝王们组成的欧洲往往植根于各国关于政治救世主理念的传播, (如德国、意大利、俄国, 甚至英国与法国)。一战结束后, 欧洲转而摇摆迈向新型的民主秩序与过程正当性, 随后又动摇转回新形式的政治弥撒亚主义——法西斯主义与共产主义。正如人们常常讲的一样, 在第二次世界大战之后, 西欧据说振荡回至追求民主和过程正当性。我恰恰是要在这点上指出一个有趣的但人们常常忽略的转变。

一方面, 之后成为欧盟成员国的西欧国家无比决绝地变得民主, 他们的爱国主义植根于他们新的宪法价值观, 关于那些被光荣地抛弃、甚至是取笑的、救世主的国家概念的宣传完全失去了吸引力。众所周知, 那些一度用镇压和血腥来维护的帝国, 现如今已被毫不犹豫地抛弃<sup>39</sup>。

然而, 他们共同的追求, 欧洲一体化, 在我看来是最卓越的 (*par excellence*) 一次政治弥撒亚冒险, 弥撒亚变成了其最初和持久的政治文化的核心特征。其动力和主要的正当性特征正体现在其所提供的愿景、所怀抱的梦想和所承诺的美好未来。正是这一特征, 不仅解释了其长期坚挺的动力 (尤其是在社会精英与青年人中), 也解释了其关键的结构和体制选择。它还为现如今欧洲的情形提供了更深层次的解释。

由于政治弥撒亚主义, 不像民主赤字那样反复被人讨论到令人生厌 (*ad nauseam*) 和无聊 (*ad tedium*), 是欧洲正当性的一个特征, 且受到较少关注, 我认为给予它更多关注是合理的。

## V 舒曼宣言——政治弥撒亚主义的体现

舒曼宣言 (*The Schuman Declaration*), 结合其伟大愿景和宏伟蓝图来看, 或多或少都有点类似于欧洲的“独立宣言”。值得注意的是, 《巴黎条约》的序言中很多都援引了舒曼宣言的原文, 而该条约的实质内容也正是基于这一宣言所带来的理念。通过政治弥撒亚主义这一概念棱镜来重新审视该宣言是非常有趣的。我们很容易就能如期在其宪政的、权威性质的文件中观察出其标志性特点。这些特点体现在写入宣言的内容, 同样重要的是, 也体现在没有写入宣言的内容中。请注意 (*nota bene*): 欧洲一体化进程与其欧洲弥撒亚主义的前身——君主制和帝王制, 以及之后的法西斯

<sup>38</sup> MARK MAZOWER, *DARK CONTINENT—EUROPE'S TWENTIETH CENTURY* (1998).

<sup>39</sup> Justine Lacroix, *For A European Constitutional Patriotism*, 50 *POL. STUD.* no. 5, 944, 949 (2002).

主义和共产主义均不能等同。它是自由的、高尚的，但尽管如此，它也是政治弥撒亚主义的。

弥撒亚主义的特征无论在其修辞还是实质内容上都非常明显。首先，注意其语言的使用——仪式性的和“说教的(sermonial)”，伴有些许悲怆(pathos)（和矫揉造作 bathos）。

“世界和平只有通过做出与威胁和平的危险相称的创造性的努力才得以守护……

一个有组织且充满生机的欧洲可以对文明带来的贡献是不可或缺的……

……欧洲邦联化的第一步将改变那些长期致力于为战争生产军需品的地区的命运……

任何法国与德国之间的战争都变得不仅是不可想象，实际上也不可能再发生。

[煤钢的联合]生产将被作为一个整体无差别或例外地提供给全世界。

它可能会成为让那些长期流血对立的国家形成一个更广泛也更深入的共同体的发酵剂。”

这是一种宏伟的、鼓舞人心的、邱吉尔式的表达（也许有人会带些讽刺如是说）。一些旧习，如白人的负担（the White Man's Burden）和传教士的传统还难以消逝：

随着资源的不断增长，欧洲也将能够追求其最重要的任务之一，即非洲大陆的开发。

但是，并非只有华丽辞藻如此，其实质本身也充满救世主的色彩：一个至今至少鼓舞了三代欧洲理想主义者的迷人愿景，即“欧洲人民前所未有的紧密联盟”，和平与繁荣为其锦上添花，成为一片向我们招手的理想之国。

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<sup>40</sup> Franco Piodi, *From the Schuman Declaration to the Birth of the ECSC: the Role of Jean Monnet* (May 2010), [http://www.europarl.europa.eu/pdf/cardoc/24663-5531\\_EN-CARDOC\\_JOURNALS\\_No6-complet\\_low\\_res.pdf](http://www.europarl.europa.eu/pdf/cardoc/24663-5531_EN-CARDOC_JOURNALS_No6-complet_low_res.pdf); Thomas Hoerber, *The Nature of the Beast: the Past and Future Purpose of European Integration*, 1 L'EUROPE EN FORMATION 17 (2006); Joseph Weiler, *To be a European Citizen: Eros and Civilization*,

这个新欧洲计划的动力值得进一步探索。在语言层面上，其巩固和平和重建欧洲繁荣的目标简单而务实，但这一计划的深层结构还有更多的内容。

和平，在任何时代都是人们的迫切所愿，从纯功利主义的角度有其独特的吸引力。然而，显而易见的是，在舒曼计划被提出这一历史大背景下，和平作为一个理想，其概念触及了比圣经中对和平的经典比喻，如偃武修文、安居乐业和羊狼共处等还要更深层次的内涵。我们面临的两难境地正是所谓的宽容与正义（Grace and Justice）的冲突的一个绝好例证，哲学家与神学家对此冲突也已苦思冥想多年——从奥卡姆的威廉（William of Ockham）（前现代主义时期），弗里德里希·尼采（Friedrich Nietzsche）（现代主义时期）到恶名累累但却思想深邃的马丁·海德格尔（Martin Heidegger）（后现代主义时期）。

毕竟这些是50年代早期，人们仍然还沉浸在战争刚刚过去的恐惧之中，对德国侵占时那些无法形容的残忍与野蛮记忆尤为深刻。对于荷兰、丹麦或者法国这样的国家，仇恨彻底地消退将需要很多年。在1950年，建设平等主体共同体，为昨日的敌人长期和平共处提供结构基础的想法，并不单纯是经验丰富的政治家们的锦囊妙计。

首先，它是“勇敢者的和平”，需要勇气与胆量。更深层次上讲，它成功地触及了欧洲的两个文明之柱：启蒙运动以及法国大革命的遗产、和欧洲的基督教传统。<sup>41</sup>

人民已经通过打败德国纳粹获得了自由——以及那些认为自己被国家社会主义（纳粹主义）所解放的狂热德国人（和他们的奥地利共犯一样）。但这是一项体现于舒曼宣言中，在跨国层面增进平等与博爱的事业。一战后凡尔赛版本的和平是要俘获过去的敌人，削弱他，牢牢压迫让他抬不起

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in THE CONSTITUTION OF EUROPE ‘DO THE NEW CLOTHES HAVE AN EMPEROR?’ AND OTHER ESSAYS ON EUROPEAN INTEGRATION 8 (1999) (*Introduction: We Will Do, and Hearken*).

<sup>41</sup> See, e.g., Jürgen Habermas & Jacques Derrida, *February 15, or What Binds Europeans Together: A Plea for a Common Foreign Policy, Beginning in the Core of Europe*, in OLD EUROPE, NEW EUROPE, CORE EUROPE: TRANSATLANTIC RELATIONS AFTER THE IRAQ WAR 5, 10–12 (D. Levy ed., 2005); ALAIN FINKIELKRAUT, LA DÉFAITE DE LA PENSÉE [THE DEFEAT OF THOUGHT] (1987); JOSEPH WEILER, L’EUROPE CHRÉTIENNE: UNE EXCURSION [THE CHRISTIAN EUROPE: AN EXCURSION] (2007); JEAN-MARC FERRY, LA RÉPUBLIQUE CRÉPUSCULAIRE: COMPRENDRE LE PROJET EUROPÉEN IN SENSU COSMOPOLITICO [THE TWILIGHT REPUBLIC: UNDERSTANDING THE EUROPEAN PROJECT IN SENSU COSMOPOLITAN] (2010); ROBERT SCHUMAN, POUR L’EUROPE [FOR EUROPE] 55 (1986).

头，当然，这种和平的结果是灾难性的。这里则不同，我们所追求的是将去年的敌人视为和我们平等的人——德国应被视为一个在事业上充分平等的伙伴——而且像兄弟般相互依存，以至于解决未来纠纷的想法甚至将变得不可想象。<sup>42</sup>这实际上就像康德（Kant）所梦想的一样，是启蒙主义在国际层面上发展。拥护舒曼计划正如在欧洲文明的丰富矿藏中挖掘到了最强大的理想主义矿层。

舒曼计划同时也呼吁宽恕，克服那无可厚非的仇恨所必须要面对的挑战。在那种特殊的历史背景下，舒曼式的和平理念与基督教所传播的，呼吁宽恕敌人、博爱与仁慈的独特教义、意象与价值产生共鸣，这些价值观念在最近因大规模的背叛而显得格外神圣。在这个意义上讲，舒曼计划唤起了忏悔（Confession）和赎罪（Expiation），也与基督教对于悔改、重生以及人类最终良善的信仰遥相呼应。考虑到舒曼计划发起人的个人背景——阿登纳（Adenauer）、德·加斯帕里（De Gaspari）、舒曼（Schumann）和莫奈（Monnet）本人——他们都是极其虔诚的天主教徒，<sup>43</sup>这样的共鸣也就不足为奇了。

鉴于田园“王国”那两个最有力的愿景——人道主义和宗教在一项事业中相结合——所具有的强大的隐形吸引力，这一计划产生的驱动力，尤其在那些感觉自己应对欧洲刚刚走出的这场浩劫负起直接责任的政治阶层精英当中，就并不让人意外了。<sup>44</sup>这也解释了为何从左翼到右翼，无论保守还是激进，都会拥护这一事业。

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<sup>42</sup> Angeles Munoz, *L'Engagement Européen de Robert Schuman [The Robert Schuman European Commitment]*, in ROBERT SCHUMAN ET LES PERES DE L'EUROPE: CULTURES POLITIQUES ET ANNEES DE FORMATION [ROBERT SCHUMAN AND FATHERS OF EUROPE: POLITICAL CULTURE AND YEARS OF TRAINING] 39, 44 (Schirmann ed., 2008).

<sup>43</sup> Fimister, *Integral Humanism and the Re-unification of Europe*, in ROBERT SCHUMAN ET LES PERES DE L'EUROPE: CULTURES POLITIQUES ET ANNEES DE FORMATION [ROBERT SCHUMAN AND FATHERS OF EUROPE: POLITICAL CULTURE AND YEARS OF TRAINING] 25 (Schirmann ed., 2008) (“Schuman was an ardent Roman Catholic, and his views about the desirability of political unity in Western Europe owed much to the idea that it was above all the continent’s Christian heritage which gave consistence and meaning to the identity of European civilization. And the Europe he knew and loved best was the Carolingian Europe that accorded with his religious faith and his experience of French and German cultures”); Mauleon Sutton, *Chapter 1: Before the Schuman Plan*, in FRANCE AND THE CONSTRUCTION OF EUROPE, 1944–2007: THE GEOPOLITICAL IMPERATIVE 34 (2007); Alcide De Gasperi, Address at the Consultative Assembly of the Council of Europe in Strasbourg (Sept. 1952) (“It is with deep faith in our cause that I speak to you, and I am confident that through the will of our free peoples, with your support and with God’s help, a new era for Europe will soon begin”).

<sup>44</sup> One should add that the transnational reach of the Schuman plan served, as one would expect, a powerful internal interest the discussion of which even today meets with resistance. The challenge of “fraternity” and the need for forgiveness, love and

弥赛亚范式也（部分地）解释了为何联盟能在其自身对于民主和人权原则——联盟要求候选成员国恪守这两个原则——未有一个切实的承诺的情况下运作如此长的时间。候选国家必须成为欧洲人权公约的成员国，但是欧盟本身却并未加入；那些国家不得不证明其实施民主的证据，但欧盟本身却没有——这两个异常现象并未引起人们的非议。

然而值得注意的是，其弥赛亚特征并非仅仅反映在华丽的辞藻中。在其原本未经润饰的版本中，宣言在具体操作层面上有着很细致的阐述，然而你在宣言却找不到民主或人权一词，这是一种雷鸣般的沉默。这是一种“放手做吧”类型的项目，因伟大的理想主义（以及被一整代历史学家如艾伦·米尔沃德（Alan Milward）<sup>45</sup>和查尔斯·梅耶（Charles Maier）<sup>46</sup>等所阐述的，一种的对国家利益的仔细权衡）而充满生机。

从其创立之初，欧洲的双螺旋就由欧盟委员会和欧洲理事会所组成：一个国际（被认为是）非政治性的跨国行政/执行组织（委员会），并不像我们传统所讲的与成员国（理事会）合作，而是与成员国政府的行政部门进行合作，多年以来都拥有一个在处理日常事务中不受任何议会，无论是欧洲或是成员国，监督审查的平台。民主压根就不存在于欧洲一体化的原始蓝图中。<sup>47</sup>

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grace was even more pressing internally than internationally. For each one of the original Member States was seriously compromised internally. In post war Germany, to put it bluntly, neither State nor society could function if all those complicit in National Socialism were to be excluded. In the other five, though ostensibly and in a real sense victims of German aggression, important social forces became complicit and were morally compromised. This was obviously true of Fascist Italy and Vichy France. But even the little Luxembourg contributed one of the most criminally notorious units to the German army and Belgium distinguished itself as the country with the highest number of indigenous volunteers to the occupying German forces. The betrayal of Anna Frank and her family by their good Dutch neighbors was not an exception but emblematic of Dutch society and government who tidily handed over their entire Jewish citizenry for deportation and death. All these societies had a serious interest in “moving on” and putting that compromised past behind them. If one were to forgive and embrace the external enemy, to turn one’s back to the past and put one’s faith in a better future, how much more so, how much easier, to do the same within one’s own nation, society even family.

<sup>45</sup> ALAN MILWARD, *THE EUROPEAN RESCUE OF THE MEMBER STATE* (Routledge, 2nd ed. 2000).

<sup>46</sup> See generally *THE MARSHALL PLAN AND GERMANY: WEST GERMAN DEVELOPMENT WITHIN THE FRAMEWORK OF THE EUROPEAN RECOVERY PROGRAM* (Maier & Bischof eds., 1991).

<sup>47</sup> Kevin Featherstone, *Jean Monnet and the Democratic Deficit in the European Union*, 32 *J. COMMON MKT STUD.* no. 2, 149, 150 (1994); see generally Jacques Delors, *Independent* (July 1993).

这样一种见解毫不奇怪，也不激进。难道把欧洲的未来描绘成经过几十年后，“实践者与信仰者”（尤其是欧盟的最原始机构——委员会，以及一个在理事会和成员国常驻代表会议（COREPER）幌子下的实际赋有权力的成员国行政部门）、“精英先锋”（如果给予丰厚酬劳），这些自封的领导者的权力将不得不被欧洲议会掳走，还能称得上美好吗？甚至连欧洲议会都是一个奇特的民意所向。是否正是因为其在大部分存在的时间都以欧洲一体化的拥护者现身，以至于不可避免地，当欧盟和欧洲一体化在公民中激发了恐惧和谨慎（在这样一种激进的欧洲政治转型中这是自然而然的），欧洲议会并未感觉自己是公民可以去表达那些恐惧与担忧的地方？

提出政治弥赛亚主义不仅仅是为了观念上的澄清，更是为欧洲一体化如何在过去非常成功地募集了许多支持提供一种解释。它们打造了一种注重实践、成就和日程不断扩张的文化。考虑到欧洲一体化的宏伟规模，人们应当看到并承认它们美好的方面。

然而这只是故事的一部分。它们还可以解释一些关于欧洲正当性与驱动力衰颓的原因，这种衰颓在当今形势中是如此明显。政治弥赛亚主义特点之一就是它作为一种驱动和正当化机制的时候总是会崩塌。当弥赛亚事业失败之时，当许诺的变革没有来临，它明显地崩塌了。有趣的是，且与欧洲一体化的用语更相关的是，即便在成功的时候它也播下了崩塌的种子。在某一层面上讲，这种崩塌是弥赛亚事业本身不可避免的一个特征。现实总是更加复杂、充满挑战、更乏味且最终无法与之前人们对其所怀抱的梦想相媲美。结果不仅仅缺乏驱动力与合法化，还会催生真正的怨恨。

迦南（Canaan），这个原本的应许之地，是一个与此前的梦想完全不同且对其充满挑战和敌意的主张。宣布独立的印度、肯尼亚，甚至是美国都与其之前所追求的梦想和喜好截然不同。单独地讲，这就像是诸多求爱和恋爱的故事。蜜月总是比婚姻的现实更加美好。尽管天堂在遗失之后才会如此，乐土本身总是无法完成承诺。这也是弥赛亚主义本体论的一部分。

在欧洲一体化背景下，舒曼梦想中那868个激励人心的词语与（已失效却在如今的里斯本条约中重现的）欧洲宪法中那154,183个非常写实的词语的区别正是这一现象的象征性表现。

就欧洲来说，除了弥赛亚作为驱动力和正当性要素的崩塌，还有一些其他偶然的因素。在一个层面上，欧洲是其自身成功的牺牲品。时间的流逝加上愈发巩固的和平，欧洲所呈现的另一种国家之间的对话方式（discourse）是如此的成功，以至于对于欧洲的新生代人来说，舒曼愿景



所具有的实用主义和理想主义的吸引力都是无法另人理解。与这些吸引力相对立的现实是如此强大——那个法国德国之间剑拔弩张之类的时期已经一去不复返，取而代之的是一个充满生机的文明线，各方情势良好，都归功于欧洲本身的建构。

在另一个层面，很多社会风俗都已发生变化。欧洲在很大程度上成为了后基督教的社会。对个人及其权利的深刻认同，不屈不挠地（很多方面也是值得称颂地）将个人放在政治关注点的中心位置，这为自我为中心的个人主义的产生做出了很大的贡献。欧洲的社会驱动力在个人的直接利益受到威胁的时候最为强大，而在为他人需要而付出的时候最为脆弱，正如最近的欧元危机、移民危机和其他一些事件都是典型的例子。所以对于舒曼构想所失去的驱动力的部分解释在于它所能提供的要么看起来全然无关，要么全然无法感染当代欧洲社会那截然不同的理想主义的感性。

结果是，如果政治弥赛亚主义不能快速地取得来自于大众的正当性，它会很快地变得疏离，像傀儡（Golem）一样反抗它的创造者。

民主并不是欧洲一体化原始基因的一部分。它仍旧感觉像是一个外来的移植物。随着其最初的政治弥赛亚主义的崩塌，这种我们都有目共睹的渐行渐远是可以预见的。而且正因如此，当受到如欧元危机一样的失败的打击，当面包（the Panem）消失殆尽的时候，所有正当性的源泉突然都同时崩塌。

这样的崩塌来的很不合时宜，恰好是在欧盟最需要其正当性源泉的时候。问题是欧洲的，也不得不在欧洲层面解决。可惜，为了使其解决方案被认为是正当的，为了使欧洲一体化的下一个阶段不会被愤恨的恐惧所驱动，那些建构者很遗憾地不能依靠欧盟本身的决策过程来解决问题。他们不得不奋力浸入成员国的政治结构和决策过程中去。国家议会、国家司法机构、国家媒体和国家政府将不得不为解决方案增添正当性，这种解决方案不可避免地要涉及更程度的一体化。这将会成为一个完全具有欧洲特征的现象，在欧洲建构演变的决定性时刻，民族国家作为一体化进程的最深层次的正当性源泉，其重要性，甚至是首要作用将会再次得到证明。

# **The International Criminal Court: Pursuing International Criminal Justice and Ending Impunity**

*Judge Sang-Hyun Song\**

**I** am South Korean. When I was eight years old, during the Cold War, war broke out on the Korean peninsula. It was a cruel and brutal war for millions of civilians.

My family lived in Seoul. It was a city that was changed hands several times during the chaos. When I was nine, my family was caught in the middle of one of these battles for Seoul. We hid for three months in a hot and humid underground bunker. For three months, a city was being destroyed, and thousands were being killed, just a few feet above our heads.

It was my job to leave the bunker every day to find and collect food where I could. I would walk many kilometers, and I saw hundreds of the dead.

It was summer and those days were long and hot. There can be no way to forget the precise and sickening smell of bodies left to decompose where they fell. Fathers, Mothers, Brothers, Sisters, Sons and Daughters; their bodies crowded the streets.

A nine-year-old boy does not forget the horrors of war when they are burned into him so acutely.

On occasion, forces on both sides were ordered to directly target civilians. Entire villages were decimated by brutal massacres.

Over three years of war, countless civilians died, possibly several million. The brutality and chaos of the war mean that we have no precise statistics. We have no true record of the people we lost. They were killed

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\* This is a speech's manuscript addressed by Judge Sang-Hyun Song at Peking University School of Transnational Law on May 3, 2013. Judge Sang-Hyun Song is the President of the International Criminal Court (ICC). President Song became a judge of the ICC in March 2003 for a three-year term, in 2006 he was elected to a full term of nine-year-term, and he became President of the ICC in 2009 and will serve until 2015. For more than thirty years, he taught as a professor of law at Seoul National University Law School, beginning in 1972. He has also held visiting professorships at a number of law schools, including Harvard, New York University, Melbourne and Wellington.

through starvation, becoming caught in crossfire, or being deliberately slaughtered by military forces.

Now as the President of the International Criminal Court, I have met child soldiers who have been robbed of a childhood—thrust into murder and rape. I have met victims missing arms, legs, lips, noses and ears. I have met victims who have suffered rape, mutilation, and sexual slavery.

“The International Criminal Court is a symbol of the global community’s determination that this must end.” It is a statement from an assembly of nations that humanitarian atrocities threaten peace and security that these shocking crimes must not go unpunished, and that impunity must be brought to an end.

## **I Origins of ICC**

Prior to the International Criminal Court, the ICC, there was no permanent international institution in charge of investigating mass atrocities and holding perpetrators to account.

In 1998, State representatives, diplomats, lawyers, activists and scholars gathered at a conference in Rome to negotiate over how an international criminal court might function.

This was a historic meeting. So historic that I don’t think it would be an exaggeration to say that only an optimistic few expected it to succeed. But it did succeed.

On the 17th of July 1998, the conference agreed upon a treaty not only establishing an International Criminal Court, but creating a broad framework for international criminal justice. This framework was to be woven out of international and domestic laws and was designed to end impunity for the gravest of human crimes.

The treaty was called the Rome Statute.<sup>1</sup> Many people were impressed that an agreement had been reached, but many remained pessimistic about its future. They thought it might take ten years to get the 60

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<sup>1</sup> Rome Statute of the International Criminal Court, July 17, 1988, 2187 U.N.T.S. 90 (entered into force July 1, 2002).

ratifications required for the treaty to enter into force. In less than four years, we had 89.

China was involved closely with the Rome conference. China supported, and continues to support, the global ideal of an independent international criminal court. And despite not signing the treaty in the end, China did have a lot of input into the drafting of the agreement.

The Court began operating in 2002. I joined as one of the first judges in early 2003. Back then, the Court had an uncertain future.

The Court began with an advance team of just five staffs, working out of temporary rooms in the Dutch Foreign Affairs Department. When the Court held one of its first press conferences in its new building, the staffs made an effort to hide our empty offices and exposed telephone wiring from journalists.

These were humble beginnings for an organization which now stands at the forefront of a system of international criminal justice and which reaches across the globe.

Those 89 countries that originally brought the Rome Statute into force have now grown to an assembly of 122, with new countries joining each year. As you can see, it is a coalition, which spreads across the world.

## **II The ICC in the Asia-Pacific**

As we look to the Asia-Pacific, we can see there are 18 States Parties to the Rome Statute in the region. On these numbers, the Asia-Pacific region has been severely underrepresented comparing with all the other regions. However, to consider only the cold hard statistics would be misleading.

Major players in the region, such as Indonesia, Malaysia, China and Pakistan, have expressed support for the Court's mission to establish individual accountability for war crimes, genocide and crimes against humanity. I note that Indonesia has embraced the goal of ratification of the Rome Statute in their National Human Rights Action Plan.

I have had many productive meetings with representatives from the Asia-Pacific States, which have a high level of interest, and are considering joining the community. Countries in the Asia-Pacific, China in par-

ticular, have a long and proud history of order, justice and law. Coming from Asia myself, I would certainly welcome increasing participation from this region.

So, what is the Rome Statute, and how does it create a system of international criminal justice?

### **III Crimes**

First, we should consider which kinds of crimes the Statute is responsible for. States sought to create a system to prosecute the worst offences ever codified in law. These crimes include genocide, crimes against humanity, war crimes and the crime of aggression.

At this point, I should clarify that the ICC is solely a criminal court, not a human rights court. The ICC only investigates and prosecutes individuals with potential criminal liability, and we do not look to the responsibility of States or organizations.

At the conference in Rome, participants drew on existing international criminal law, which had been developed through the tribunals of Tokyo, Nuremberg, Rwanda and Yugoslavia.

Each kind of the crimes that covered by the Rome Statute is defined in the text of the treaty.

The crime of genocide is defined in Article 6 of the Rome Statute. It involves acts that are committed with the intent to destroy a national, ethnic, racial or religious group.

It also includes violent acts such as murders, serious mental or physical assault, as well as measures aimed at preventing births, removing children from their parents, or any other methods driven by the same goal.

Crimes against humanity are outlined in Article 7 of the Rome Statute. They include acts committed as part of an intentional and systematic attack directed against any civilian population.

This may include murder, slavery, deportations, illegal imprisonment, torture and other inhuman acts. The crime of apartheid is also specifically included as a crime against humanity.

Importantly, the Rome Statute includes detailed reference to particularly brutal sexual crimes—crimes such as systemic rape, enforced sexual slavery, forced pregnancy, and forced sterilization.

These repugnant crimes leave the deepest and most hellish of personal scars upon their victims. The explicit recognition of these crimes in the text of international criminal law is as significant as it is imperative. These are victims who have been too often denied justice.

The crimes of war covered by the Rome Statute are outlined in Article 8. These are largely drawn from the Geneva Conventions. They guard protected persons, such as prisoners of war, from killing, deportation, torture, confinement and other insufferable conditions. The Article also codifies prohibitions on taking hostages, targeting civilians, the use of chemical weaponry, using human shields and deploying child soldiers.

This Article is the longest and most detailed I have spoken about. It is also the one with the longest history. It is a history that takes root in China. It was here that one of the earliest known works was written on what we now know as war crimes. This was long before tribunals in Tokyo and Nuremburg exposed the crimes committed in World War II.

Indeed, thousands of years earlier, during the era of the warring states, bamboo strips were inscribed with principles which live on today in the Rome Statute.

Sun Tzu, a Chinese military strategist and philosopher, wrote more than 2,000 years ago that captured enemy vehicles should have their flags changed before redeployment. This principle lives on in Article 8, Paragraph 2, section B (7) of the Rome Statute. He also wrote that enemy soldiers are to be treated kindly and given care, as set out in Paragraph 2 A of Article 8, which embraces the Geneva Conventions.

Sun Tzu wrote “Lords must not raise armies out of rage; commanders must not launch battles out of fury.... For those enraged may be happy again, those infuriated may be cheerful again, but annihilated countries may never exist again, nor may the dead ever live again.”

There is a reason why Sun Tzu’s text endures to this day.

I now turn to the final crime listed in the Rome Statute, the crime of aggression. The crime of aggression involves the planning, preparation,

initiation or execution of an attack on another State which violates the Charter of the United Nations.

This kind of crime is detailed in Article 8 bis, however, it is a dormant provision for the time being. This is because parties at the Rome conference could not reach a full agreement and decided to postpone its incorporation.

The ICC does not currently have jurisdiction over the crime of aggression, however, it may come into force in 2017. I will try to avoid being too technical and simplify my explanation of how this may happen.

For jurisdiction over the crime of aggression to be awakened, at least 30 countries must ratify the amendments to the Rome Statute concerning this crime. Furthermore, it requires two thirds of States Parties to the Rome Statute to give a positive vote on the amendments at an annual meeting of Rome Statute countries, known as the Assembly of States Parties.

## **IV Jurisdiction**

Now that we have covered the crimes that the ICC is responsible for, we can turn to the other aspects of the Court's jurisdiction.

### *A Jurisdiction in Time*

I will start with the easiest issue, which is temporal jurisdiction. This is as simple as it being crucial. The ICC does not have jurisdiction over any acts that were committed before the Rome Statute entering into force in 2002. This is explicit in Article 11.

If a State becomes Party to the Statute afterwards, the Court may not investigate matters occurring before their specific ratification. It is so unless the State itself accepts the ICC's jurisdiction for those matters.

It is important to understand that the ICC is a prospective court looking forward, not a retrospective court delving into history. In this way, it is very different from the temporary tribunals of Tokyo, Nuremburg, Rwanda or the Former Republic of Yugoslavia.

### *B Territorial and Personal Jurisdiction*

The second issue of competence concerns territorial and personal jurisdiction. This is a little more complicated.

The Court has jurisdiction over crimes committed in countries that have joined the Rome Statute, as well as crimes committed by citizens of those States. If a crime is committed in a country that is not a party to the statute and the suspect is not a national of a State Party, the court will have no jurisdiction.

However, there are two exceptions. One is when a country accepts the jurisdiction of the ICC, even though it is not a State Party. This happened in the case of Côte d'Ivoire—also known as the Ivory Coast—which later became a party to the Rome Statute.

The second exception is when the United Nations Security Council, acting under Chapter VII of the Charter, refers a situation to the ICC for possible investigation and prosecution.

This has happened twice with Darfur, Sudan, and Libya. Darfur was referred to the Court in 2005, with both China and the United States abstaining. In 2011, China supported the referral of Libya, as so did the United States, making the referral unanimous.

## **V A Framework for Justice: Complementarity**

Now that we have looked at the ICC's jurisdiction, I would like to talk about the broader framework of International Criminal Justice, which the Rome Statute establishes.

I mentioned before that the Rome Statute creates a system of international justice woven from both domestic and international legal systems. This system is created from the principle of complementarity.

The Rome Statute encourages States to codify Rome Statute crimes into their own domestic law, and to prosecute any such crimes in their national courts. This means that the International Criminal Court truly exists only as a failsafe court.

It is only when countries are unable or unwilling to genuinely investigate and prosecute these cases that the ICC will become involved. The ICC is a court of last resort. In this way it is complementary to domestic systems.



In reality, many countries, especially those being ripped apart by war, lack the capacity to mount trials of the complexity and scale demanded. The ICC will therefore always be required as backup solution.

The complementarity principle is fundamental to the Rome Statute. It is important for two primary reasons.

First, it is in the interests of transparency and access to justice to hold proceedings as close as possible to where atrocities occurred. This is where most of the evidences, victims and witnesses are located. As many countries have outlined in recent statements to the U.N., it is beneficial for reconciliation to have justice served as close as possible.

Second, the principle of complementarity ensures the protection of state sovereignty. This assures States that the international community will not unnecessarily interfere with their affairs. This principle has removed a major stumbling block to nations accepting the jurisdiction of an international criminal court.

### *A Ending Impunity*

It is in this way, through a networked system of domestic legislation, and an international failsafe court, that the Rome Statute has built a system of international criminal law to bring order, justice and accountability to those who need it most.

Those suspected of committing genocide, crimes against humanity, and war crimes, can no longer roam with impunity. All 122 State Parties to the Rome Statute are compelled to arrest and to extradite ICC suspects on their territory.

Perpetrators can no longer count on international indifference.

### *B Support and Progress*

Even countries that are not party to the Statute are actively supporting the ICC. The United States, which was originally hostile to the Court, recently helped transfer a suspect, Bosco Ntaganda, who appeared at their embassy in Rwanda. The United States has also recently announced millions of dollars in reward money for information leading to the apprehension of those subject to ICC arrest warrants.

Other major powers, such as China and Russia, have expressed support for the goals of the Rome Statute.

While we operate in a world where political considerations often rule, the ICC stands apart to preserve its character as a judicial institution. It is our independence and integrity which have won the trust, respect and international support that the ICC continues to require.

The path of judicial independence is often a delicate one to navigate in a political world, but I am convinced that this is the only way to fulfil our mandate to end impunity for the world's most abhorrent crimes.

From those early days of 5 staffs and tangled wiring, the ICC has grown. We now have more than 800 staff and officials. They come from all corners of the globe. They are judges, associates, prosecutors, investigators, interpreters, diplomats, lawyers, victims' representatives, and other professionals in many different roles.

Unfortunately, Asia still remains underrepresented—but this is an opportunity for you. I would invite all of you in this room to consider future involvement with the ICC, as a staff member, or participating in our comprehensive internship program. A global court needs a global perspective, and Asia must be a part of this.

The ICC is now involved in more than 15 countries across the world. Our prosecutor has opened investigations in 8 former or current conflict zones, and we have field offices in five of these locations. Preliminary examinations are currently underway in countries as diverse as Afghanistan, Colombia, Georgia, Guinea, Honduras, Korea and Nigeria. The ICC has been seized of 18 cases, involving 31 suspects. The first trial judgements were issued last year.

## **VI Conclusion / Call for Asian Participation**

I said earlier that many people believe this century will be one of Asian leadership. I am one of those people. There is truly no better time for Asian States to increase engagement with international institutions on global issues. With a long and proud history and a rich tradition, Asia certainly has much to contribute.

China is a country with thousands of years of recorded history, and it is a history which is still being written. It has been more than 30 years since China began the process of reform and opening up, and it is a process which continues to this day.

The tremendous success of economic integration is proof that China has much to offer the world, and that the world has much to offer in return. Reform and opening up—it is a process which encompasses more than just economics.

We no longer live in provincial times. National borders are not what they once were. We are all global stakeholders. We share a stake in the global economy, in the global environment, in global society, in global security and in our collective global humanity.

The Chinese ideals of rules-based order, of a harmonious world—these are ideals shared by the international community and embodied in institutions such as the ICC. By playing its part as a responsible global power, China can embrace its rise as we work together to better humanity, and towards sustained global harmony.

Here at the Peking University School of Transnational Law, I know that I am not just speaking to students, but to future leaders. All of you have the power to rise and shape the future of this region, and with it, the world.

I am sure you will stand up and ready yourselves for the challenge. It must truly be an exciting time to be young, and to be Asian.

## Human Rights Litigation in the United States After *Kiobel*

Paul B. Stephan\*

In April, the Supreme Court decided *Kiobel v. Royal Dutch Petroleum Co.*,<sup>1</sup> a case seeking to impose civil liability on an Anglo-Dutch corporation for atrocities carried out by Nigerian security forces against Nigerian nationals. Observers looked to the Court to provide some guidance on the growing number of lawsuits of this character brought in the United States. This lecture describes what the Court did, explains what it did not do, and speculates about what the future holds for human rights litigation in the United States.

Human rights litigators live in dread of the Supreme Court. Since 1980, they have wrung from the lower federal courts a series of victories making it reasonably easy to bring, if not necessarily win, lawsuits against persons accused of violating human rights law. Their victories included:

- Acceptance of the fundamental proposition that the customary international law of human rights enters the U.S. legal system as federal common law as the result of a 1789 jurisdictional statute called the Alien Tort Statute;<sup>2</sup>

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<sup>1</sup> *Kiobel v. Royal Dutch Petroleum Co.*, 133 S. Ct. 1659 (2013).

<sup>2</sup> United States Judiciary Act of 1789 §9, 28 U.S.C. § 1350 (1982).

- Recognition of a federal cause of action to enforce this body of law;
- Endorsement of a license for judicial creation of international human rights law, freed from the bounds of existing legislation or treaties;
- Extension of liability to private actors, most importantly including multinational corporations;
- Including imputed liability for private actors as a means of extension;
- Application of this liability to foreign actors and conduct;
- Surmounting defenses such as act of state and foreign official immunity; and
- Relaxation of conventional restraints on international civil litigation such as personal jurisdiction and *forum non conveniens*.

All this came about with only the most minimal legislative authority and only intermittent and guarded support from the Executive. The litigators know that their victories rest ultimately on twin commitments, both more policy than legal. The judges who support their cause believe that human rights violations cry out for legal intervention, and think that civil suits in U.S. courts are a good, if not necessarily the best, way for this intervention to proceed. The litigators have reason to doubt that a majority of the Supreme Court shares these commitments. They worry that it might look more skeptically at the admittedly scant positive legal authority that the human rights plaintiffs have to support their claims.

In 2004, when the Court took up *Sosa v. Alvarez-Machain*, the human rights community held its collective breath.<sup>3</sup> The case came from the Ninth Circuit, a court of appeals demonstrably out of step with the Justices in Washington, and involved a plaintiff who already had seen the Supreme Court overturn an earlier victory in the Ninth Circuit.<sup>4</sup> The initial news that the Court indeed had again reversed the Ninth Circuit prompted depression and dismay. But a careful reading of the Court's opinion restored the litigators' spirits. The Court had seemed to endorse the first two points, had limited rather than upended the third; and said nothing discouraging about the remaining concepts that sustained human

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<sup>3</sup> *United States v. Alvarez-Machain*, 504 U.S. 655 (1992).

<sup>4</sup> *Id.*

rights litigation.<sup>5</sup> The courthouse doors were still open, and in the following years the number of suits even grew.

Fear and loathing returned in 2011, when the Court agreed to review the Second Circuit decision in *Kiobel v. Royal Dutch Petroleum Co.*<sup>6</sup> Human rights lawyers hated the lower court's ruling, which held that the federal common law of international human rights did not include corporate liability, a concept generally alien to public international law. But they doubted that the Supreme Court would do much good and feared that it would make much mischief. These fears came closer to realization in 2012, when the Court ordered re-argument so that it might consider, not just whether U.S. law held corporations civilly liable for human rights violations, but whether U.S. law imposed liability on anyone for conduct taking place outside the United States.

On the one hand, it might seem odd to say that a body of law designed to vindicate victims of international legal transgressions should confine itself to the territory of a single state. Who is international human rights law for, if not for everyone? On the other hand, the evolution of U.S. civil litigation into a means for righting wrongs that occur anywhere in the world, even where neither the victims nor the transgressors had any significant tie to the United States, seems a bit odd. To appreciate why, some appreciation of the foundations of international law is necessary.

International law embraces two fundamental principles, namely territorial sovereignty and state responsibility. International law intrudes on a sovereign's domestic acts only if the sovereign has agreed to the intrusion. Moreover, international law does not regard a sovereign as responsible for all acts anywhere in the world, but rather for acts taking place on its territory and those instances where it projects its authority and power outside its borders.

For the United States to hold itself out as an international lawmaker, prescribing the rules and consequences of disputes with which it had no connection under traditional international law concepts, struck some as not only unjustified, but itself a breach of international law. First, in the alien tort cases, the United State purported to resolve disputes in which it had neither any residual responsibility to the international community nor any grievance based any international law. Second, no other state had consented to the United States' assertion of the right to prescribe and apply the rules governing disputes about atrocities committed on that

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<sup>5</sup> *Sosa v. Alvarez-Machain*, 542 U.S. 692 (2004).

<sup>6</sup> *Kiobel v. Royal Dutch Petroleum Co.*, 621 F.3d 111 (2d Cir. 2010).

state's territory. Accordingly, the U.S. government during the first decade of the new century began to argue that the federal common law of international human rights should not extend past transactions that implicated U.S. responsibility under international law. As a practical matter, this meant limiting civil suits to transgressions that occurred on U.S. territory.

In essence, the issue brought two competing conceptions of international law into sharp contrast. One is universalist and focused on the needs of humanity as a whole; the other regards states as the only legitimate law-givers in the international sphere. On the one hand, many would argue that international law has evolved over the last half-century or so from a set of rules that only governs relations among states, to a body of law that also vindicates the fundamental interests of humanity against all who threaten them. In international law's universality, these proponents see an underlying commitment to core values from which no actor, state or non-state, can derogate. International law has become the pathway for human respect and flourishing in a profoundly transformed international landscape. Moreover, domestic judges do well when they lend their resources to this universalist enterprise.

The other conception is of an international legal system designed and constructed by states. States turn to international law and international institutions to solve problems that are beyond the capacity of any one state. They do not, however, make any more international law than they need, or at least want. In particular, identification of a particular problem, such as disregard of fundamental human rights, does not imply a license for any and all to impose a solution. Delegation to the International Criminal Court in the Hague of the authority to address particular human rights violations through international criminal proceedings does not mean that individual states have a parallel right to attack the same problems through civil litigation, at least not when those states have no connection to those problems other than that shared with all humanity.

As an abstract matter, both conceptions of international law, the universal and the state-based, have much to recommend themselves. In economic and social terms, people increasingly live in a global, transnational world that seems to push aside state authority. The communications revolution, embodied in the worldwide web and social media, seems to constitute humanity as an independent force, unshackled by traditional structures of authority. In the modern world, information is power, and information leaps easily over national borders. Shouldn't international law follow in the wake of these transformations and lose the state monopoly on lawmaking?

Yet however important is knowledge and the virtual world, the physical space on which states still exercise territorial sovereignty remains fundamental. The servers and the transmission networks exist physically, not virtually. People have a physical location. And where territory matters, so do states.

Considerations of raw power aside, only states enjoy the ultimate authority legitimately to employ force in pursuit of their objectives. There are plenty of violent private actors, but we normally think of them as criminals or terrorists, not alternative governance structures. Not all states organize themselves in ways that promote human flourishing and happiness—perhaps none do so optimally—but humanity has not yet devised alternatives to states when it comes to governing territory. Their competitors face real problems of legitimacy. And that means those who purport to proclaim law on behalf of humanity have a hard time explaining where their authority comes from, if not from states.

As it turned out, in *Kiobel* the Supreme Court did not choose between these competing visions of international law. Instead, the Court's majority focused on domestic law and domestic legal principles. It framed the question it had to decide not as an issue of what is right, but rather of what authority should federal courts ascribe to themselves in the face of ambiguous legislative commands. The case, in other words, turned on a particular conception of separation of powers, not international law. The human rights community still is not happy with the decision, but, as with *Sosa*, the news is not as bad as it first seemed.

Since the 1970s, the Supreme Court has concerned itself with what might be called the problem of self-judging federal jurisdiction. The Constitution makes clear that the subject matter jurisdiction of federal courts—the power of a federal court to hear particular kinds of disputes—is limited. During the 1960s, federal courts began devising strategies to overcome these limits through tricks of statutory interpretation. If Congress enacted a legal rule but did not specify how to enforce it, courts would imply a right of victims of rule violations to bring a federal claim for compensation. If Congress specified federal court jurisdiction as to a category of disputes, courts would infer a license to create the rules of decision that would apply within that category. And if Congress did not specify the boundaries of a rule, courts would extend it to foreign conduct, at least if the parties or conduct had some connection to the United States. These courts saw their own power as a good thing that wanted extension, at least when Congress had not clearly decreed otherwise.



By the 1970s, the Court began to express doubts about this tendency, and in the 1980s and 1990s, it pushed back hard. Among other things, it pronounced a presumption against extraterritoriality as a tool for interpreting ambiguous legislation. Courts always had interpreted statutes as bounded by the general international law limits on prescriptive jurisdiction, but the recent cases demanded more. If Congress wanted to regulate foreign transactions, it would have to do so clearly and explicitly. Thus, in 2010, the Court in *Morrison v. National Australia Bank* threw out five decades of lower court precedent and proclaimed that civil suits based on fraudulent securities transactions had no place in federal court, unless the transactions (and not the acts of fraud) occurred on U.S. territory.<sup>7</sup>

Critics of this development responded, extraterritorial as to what?<sup>8</sup> Rare is the transaction where nothing connects the suit to the United States. What are the criteria for determining what exactly must be domestic, if some part of the case is domestic? The short answer is that it depends on the legislative scheme, but arguably this only pushes back the question. Are the federal securities laws about regulating sales of securities, or about regulating fraud? *Morrison* argued, based on reasonably strong evidence in the language of the legislation at issue, which the securities laws focus on sales. But what about other regimes where the clues provided by Congress are less evident?

This is the problem that *Kiobel* presents. The majority argued that *Morrison*'s presumption against extraterritoriality applies to the federal common law of international human rights, because Congress has not indicated that it wants U.S. courts to impose this common law on foreign transactions. But what exactly constitutes a foreign transaction? In *Kiobel*, everything was foreign—the plaintiffs, the defendants, the place where the atrocities occurred. The only link to the United States was that a U.S. court arguably had personal jurisdiction over the foreign defendant, and the plaintiffs wanted to be in that court.<sup>9</sup> Every member of the Court agreed that this was not enough, whether one applied the presumption against extraterritoriality or some other standard. But, because this federal common law derives from a very old and until recently unused juris-

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<sup>7</sup> *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010).

<sup>8</sup> See, e.g., William S. Dodge, *The Presumption Against Extraterritoriality After Morrison*, 105 AM. SOC. INT'L L. PROC. 396 (2012).

<sup>9</sup> The plaintiffs' theory as to why a New York court had personal jurisdiction over a foreign corporation that did not do business directly in the United States, but did have U.S. subsidiaries and had listed its stock on U.S. exchanges, will be assessed next Term in a case coming out of the Ninth Circuit. *Bauman v. DaimlerChrysler Corp.*, 644 F.3d 999 (9th Cir. 2011), cert. granted, 133 S. Ct. 1995 (2013). Although the facts of the two cases are not identical, they overlap significantly.

dictional grant, Congress has not left us many clues about the purpose of this regulatory regime.

One might construct an answer, consistent with the state-based concept of international law. It is plausible; indeed I think the historical evidence is rather clear, that Congress adopted the so-called alien tort statute back in 1789 to address a problem of state responsibility under international law. By this I mean that Congress understood that foreign nations would hold the United States responsible for certain acts by private persons, and one way that the United States could respond to this obligation would be to permit victims of those acts to bring civil suits for compensation against their attackers. The events that probably prompted Congress to act involved outrages on the person or property of foreign diplomats on U.S. territory. Congress might further have understood that, under principles of territorial sovereignty as they were understood in 1789, international law would require a state to answer for private (non-state) conduct on its own territory, but not for conduct carried out by non-state actors on another sovereign's territory. If this reasoning is correct, then the presumption against extraterritoriality would limit the scope of civil liability based on the location of the conduct giving rise to a claim for compensation. In other words, did the international law violation occur within the United States?

But this construction stills demands an answer to the question, what constitutes an internationally wrongful act? What about internationally wrongful omissions? Does international law impose an obligation on a state to take action against persons found on its territory who have committed an international harm somewhere else? In other words, does international law require that states not give haven to persons responsible for international law violations, and in particular human rights violations? Does providing a haven for such a person satisfy the territorial limit expounded by the *Kiobel* majority?

Unfortunately, the *Kiobel* opinion does not give much of an answer. The majority states, rather cryptically, that "where the claims touch and concern the territory of the United States, they must do so with sufficient force to displace the presumption against extraterritorial application."<sup>10</sup> What counts as touching and concerning, as well as how to assess "force," goes unanswered. Even more unhelpful is Justice Kennedy's concurring opinion, given that he provided the crucial fifth vote. It says, "The opinion for the Court is careful to leave open a number of signifi-

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<sup>10</sup> *Kiobel*, 133 S. Ct. at 1669.

cant questions regarding the reach and interpretation of the Alien Tort Statute. In my view that is a proper disposition.”<sup>11</sup> Presumably what must occur within the United States is conduct that transgresses the federal common law derived from the Alien Tort Statute. Perhaps the conduct itself, and not its planning and direction, must occur domestically.<sup>12</sup> But we cannot have great confidence in the existence of other limits or exceptions to the territoriality requirement.

Justice Breyer and his colleagues, while agreeing with the outcome of dismissal, fully embraced the “haven” theory of international wrong. Breyer relied on a somewhat fanciful analogy between piracy and human rights violations, asserting that international law today imposes the same positive obligation on states to dispose of human right violators in their midst that it once did (and perhaps still does) with respect to pirates. The argument seems flawed. International law rather clearly requires states harboring perpetrators of torture, genocide and grave war crimes to either prosecute or extradite those persons, but it does not require those states also to give victims a path to compensation. But Breyer’s position at least provides some clarity and links the scope of liability to a theory about international law, even if theory itself is mistaken.

A short opinion by Alito, joined by Thomas, seems to make my point about this mistake. They argue that federal common law allows a civil suit only if conduct on U.S. territory violates a clear and widely accepted rule of international law. Breyer’s violation-by-omission concept flunks this test, although Alito is too polite to say so. But that accounts for only two votes, and a majority requires five.

Breyer’s point might be somewhat different. He might believe that once a state accepts the right of another state to impose criminal penalties on its nationals for conduct on its territory, as states do with respect to torture, genocide, and war crimes, it has as a matter of international law waived any objection to a civil suit involving the same conduct. This represents an application of the greater-comprises-the-lesser principle, and presumes that a criminal prosecution is a greater intrusion than is a civil suit for compensation.

I think this argument also is wrong, but the question is closer. It is not necessarily true that civil liability is a lesser intrusion than is criminal

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<sup>11</sup> *Id.* (Kennedy, J., concurring).

<sup>12</sup> In *Sosa*, the Court interpreted the analogous Federal Tort Claims Act as not allowing tort suits where only the planning and supervision, and not the offending conduct, occurred in the United States.

liability. Especially under the unique U.S. system of civil litigation, civil liability can entail large monetary sanctions not tied to the level of injury suffered by a victim. Even more importantly, private parties decide when to bring a civil suit, and do not have to account for the diplomatic or political consequences of this decision. To the extent that a state exercises ultimate control over the decision when to prosecute (as they do, in every jurisdiction with which I am familiar, with respect to conduct defined as crimes under international law, even when private persons otherwise can initiate a criminal prosecution), the risk of burdensome and unfounded suits is much lower. It is exactly these arguments that have led courts in Australia, Canada, New Zealand and the United Kingdom to reject civil liability under those circumstances where the national prosecutor may bring a criminal prosecution for grave human rights abuses.<sup>13</sup> Thanks to Kennedy's reservation, however, we don't know whether the haven theory is dead or merely sleeping. The *Kiobel* majority certainly did not endorse it, but neither did the majority of the majority (Scalia, Kennedy and Roberts) reject the theory, and, according to Kennedy, every question left undecided remains open. Only further litigation will produce answers.

What remains of human rights litigation in the United States? I can only speculate, but here are a few guesses:

1. In theory, Congress could respond to *Kiobel's* invitation by adopting a statute defining a civil action in federal court based on international human rights law. Even if such a statute exceeded the boundaries of prescriptive jurisdiction permitted by international law, U.S. courts would enforce it. On the one hand, Congress responded to the last two Supreme Court decisions on the presumption against extraterritoriality with new legislation.<sup>14</sup> On the other hand, the present political climate does not hold out much promise of legislative action in any area of public interest, including matters even more important than international human rights. We shall have to wait and see.

2. The courts could distinguish claims against U.S. actors, including corporations, from those against foreign companies such as Royal

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<sup>13</sup> See *Zhang v Zemin*, (2010) 243 FLR 299 ¶121 (Austl.); *Jones v. Ministry of Interior of Kingdom of Saudi Arabia*, [2006] UKHL 26 (appeal taken from EWCA (Civ)); *Bouzari v. Islamic Republic of Iran*, (2004) 71 O.R.3d 675 ¶28 (Can. Ont. C.A.).

<sup>14</sup> Congress responded to *E.E.O.C. v. Arabian American Oil Co.*, 499 U.S. 244 (1991), with Civil Rights Act of 1991, Pub. L. No. 102-166, § 109(a), 105 Stat. 1077 (codified at 42 U.S.C. § 2000e(f)). It responded to *Morrison* with Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 929P(b), 124 Stat. 1864 (codified at 15 U.S.C. §§ 77v(c), 78aa(b), 80b-14(b)). Both provisions provided for limited extraterritoriality.

Dutch Shell. Under some variant of the haven theory, the United States faces international accountability when it fails to redress international injuries inflicted by its subjects. I suspect this argument will not succeed, however. First, as a straightforward matter of international law, it simply is not true that a sovereign always is answerable for the wrongful conduct of its subjects. Especially if other sovereigns have jurisdiction to take action, such as when the misconduct occurred on their territory, there is no basis in international law to insist that the subject's sovereign must act as well. Second, as a practical matter, it is hard to imagine U.S. courts or Congress burdening U.S. companies with a legal obligation regarding their overseas conduct that does not apply to their foreign competitors. As recent patterns in Foreign Corrupt Practices Act enforcement illustrate, U.S. lawmakers, both legislators and law enforcers, try hard to even the playing field between U.S. firms and their foreign competitors.

3. Plaintiffs will seek to establish U.S. facts. They might allege, for example, that high corporate officials working in the United States took part in the wrongful conduct, such as by soliciting state action or accepting its benefits. Such allegations might survive a motion to dismiss and lead to settlements. But, for the reasons discussed above with respect to U.S. defendants, I doubt that the courts will endorse a rule that exposes U.S. firms to greater legal risk than their foreign competitors would face.

4. Plaintiffs will sue the U.S. government and U.S. officials for human rights abuses. This was the fact pattern in *Sosa*. It didn't work in that case because the United States waives its sovereign immunity only for acts on US soil, and the Supreme Court did not regard acts planned in the U.S. but carried out in Mexico as taking place on U.S. territory.<sup>15</sup> Moreover, suits against U.S. officials for anything connected with their work are converted by statute into a suit against the United States.<sup>16</sup> So the only suits that would survive a sovereign immunity defense would be those raising claims against U.S. officials for acts that the U.S. government would refuse to treat as part of their work.

5. Plaintiffs might bypass federal law altogether and sue in state courts. Nothing in principle bars a state court from hearing a claim under foreign or international law, as long as the plaintiffs can get personal jurisdiction over the defendant. States may even impose greater legal burdens on its own residents, as California arguably does with respect to

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<sup>15</sup> *Sosa*, 542 U.S. at 700–12.

<sup>16</sup> *Osborn v. Haley*, 549 U.S. 225, 227 (2007) (certification by Attorney General that a tort suit against a federal employee arises out of the course of the employee's employment is conclusive, converting suit into one against the United States).

firms that have their headquarters in that state. The principal legal barrier for plaintiffs will be claims of federal preemption. Some Supreme Court cases indicate that states cannot use civil suits in a manner that substantially interferes with the foreign relations of the United States. Defendants also might argue more narrowly that the federal common law of international human rights preempts state efforts to adopt overlapping and different rules. It is impossible to predict how these arguments will play out.

These doctrinal developments are important and interesting, but it also may be worthwhile to step back and consider what these events reveal about the sociology of litigation. The early lower court suits on which the development of alien tort law rested—*Filártiga v. Peña-Iralain* 1980 and *Kadić v. Karadžić* 1995—pitted victims of atrocities against the thugs who perpetrated them.<sup>17</sup> In neither case did the defendant have significant assets in the United States or any realistic hope of remaining in the country. Although both defendants may have been competently represented, they by no means had the best and most creative legal talent that the United States can offer. The plaintiffs, by contrast, had gifted as well as committed movement lawyers as their counsel. This inequality in arms made it unlikely that all of the weaknesses in the legal theories on which the plaintiffs relied would be exposed.

Over the last 18 years, these theories now have been tested by defendants that can afford the very best representation. Increasingly, they have relied not simply on experienced defense litigators, but on international law experts that appreciate the elisions in the principal liability theories that the plaintiffs have asserted. Moreover, the views of the government's lawyers have evolved, as the potential drawbacks of these suits have become evident. Especially in the Supreme Court, the community of international law experts no longer speaks with one voice, but rather quarrels over the core principles of international law that govern human rights litigation.

The Justices have come to see the matter as complicated, are for the most part uncomfortable about making any strong assertions in the area (Justice Breyer excepted), and have looked for other means of disposing of these cases. They have, in a word, come to view alien tort litigation mostly as a species of civil litigation, and not as a means for honoring, enriching, and enforcing international law. And within the context of civil litigation, the outcomes of *Sosa* and *Kiobel* fit into a broader pattern

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<sup>17</sup> *Filártiga v. Peña-Irala*, 630 F.2d 876 (2d Cir. 1980); *Kadić v. Karadžić*, 70 F.3d 232 (2d Cir. 1995).

of growing skepticism about the benefits of private suits to rectify public wrongs.

This suggests an even larger point. American lawyers tend to celebrate their judges, the federal ones in particular and the Supreme Court Justices most of all. We should, of course, be proud of our institutions. It seems, however, as if some lawyers believe that law isn't really law unless the Supreme Court has endorsed it. If what lawyers do does not find its way into litigation in a way that a court can apply and explain, practitioners seem to think that their commitments and principles simply do not count for much.

But civil litigation may not be the best place to look for international law, especially in the United States. A case is inevitably framed by the interests of the litigants, which may accidentally correspond to the general public interest. The U.S. system, exactly because it encourages creative claims and a good deal of experimentation, lends itself to generating what the social scientists call false positives—assertions about the state of the world that do not correspond to reality. In particular, there is no good filter to distinguish international law as we find it—*lex lata*—from international law as some would like it to be—*lex ferenda*.

Moreover, the correspondence between litigation and the application of international law is more incidental than direct. The Supreme Court observed a half century ago in the famous *Sabbatino* case that international law enters civil cases only fortuitously, and most of the instances where a principle of international law might matter never wind up in court.<sup>18</sup> Courts, the *Sabbatino* majority explained, lack the competence to develop international law not only because of lack of expertise, but because their job—deciding cases—so rarely overlaps with international law enforcement. The Court's conclusion then—if you want international law, go to a political body with the capacity to make it—still has force today.

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<sup>18</sup> *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 431–36 (1964).

# Rewriting the New “Great Game”: China, the United States, and their International Public Lawyers<sup>1</sup>

*Diane A. Desierto* \*

The June 2013 United States-China Summit signals a watershed moment for postmodern international law and global policy, implicitly conveying China’s bid to shift from the United States’ unipolar hegemony, to one of shared ‘Great Power’ responsibility. This dialogue revives the 1800s Great Game themes on the appropriate spaces of sovereignty and internationalism, and in the contemporary spheres of US-China relations, is critically being translated in both countries’ day-to-day engagement of international economic law, *jus ad bellum* (the law governing the use of force) and *jus in bello* (the law governing the conduct of hostilities). The peaceful outcome of this century’s new Great Game will be decided mostly through the crucial role of each country’s corps of international public lawyers. This lecture identifies the urgent areas of expertise, experience, education, and engagement necessary for Chinese law students and future leaders.

## **I Introduction: An International Lawyer’s Lens**

I am not a historical analyst, political economist, or diplomatic specialist in United States-China relations; neither am I a scholar of American foreign policy or Chinese foreign policy. I am neither American nor am I Chinese. While I have lived, studied, and worked at various points in my career as an international law scholar in the United States and China, I have also lived, studied, and worked in various countries

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throughout Asia and Europe.<sup>2</sup> I have had training in both common law and civil law traditions, before I moved on to specialize in international law. One could rightly say (and I concede in advance) that my thoughts on the lecture topic today would be rather different from what most enthusiasts and/or critics of US-China relations would expect.<sup>3</sup>

I do, however, claim the viewpoint of an international public lawyer<sup>4</sup>—and one who has had the great privilege of teaching international law this past year in China's premier law school, and who, in the coming months, would be tasked with the responsibility of succeeding to the void

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<sup>2</sup> Among other affiliations and/or designations, the author was Law Clerk to H.E. Judge Bruno Simma H.E. Judge Bernardo Sepulveda-Amor at the International Court of Justice, the Hague, Netherlands; Research Fellow at the Max Planck Institute of Comparative Public Law and International Law in Heidelberg, Germany; Shearman & Sterling Scholar and Runner-Up Laureate of the Academie du droit de l'arbitrage in Paris, France; Professorial Lecturer at the University of the Philippines, Lyceum of the Philippines, and the Foreign Service Institute of the Department of Foreign Affairs; Rapporteur at the ASEAN Integration through Law project of the National University of Singapore; Consultant to the Office of the Chief Economist of the Asian Development Bank. The author is currently a Member of the Scientific Advisory Board of the European Journal of International Law, Member of the Editorial Board of the Asian Yearbook of International Law, and Director of Studies for Public International Law (2017) of the Hague Academy of International Law.

<sup>3</sup> US-China relations constitute an entire analytical discipline occupying a prominent place in international academic scholarship from both sides of the Pacific. Some influential works include Michael Oksenberg and Robert B. Oxnam (Eds.), *Dragon and Eagle: United States-China Relations: Past and Future* (New York, 1978); Gordon H. Chang, *Friends and Enemies: The United States, China, and the Soviet Union, 1948–1972* (Stanford Univ. Press, 1990); Yang Zhong and Che-huan Shen, Reading China: How Do America's China Scholars View US-China Relations and China's Future?, 41 *PS: Political Science and Politics* 2 (Apr. 2008), 359–365; Roderick MacFarquhar, Jerome Cohen, Jonathan Spence and Tu Weiming, Whither China: Strategic Competitor, Global Trader, or Antiterrorist Partner?, 55 *Bulletin of the American Academy of Arts and Sciences* 3 (Spring 2002) 69–90; Steve Chan, *Looking for Balance: China, the United States, and Power Balancing in East Asia* (Stanford University Press, 2012); Immanuel C.Y. Hsu, *China without Mao: The Search for a New Order* (Oxford Univ. Press, 1990); Jerome Cohen and H.D. Chiu, *People's China and International Law* (Princeton Univ. Press, 1974).

<sup>4</sup> International public lawyers are an inherently heterogenous group. I purposely include government lawyers working for the public interest within "invisible college of international lawyers". See Oscar Schachter, *The Invisible College of International Lawyers*, 72 *NW. U. L. REV.* 217 (1977); Allan C. Hutchinson, *'In the Public Interest': The Responsibilities and Rights of Government Lawyers*, 46 *OSGOODE HALL L.J.* 105 (2008) (where the author argues that legal ethics and professional responsibility are "part of a larger democratic understanding of law and justice," at 106). On the various dimensions and functions discharged by international public lawyers, see Shirley V. Scott, *The Political Life of Public International Lawyers: Granting the Imprimatur*, 21 *INT'L REL.* 411 (2007); Gillian Triggs, *The Public International Lawyer and the Practice of International Law*, 24 *AUSTL. Y.B. INT'L L.* 201 (2005).

left by the eminent international lawyer Professor Jon van Dyke,<sup>5</sup> in order to help shape the international law program of a United States law school that also has a distinct focus in Asia-Pacific legal studies. To the extent that I am called upon to speak truths to power as an international public lawyer, today's lecture is my tribute both to this (our) academic home that I am grateful to have assisted in building this past year, as well as to the future academic home where the international public lawyer's duty to contribute must continue. I see no hard disjunction between the work of an international public lawyer in either institution. In this, I hearken to Hersch Lauterpacht's view that there are no fixed demarcations between the legal and the political (or the "justiciable and non-justiciable") in international law, and that it is the "duty incumbent upon the lawyer to adopt a critical attitude in regard to that doctrine in the interest not only of the dignity of the science of international law, but also of an effective peaceful organization of the international community which it is the legitimate business of international lawyers to promote."<sup>6</sup> International public lawyers have a fundamental duty to be advocates of international peace – "peace is not only a moral idea... [it] is pre-eminently a legal postulate."<sup>7</sup> This duty – one to which I deem myself personally bound – knows no geographic or institutional compass.

I will return to what I mean by "speaking truths to power as an international public lawyer"<sup>8</sup> in the last part of this lecture. Suffice it to say that these disclosures of my background are made merely to convey that my approach to this topic is necessarily informed by a plurality of social science disciplines, educational pedagogies, cultural experiences, and historical narratives to which I have been exposed. My lecture today, therefore, proceeds from the lens of an international public lawyer that always seeks to situate, understand, and navigate international law in diverse legal systems and traditions.<sup>9</sup> From where I stand as an observer,

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<sup>5</sup> His contributions to international law scholarship on the law of the sea, human rights, and dispute settlement are vast and cannot be enumerated here. For a brief synthesis skimming the surface of his legacy of contributions to international legal academia, see Jon Markham Van Dyke (1943–2011), *In Memoriam*, in 27 OCEAN YEARBOOK, xv (Aldo Chircop et al. eds., 2013).

<sup>6</sup> HERSCH LAUTERPACHT, *THE FUNCTION OF LAW IN THE INTERNATIONAL COMMUNITY* 310 (The Lawbook Exchange, Ltd., reprinted 2000).

<sup>7</sup> *Id.* at 438.

<sup>8</sup> By this, I purposely do not intend to convey a deconstructionist approach or methodology to the sources of international law. See Antony Carty, *Critical International Law: Recent Trends in the Theory of International Law*, 2 EUR. J. INT'L L 1, 1 (1991).

<sup>9</sup> See W. MICHAEL REISMAN, *THE QUEST FOR WORLD ORDER AND HUMAN DIGNITY IN THE TWENTY-FIRST CENTURY: CONSTITUTIVE PROCESS AND INDIVIDUAL COMMITMENT* Ch. 14 (2013) ("The Penumbra of Professionalism: The Citizenship Role of the International Lawyer").

what is taking place in both the United States and China in regard to each country’s treatment of, and engagement with, international law,<sup>10</sup> is the most fascinating phenomenon that, I anticipate, will likely shape the course of the post-Westphalian<sup>11</sup> and post-“Eastphalian”<sup>12</sup> international legal order and global power politics. I view this phenomenon as this century’s rewriting of the “New Great Game”.

## II “Great Game” Configurations: Classic “Great Game” to “New Great Game”

Arthur Connolly, a British-Irish intelligence officer, first coined the term “The Great Game” in the 1800s to describe the decades of conflict and strategic rivalry between the Victorian British Empire and Tsarist Russian Imperial Empire to seize control of, and dominate, the fledgling states and territorial entities of Central Asia.<sup>13</sup> This classical version of “The Great Game” ended with the 1907 Anglo-Russian Convention that delineated the boundaries of control set for each imperial side.<sup>14</sup> What was then Persia was split into a Russian northern zone, a British south-eastern zone, and a buffer neutral zone in between. Afghanistan became a

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<sup>10</sup> Much has been written on each country’s respective engagement with, and enforcement of international law within their judicial and public law traditions. See among others Oona A. Hathaway, Sabria McElroy, and Sara Aronchick Solow, *International Law at Home: Enforcing Treaties in U.S. Courts*, 37 *YALE J. INT’L L.* 52 (2012); Hungdah Chiu, *Communist China’s Attitude Toward International Law*, 60 *AM. J. INT’L L.* 245 (1966). Eric Posner and John Yoo argued in 2006 that the United States should “bind itself and the world to strict adherence to international law and international institutions such as the United Nations and the World Court”, as a way of managing US-China geopolitics in view of China’s rise as a world power. See Eric A. Posner and John Yoo, *International Law and the Rise of China*, 7 *CHI. J. INT’L L.* 1 (2006–2007).

<sup>11</sup> The post-Westphalian legal order is not necessarily synonymous with hard conceptions of nation-State sovereignty. For the key work on this subject, see STEPHANE BEAULAC, *THE POWER OF LANGUAGE IN THE MAKING OF INTERNATIONAL LAW: THE WORD SOVEREIGNTY IN BODIN AND VATTTEL AND THE MYTH OF WESTPHALIA* Part III (2004) (“The Social Power of the Myth of Westphalia”).

<sup>12</sup> Tom Ginsburg coined “Eastphalia” to describe the ironic return of rising power Asian countries to strong conceptions of nation-state sovereignty associated with the classic Westphalian period. See TOM GINSBURG, *EASTPHALIA AS THE PERFECTION OF WESTPHALIA* 27 (2010).

<sup>13</sup> See PETER HOPKIRK, *THE GREAT GAME: THE STRUGGLE FOR EMPIRE IN CENTRAL ASIA* 270 (1994).

<sup>14</sup> See IRA KLEIN, *THE ANGLO-RUSSIAN CONVENTION AND THE PROBLEM OF CENTRAL ASIA, 1907–1914*, 126–47 (1971); see also Rose Louise Greaves, *Some Aspects of the Anglo-Russian Convention and Its Working in Persia, 1907–14*, 31 *BULL. SCH. ORIENTAL & AFR. STUD.* 69 (1968).

British protectorate. Britain bound itself not to seek concessions beyond a line delimited from the Persian, Russian, and Afghan frontiers.<sup>15</sup>

Scholars dub the Cold War between the United States and the Soviet Union as the second iteration of the Great Game (“Great Game II”).<sup>16</sup> While there was no overt or direct military confrontation between both countries in this era, it was a period infamously marked by the threat of mutually assured destruction from each side’s possession of nuclear weapon.<sup>17</sup> The “Great Game II” was also sharply more ideologically-based than its predecessor – this was the era of the political gulf between democracy and communism, and contrasting economic theories between the capitalism and neoliberalism of a free market and enterprise system, and the socialism of micromanaged and centrally planned economies.<sup>18</sup> The end of the Cold War saw the dismantling of the Soviet Union and the rise of the United States as the world’s sole postwar superpower. It is the United States’ role as unipolar realist hegemon<sup>19</sup> that has mainly shaped the contours and institutions of the postmodern international system that we know today.<sup>20</sup>

Today, other scholars have coined the phrase the “New Great Game” to describe the geopolitical rivalry between the United States, the United Kingdom, and other countries of the North Atlantic Treaty Organization (NATO) against Russia and China over the vast petroleum reserves in the Central Asia and Transcaucasia region.<sup>21</sup> The academic

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<sup>15</sup> Full text of the Agreement Concerning Persia (1907) available at [http://avalon.la.w.yale.edu/20th\\_century/angrusen.asp](http://avalon.la.w.yale.edu/20th_century/angrusen.asp) (last accessed June 10, 2013), Articles I to V. See also David Fromkin, *The Great Game in Asia*, 58 FOREIGN AFF. 936 (1980).

<sup>16</sup> ERIC WALBERG, POSTMODERN IMPERIALISM: GEOPOLITICS AND THE GREAT GAMES 50–98 (2011) (describing the finance, military, political, and ideological strategies during the ‘Great Game II’, or the Cold War between the United States and the Soviet Union). See generally Mark Kramer, *Ideology and the Cold War*, 25 REV. INT’L STUD. 539 (1999).

<sup>17</sup> MARK BEYER, NUCLEAR WEAPONS AND THE COLD WAR 25 (2005).

<sup>18</sup> WALBERG, *supra* note 16, at 53. See also Richard Ned Lebow, *The Rise and Fall of the Cold War in Comparative Perspective*, 25 Rev. Int’l Stud. 21 (1999). For interesting perspectives on the role of hard American and Soviet national security policies in shaping the Cold War, see MELVYN P. LEFFLER & DAVID S. PAINTER, ORIGINS OF THE COLD WAR – AN INTERNATIONAL HISTORY Ch. 1 & 2 (2005).

<sup>19</sup> See Alastair Buchan, *The United States as a Global Power*, 24 INT’L J. 205 (1969); BARRY BUZAN, THE UNITED STATES AND THE GREAT POWERS: WORLD POLITICS IN THE TWENTY-FIRST CENTURY 165–72 (2004).

<sup>20</sup> David A. Kay, *United States National Security Policy and International Organizations: A Critical View of the Literature*, 23 INT’L ORG. 755 (1969); Ian Clark, *Bringing hegemony back in: the United States and international order*, 85 INT’L AFF. 23, 34–35 (2009) (regarding the United States as more of a “coalitional hegemon” based on a post-1945 strategy of institution and alliance building).

<sup>21</sup> Ariel Cohen, *The New Great Game: Oil Politics in the Caucasus and Central Asia*, THE HERITAGE FOUND. (Jan. 25, 1996), <http://www.heritage.org/research/reports/>

literature in international relations and comparative politics on this “New Great Game” is vast – but all are in agreement that this is a game no longer about traditional imperial expansionism and sovereign control, but rather, a petroleum resource race where multibillion dollar pipeline projects, strategic tanker routes, international consortia operations, shareholder values and international financing and leveraging sources, investment contracts and trade interests – and ultimately, global market share and production, transnational corporate power, as well as world oil and fuel prices are at stake.<sup>22</sup>

I am of the view that the respective authoritative decision-makers of the United States and China are now in the process of rewriting this “New Great Game” based on their own strategic relationship. I refer to “authoritative decision-makers,”<sup>23</sup> and not United States or China alone, because as a self-identifying member of the New Haven School of International Law,<sup>24</sup> I am ideologically predisposed to look at multiple processes of decision-making in States and the modes of attribution of different lines of conduct to a State, rather than assuming that States are

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1996/01/bg1065nbsp-the-new-great-game; Ian Cuthbertson, *The New ‘Great Game’ (Central Asia and the Transcaucasus)*, 11 *WORLD POL’Y J.* 4 (1994); Arif Ahmadov, *Great Power Rivalry in the Caucasus and the Greater Caspian Region: 1991–2011*, unpublished thesis (May 2011) submitted to Washington University, <http://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1435&context=etd&seid=1&referer=http%3A%2F%2Fwww.google.com%2Furl%3Fsa%3Dt%26rct%3Dj%26q%3Dthe%2Bnew%2Bgreat%2Bgame%2Btranscaucasus%26source%3Dweb%26cd%3D8%26ved%3D0CFQQFjAH%26url%3Dhttp%253A%252F%252Fopenscholarship.wustl.edu%252Fcgi%252Fviewcontent.cgi%253Farticle%253D1435%2526context%253Ddet%26ei%3D-mTnUfirsAeaviQfCjHAw%26usq%3DAFQjCNGRQVWDRFuNIVsV44HDQ93MDmS2DA%26sig%26DIYwPDjem7-p9azVP996ESg%26bvm%3Dbv.49478099%2Cd.aGc#search=%22new%20great%20game%20transcaucasus%22>.

<sup>22</sup> *Id.* at note 22; Cuthbertson at 41–43; Rajan Menon, *In the Shadow of the Bear: Security in Post-Soviet Central Asia*, 20 *Int’l Sec.* 149 (1995); R.G. Gidadhbli, *Oil Politics in Central Asia*, 34 *ECON. & POL. WKLY.* 5 (Jan. 30 – Feb. 5, 1999), 260–263; Dianne L. Smith, *Central Asia: A New Great Game?*, 23 *ASIAN AFF.* 147 (1996).

<sup>23</sup> *See* ; W. Michael Reisman, *The View From the New Haven School of International Law*, 86 *AM.SOC’Y INT’L L.PROC.* 118 (1992).

<sup>24</sup> *See* Myres S. McDougal and W. Michael Reisman, *The Prescribing Function in the World Constitutive Process: How International Law is Made*, in *INTERNATIONAL LAW ESSAYS* 355 (Myres S. McDougal & W. Michael Reisman eds., 1981); Tai-heng Cheng, *Positivism, New Haven Jurisprudence, and the Fragmentation of International Law*, in *NEW DIRECTIONS IN INTERNATIONAL ECONOMIC LAW* 411 (Todd Weiler & Freya Baetens eds., Brill 2011); Siegfried Wiessner and Andrew R. Willard, *Policy-Oriented Jurisprudence and Human Rights Abuses in Internal Conflict: Toward a World Public Order of Human Dignity*, in 36 *THE METHODS OF INTERNATIONAL LAW* 47 (Steven R. Rainer & Anne-Marie Slaughter eds., ASIL 2004). For a recently attempted third-party summary of the New Haven School of International Law’s conceptual positions and methodology, *see* JEAN D’ASPREMONT, *FORMALISM AND THE SOURCES OF INTERNATIONAL LAW: A THEORY OF THE ASCERTAINMENT OF LEGAL RULES* 105–10 (Oxford Univ. Press 2011).

monolithic entities issuing linear decisions or acting in universally attributable or identifiable ways. What an international relations or comparative politics scholar would easily characterize as “American foreign policy” or “Chinese foreign policy,” a New Haven international legal scholar would rather disaggregate and disambiguate down to the essential lines of authority that have produced particular policies in a prevailing social context. It is through this narrow prism that I now turn to examine some implications for international law in the June 2013 Summit between United States President Barack Obama and Chinese Chairmen Xi Jinping.<sup>25</sup> It is my view that the Summit – the first historic meeting between Heads of State of both countries since US President Richard Nixon’s 1972 meeting with Chairman Mao Zedong in China<sup>26</sup> – signals another watershed moment between both countries’ authoritative decision-makers, at a particularly crucial time of altered strengths between the unipolar hegemon riven by economic crises,<sup>27</sup> and the rising power currently the world’s second-largest economy and projected by world economists and financial analysts to overtake as the world’s first or largest economy by the year 2027.<sup>28</sup>

The 2013 Summit is geopolitically significant for having initiated a bilateral dialogue on policies between the established hegemon and the rising power, their respective relationships with the Asia-Pacific region, as well as the broader themes of global order and the postmodern interna-

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<sup>25</sup> *Getting to Know You*, N.Y. TIMES (June 4, 2013), [http://www.nytimes.com/2013/06/05/opinion/president-obama-meets-president-xi-jinping.html?\\_r=0](http://www.nytimes.com/2013/06/05/opinion/president-obama-meets-president-xi-jinping.html?_r=0); *Chinese Leader Xi Jinping Joins Obama for Summit*, B.B.C. NEWS (June 8, 2013), <http://www.bbc.co.uk/news/world-asia-china-22798572>; see also Oriana Skylar Mastro, *The Obama-Xi Summit: A New Era in Bilateral Relations?*, THE NAT’L BUREAU ASIAN RES. (June 12, 2013), <http://www.nbr.org/research/activity.aspx?id=345#.Ued9AOCvkb4>.

<sup>26</sup> For the famous biographical account of the 1972 Nixon-Mao meetings, see generally MARGARET MACMILLAN, *NIXON AND MAO: THE WEEK THAT CHANGED THE WORLD* (2007).

<sup>27</sup> See Anne-Marie Slaughter, *No More Superpower?*, N.Y. TIMES (June 24, 2011), [http://www.nytimes.com/interactive/2011/06/24/opinion/global/20110624\\_SUPERPOWER.html](http://www.nytimes.com/interactive/2011/06/24/opinion/global/20110624_SUPERPOWER.html) (declaring that “America’s ability to direct or control global or even regional events is declining, but so too is the ability of every other nation”, and that “[t]he best the United States can hope for is ‘credible influence,’ the ability to guide other nations through the appeal of our values, the power of our example, and the strength of our economy and political system.”).

<sup>28</sup> *China “Will Be the World’s Biggest Economy by 2027,”* LONDON EVENING STANDARD (Nov. 17 2009), <http://www.standard.co.uk/business/china-will-be-the-world-s-biggest-economy-by-2027-6745259.html>; Kamal Ahmed, *Jim O’Neill: China could overtake US economy by 2027*, THE TELEGRAPH (Nov. 19, 2011), <http://www.telegraph.co.uk/finance/economics/8901828/Jim-O'Neill-China-could-overtake-US-economy-by-2027.html>.

tional system.<sup>29</sup> It is a dialogue, I submit, that will be quietly underwritten – and thus crucially shaped – by each country’s corps of international public lawyers. It is for this reason that I am particularly interested in how each country’s legal system views and treats international law, because this affects the realpolitik translation of international law into foreign policy-making, and ultimately what options or courses of action authoritative decision-makers consider available for them. I will illustrate a brief doctrinal and conceptual nutshell of the complexities of the reception of international law in both the United States and China – and how there are some rather quaint parallels and divergences in each country’s treatment of the spaces of sovereignty and internationalism in their respective legal discourses.

My central argument is that the terms of the new Great Game is in the hands of each side’s corps of international public lawyers – and there might be more areas for agreement than one might ordinarily expect between two diametrically different legal traditions and political systems. Both legal traditions in the United States and China demonstrate pragmatist and/or realist readings of international law that protect their core sovereign interests,<sup>30</sup> but it is their respective authoritative decision-makers that have spelled the difference in how they have chosen to engage with the international legal system, particularly in the spheres of international economic law, *jus ad bellum* (the law governing the use of force) and *jus in bello* (the law governing the conduct of hostilities).

Where we do we see this difference? On the one hand, while Bush-era United States is frequently dubbed as neoconservative and exceptionalist when it comes to international law compliance,<sup>31</sup> the United

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<sup>29</sup> See *Obama’s Pow-Wow with Xi Jinping*, FIN. TIMES (June 10, 2013), <http://www.ft.com/intl/cms/s/0/65d95e44-d1d6-11e2-9336-00144feab7de.html#axzz2ZND2NQ8D>.

<sup>30</sup> XUE HANQIN, CHINESE CONTEMPORARY PERSPECTIVES ON INTERNATIONAL LAW: HISTORY, CULTURE, AND INTERNATIONAL 18–40 (2012). See generally Yong Deng, *The Chinese Conception of National Interests in International Relations*, 154 THE CHINA Q. 308 (1998); Jacques deLisle, *China’s Approach to International Law: A Historical Perspective*, 94 AM. SOC’Y INT’L L. PROC. 267 (2000); SHIRLEY V. SCOTT, INTERNATIONAL LAW, US POWER: THE UNITED STATES’ QUEST FOR LEGAL SECURITY 228 (2012) (“Like the United States, China has approached international law from a pragmatic perspective, the nature of its engagement continuing to be driven by foreign-policy goals.”).

<sup>31</sup> NOËLLE CROSSLEY, MULTILATERALISM VERSUS UNILATERALISM: THE RELEV-

States under the Obama administration policies reflects strategic uses of international law,<sup>32</sup> marshaling both “mainstream” institutions and procedures (such as the aggressive and repeatedly triumphant use of the US Trade Representative of dispute settlement in the World Trade Organization),<sup>33</sup> as well as claiming progressive interpretation in what are deemed to be “gray areas” in international law (such as on the legality of drone warfare,<sup>34</sup> government surveillance for national security purposes and defending against cyber-attacks,<sup>35</sup> the parameters of lawful or unlawful intervention or direct military assistance after discovery of chemical weapons use in Syria,<sup>36</sup> among others).

On the other hand, while Chinese scholars and international jurists have frequently characterized China’s international law compliance as strictly sovereignty-based or gravitating around a hard core of inter-State

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ANCE OF THE UNITED NATIONS IN A UNIPOLAR WORLD 61–62 (2008) (“The Bush administration, especially after the September 11 attacks, ideologically opposed the development of international law, disregarding both treaties and international institutions...The second Bush administration has been influenced strongly by neoconservative thinking.”); MARY ELLEN O’CONNELL, *THE POWER AND PURPOSE OF INTERNATIONAL LAW* Part I, Ch. 3 (2008).

<sup>32</sup> See Harold Hongju Koh, *The Obama Administration and International Law*, AM. SOC’Y INT’L L. (Mar. 25, 2010), <http://www.state.gov/s/l/releases/remarks/139119.htm>.

<sup>33</sup> See Chad P. Bown, *US-China Trade Conflicts and the Future of the WTO*, 33 *Fletcher F. World Aff.* 1, 45–6 (2009); United States Trade Representative, *2012 Report to Congress on China’s WTO Compliance*, 26–7, [http://www.ustr.gov/webfm\\_send/3620](http://www.ustr.gov/webfm_send/3620) (last visited July 1, 2013).

<sup>34</sup> *Barack Obama Defends “Just War” Using Drones*, B.B.C. NEWS (May 24, 2013), <http://www.bbc.co.uk/news/world-us-canada-22638533>; *Obama’s Speech on Drone Policy*, N.Y. TIMES (May 23, 2013), <http://www.nytimes.com/2013/05/24/us/politics/transcript-of-obamas-speech-on-drone-policy.html?pagewanted=all>.

<sup>35</sup> Tom McCarthy, *Obama Defends Secret NSA Surveillance Programs – As It Happened*, THE GUARDIAN (June 7, 2013), <http://www.guardian.co.uk/world/2013/jun/07/obama-administration-nsa-prism-revelations-live>; Geoff Dyer & Anna Fifield, *Obama Defends Surveillance Tactics*, FIN. TIMES (June 7, 2013), <http://www.ft.com/intl/cms/s/0/0b62853a-cf65-11e2-a050-00144feab7de.html#axzz2ZND2NQ8D>.

<sup>36</sup> James Legge, *Barack Obama Says Syria Chemical Weapon Use Would Change US “Calculus” over Intervention*, THE INDEPENDENT (Apr. 27, 2013), <http://www.independent.co.uk/news/world/americas/barack-obama-says-syria-chemical-weapon-use-would-change-us-calculus-over-intervention-8590961.html>; Mark Mazetti et al. *U.S. is Said to Plan to Send Weapons to Syrian Rebels*, N.Y. TIMES (June 13, 2013), <http://www.nytimes.com/2013/06/14/world/middleeast/syria-chemical-weapons.html?pagewanted=all>.



"consensualism,"<sup>37</sup> recent actions demonstrate a softening or finessing of its positions on what used to be inflexible interpretations on international doctrine (such as its formerly restrictive positions at the Security Council on the resort to force for humanitarian interventions),<sup>38</sup> as well as more frequent articulation of new or novel interpretations or progressive theories in the mainstream institutions or procedures within international law (such as the non-UNCLOS bases for Chinese claims in the South China Sea dispute,<sup>39</sup> defenses raised against currency manipulation alleged to be in breach of the IMF Articles of Agreement,<sup>40</sup> interpretations of GATT obligations and exceptions in the landmark Rare Earths and Audiovisual Publications cases at the WTO,<sup>41</sup> and now the pending solar

<sup>37</sup> JUNWU PAN, TOWARDS A NEW FRAMEWORK FOR PEACEFUL SETTLEMENT OF CHINA'S TERRITORIAL AND BOUNDARY DISPUTES 80 (2009) ("China believes that, because states create international law when they exercise their sovereignty, the validity and effectiveness of international law cannot forego the continuing consent and support of nation-states. State sovereignty is the very foundation upon which international law rests. State sovereignty implies at least the following corollaries: (1) sovereign equality; (2) political independence; (3) territorial integrity; (4) exclusive jurisdiction over a territory and the permanent population therein; (5) freedom from external intervention and the corresponding duty of non-intervention in areas of exclusive jurisdiction of other States; (6) freedom to choose political, economic, social and cultural systems; and (7) dependence of obligations arising from international law and treaties on the consent of States."). See also BYRON N. TZOU, CHINA AND INTERNATIONAL LAW: THE BOUNDARY DISPUTES 7–22 (1990) (summarizing various positions on consent-based international law taken by Chinese scholars and jurists such as Ho Wu-shuang and Ma Chun, Professor Chiu Jih-ch'ing, Lin Hsin, Chu Li-lu, Chu Ch'i-wu, among others).

<sup>38</sup> See Allen Carlson, *Helping to Keep the Peace (Albeit Reluctantly): China's Recent Stance on Sovereignty and Multilateral Intervention*, 77 PAC. AFF. 9, 10 (2004) (arguing "although Beijing promoted a relatively static interpretation of sovereignty and in principle opposed the idea of intervention, Chinese leaders also committed to a series of multilateral endeavours that gradually modified China's stance on intervention and, by extension, sovereignty's role in international politics.").

<sup>39</sup> For an unofficial (scholarly) discussion of the historical bases and evidence of China's claims to the disputed areas, see Li Jinming & Li Dixia, *The Dotted Line on the Chinese Map of the South China Sea: A Note*, 34 OCEAN DEV. & INT'L L. 287 (2003), <http://cat.middlebury.edu/~scs/docs/Li%20and%20Li-The%20Dotted%20Line%20on%20the%20Map.pdf>; Su Hao, *China's Positions and Interests in the South China Sea: A Rational Choices in its Cooperative Policies*, unpublished paper, Center for Strategic and International Studies, 1–12, [http://csis.org/files/publication/110912\\_Hao\\_South\\_China\\_Sea.pdf](http://csis.org/files/publication/110912_Hao_South_China_Sea.pdf) (last visited July 1, 2013).

<sup>40</sup> See Bryan Mercurio & Celine Sze Ning Leung, *Is China a 'Currency Manipulator?': The Legitimacy of China's Exchange Regime under the Current International Legal Framework*, 43 INT'L L. 1257 (2009).

<sup>41</sup> See Elisa Baroncini, *The China-Rare Earths WTO Dispute: A Precious Chance to Revise the China-Raw Materials Conclusions on the Applicability of GATT Article XX to China's WTO Accession Protocol*, 4 CUADERNOS DE DERECHO TRANSNACIONAL 49 (2012); *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, Report of the Appellate Body, (21 Dec. 21, 2009), [http://www.worldtradelaw.net/reports/wtoab/china-publications\(ab\).pdf](http://www.worldtradelaw.net/reports/wtoab/china-publications(ab).pdf); Joshua Chaffin, *China's Premier Li Keqiang Warns Europe over Trade War*, FIN. TIMES (May 26, 2013), <http://www.ft.com>

panels dispute with the European Union). From my vantage point as an international law scholar and observer, the authoritative decision-makers in the United States and China both reveal functionalist asymmetries between their “myth systems” of international law and the actual “operational codes” of their international law compliance.<sup>42</sup> Let me turn now to exposing some of these asymmetries.

### III Between Myth System and Operational Code: International Law in the United States and China

International law has never had an easy place for reception in either the legal system of the United States or the legal system of China. Indeed, I have grown accustomed to patiently engaging with the usual skepticism, disbelief, or resistance to international law from communities of domestic lawyers, or domestic legal scholars,<sup>43</sup> that I accept it to be entirely par for the course for any international public lawyer entering any legal system to confront that system’s legal architecture on issues of normativity, binding effect, and implementation.<sup>44</sup> In this respect, I find it very interesting that both legal traditions in the United States and China reflect similar tensions and concerns on the perceived potential intrusion and overreaching of international law in their systems, and the constitutional controls that are respectively maintained to govern the interaction between international law and domestic law.

Paul Dubinsky describes the status of international law in the US legal system as a “moving picture” where “so much of importance is so fluid. The law is unsettled because so many of the legal questions cur-

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/intl/cms/s/0/7f9f608e-c5f2-11e2-99d1-00144feab7de.html#axzz2ZND2NQ8D; Joshua Chaffin, *EU-China Solar Anti-dumping Talks Face Fresh Flare-up*, FIN. TIMES (July 12, 2013), <http://www.ft.com/intl/cms/s/0/9b09120c-eb0e-11e2-bfdb-00144feabdc0.html#axzz2ZND2NQ8D>.

<sup>42</sup> See W. Michael Reisman, *International Incidents: Introduction to a New Genre in the Study of International Law*, 10 YALE J. INT’L L. 1, 9 (1984) (“People who seek legal advice plainly require it with regard to both the myth system and the operational code: myth system because it is applied in part by some control institutions, operational code because it is applied by others. Myth system is readily retrievable through conventional research in the formal repositories of law. Operational code, in contrast, must be sought in elite behavior.”)

<sup>43</sup> Among my earliest works as a new Philippine law professor in 2007 was to scrutinize in detail how international law was received within the postcolonial and post-dictatorship Philippine constitutional system. See generally DIANE A. DESIERTO, FREEDOM AND CONSTRAINT: UNIVERSALISM IN THE PHILIPPINE CONSTITUTIONAL SYSTEM AND THE LIMITS TO EXECUTIVE PARTICULARIST POWER (2007).

<sup>44</sup> For authoritative essays on the theoretical interfaces between international law and domestic public law, see generally GERRY SIMPSON, THE NATURE OF INTERNATIONAL LAW (2001).

rently being revisited are of fundamental rather than marginal importance."<sup>45</sup> Harold Koh made the case for transnationalist jurisprudence nearly ten years ago, arguing that the famous Paquete Habana pronouncement of the US Supreme Court (e.g. "International Law is part of our law, and must be ascertained and administered by the courts of justice of appropriate jurisdiction, as often as questions of right depending upon it are duly presented for their determination") meant that "particular provisions of [the United States] Constitution should be construed with decent respect for international and foreign comparative law. When phrases like 'due process of law', 'equal protection' and 'cruel and unusual punishments' are illuminated by parallel rules, empirical evidence, or community standards found in other mature legal systems, that evidence cannot simply be ignored."<sup>46</sup> But this is not a universally held view by either United States courts or legal academics.

While there are various provisions of the United States Constitution that directly refer to international law sources (such as the Article II Section 2 Presidential power to "make treaties;" the Article I Section 8 Congressional powers to define and punish "Piracies and Felonies committed on the high Seas, and Offenses against the Law of Nations," to "regulate commerce with foreign nations" and to "make rules concerning captures on Land and Water," "to make rules for the Government and Regulation of land and naval Forces;" the Article III Section 2 judicial power over "all cases affecting ambassadors, other public ministers and consuls;" or the Article VI Supremacy clause indicating that "this Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land..."),<sup>47</sup> the rest of American constitutional canon on international law has been, by and large, a product of judicial development and common-law reasoning.<sup>48</sup> The Charming Betsy canon, for example, remains the famous precedent for accepting a later-in-time (*lex posterior*) rule between federal statute and treaty, as well as to construe US statutes and international law as

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<sup>45</sup> DINAH SHELTON, *INTERNATIONAL LAW AND DOMESTIC LEGAL SYSTEMS: INCORPORATION, TRANSFORMATION, AND PERSUASION* 631 (2011).

<sup>46</sup> Harold Hongju Koh, *International Law as Part of Our Law*, 98 AM. J. INT'L L. 43, 56 (2004).

<sup>47</sup> CONST. (U.S.) Art. II, Sec. 2; Art. I, Sec. 8; Art. III, Sec. 2; Art. VI.

<sup>48</sup> See Gerald L. Neuman, *The Uses of International Law in Constitutional Interpretation*, 98 AM. J. INT'L L. 82 (2004); Lea Brilmayer, *International Law in American Courts: A Modest Proposal*, 100 YALE L. J. 8 (1991); Louis Henkin, *International Law as Law in the United States*, 82 MICH. L. REV. 1555 (1983–1984).

consistent with one another.<sup>49</sup> Despite the lack of uniformity among its precedents, US jurisprudence carved out self-executing treaties and international agreements, from those that require implementing legislation before they can function as rules of decision binding upon US courts.<sup>50</sup> Likewise comity with customary international law, as articulated in *Paquete Habana*,<sup>51</sup> and brought to the forefront in modern jurisprudence under the Alien Tort Statute (including *Sosa v. Alvarez-Machain*,<sup>52</sup> and most recently in *Kiobel*<sup>53</sup>), is just as much contested through judicial gloss. The US Supreme Court's dismissal in *Medellin*<sup>54</sup> of the binding legal effect of a judgment of the International Court of Justice upon US courts certainly suggests its preference for a policy of mere respectful consideration for international adjudication without conferring legal quality to such decisions.<sup>55</sup> International law within the United States legal system is clearly a matter of varying engagement and disengage-

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<sup>49</sup> See generally *Murray v. The Charming Betsy*, 6 U.S. 64 (1804); Curtis A. Bradley, *The "Charming Betsy" Canon and Separation of Powers: Rethinking the Interpretive Role of International Law*, 86 GEO. L. J. 479 (1998).

<sup>50</sup> CURTIS BRADLEY, INTERNATIONAL LAW IN THE U.S. LEGAL SYSTEM 31–96 (2013); Alona Evans, *Self-Executing Treaties in the United States of America*, 30 BRIT. Y.B. INT'L L. 178 (1953); David Sloss, *Non-Self-Executing Treaties: Exposing a Constitutional Fallacy*, 36 U.C. Davis L. Rev. 1 (2002).

<sup>51</sup> *The Paquete Habana*, 175 U.S. 677, 700 (1900) ("International law is part of our law, and must be ascertained and administered by the courts of justice as often as questions of right depending upon it are duly presented for their determination. For this purpose, where there is no controlling executive or legislative act or judicial decision, resort must be had to the customs and usages of civilized nations, and, as evidence of these, to the works of jurists and commentators who by years of labor, research, and experience have made themselves peculiarly well acquainted with the subjects of which they treat. Such works are resorted to by judicial tribunals not for the speculations of their authors concerning what the law out to be, but for trustworthy evidence of what the law really is.") See generally Beth Stephens, *The Law of Our Land: Customary International Law as Federal Law after Erie*, 66 Fordham L. Rev. 393 (1997).

<sup>52</sup> *Sosa v. Alvarez-Machain*, 542 U.S. 692 (2004).

<sup>53</sup> *Kiobel v. Royal Dutch Petroleum Co.*, 569 U.S. (2013) ("[t]he presumption against extraterritoriality applies to claims under the ATS [Alien Tort Statute], and that nothing in the statute rebuts that presumption.")

<sup>54</sup> *Medellin v. Texas*, 522 U.S. 491 (2008).

<sup>55</sup> *Id.* at 509 ("In sum, *Medellin's* view that ICJ decisions are automatically enforceable as domestic law is fatally undermined by the enforcement structure established by Article 94 [UN Charter]. His construction would eliminate the option of noncompliance contemplated by Article 94(2), undermining the ability of the political branches to determine whether and how to comply with an ICJ judgment. Those sensitive foreign policy decisions would instead be transferred to state and federal courts charged with applying an ICJ judgment directly as domestic law. And those courts would not be empowered to decide whether to comply with the judgment – again, always regarded as an option by the political branches – any more than courts may consider whether to comply with any other species of domestic law. This result would be particularly anomalous in light of the principle that 'the conduct of the foreign relations of our Government is committed by the Constitution to the Executive and Legislative – the political – Departments.'")

ment – with over two centuries of jurisprudence on foreign sources, internationalism, and how the Executive, Legislative, and Judicial Branches functionally develop the evolving conceptions of American sovereignty alongside the international commitments and obligations assumed by the United States.<sup>56</sup>

China mirrors some of these fundamental uncertainties with the status of international law in its own legal system. The Chinese Constitution is silent on the domestic status of treaties, customary international law, or other international rules, although its preamble contains its famous Five Principles of Coexistence governing its foreign policy: “China consistently carries out an independent foreign policy and adheres to the five principles of mutual respect for sovereignty and territorial integrity, mutual non-aggression, non-interference in each other’s internal affairs, equality and mutual benefit, and peaceful coexistence in developing diplomatic relations and economic and cultural exchanges with other countries.”<sup>57</sup> While legal scholars such as Jerry Z. Li and Sanzhuan Guo write that “[t]he concept of fundamental principles of international law is widely used and accepted in China. Instead of treating general principles of international law as a separate source of international law, fundamental principles of international law are regarded as higher law and constitute parts of *jus cogens* in most cases,”<sup>58</sup> they are less clear about the actual operational effects and implementation of international law within the Chinese legal system. At best, they conclude:

[t]reaties to which China is a party are generally regarded as a part of Chinese law. Chinese domestic legislation may be passed to implement treaties, and Chinese courts may directly apply treaties in some areas such as civil and commercial areas. However, not all treaties are directly applied by Chinese courts without transformation. International human rights treaties are good examples of this. International treaties should have a lower legal status than the Constitution and the basic laws, but may have the same legal force as laws passed by the National People’s Congress Standing Committee, ad-

<sup>56</sup> BRADLEY 2013, *supra* note 50, at 329–32; DAVID L. SLOSS ET AL., INTERNATIONAL LAW IN THE U.S. SUPREME COURT: CONTINUITY AND CHANGE 589–606 (2011).

<sup>57</sup> 宪法(2004 修正)[Constitution (2004 Amendment)], preface, CLI.1.51974 CHINALAWINFO.

<sup>58</sup> Jerry Z. Li & Sanzhuan Guo, *China*, pp. 160–195, at 159, *in*, INTERNATIONAL LAW AND DOMESTIC LEGAL SYSTEMS: INCORPORATION, TRANSFORMATION, AND PERSUASION (Dinah Shelton ed., Oxford Univ. Press 2011).

ministrative regulations, or ministerial rules, depending on their concerned making procedures.

Legislative and administrative state organs may interpret treaties through their involvement in the treaty-making process, and courts interpret treaties in order to apply them, as allowed by provisions of the legislative acts. Ministerial departments, particularly the Ministry of Foreign Affairs, who are in charge of concluding treaties, may issue departmental regulations or opinions to interpret treaties. China generally does not give international customary law binding force in its domestic legal system. No matter which definition of ‘international usage’ is adopted, it usually applies only when there are neither Chinese laws nor treaties to govern in certain areas. In addition, Chinese courts have discretion to decide whether to apply international usage or not...<sup>59</sup>

Having had numerous conversations with my PKUSTL students and in particular, Professor Jin Zining here at the PKUSTL faculty on the matter of international law reception in the Chinese constitutional and legal system,<sup>60</sup> I am convinced that the shifting sands between international law and domestic law are no less contested here than they are in the United States. In both countries, the “myth system” arising from the normative environment of the legal system and its drivers appears to be one of caution, restraint, and control against the undue or illegitimate entry of international law norms into the domestic legal system and institutions of governance. But I submit that the “operational code” as to the uses of international law for each country is markedly different. The United States’ authoritative decision-makers have made deft use of their corps of international public lawyers to publicly claim compliance with international law obligations as a fundamental “rule of law” priority to establish the legitimacy of its decisions with the other authoritative decision-makers in States and international institutions.<sup>61</sup> Of course, the veracity and soundness of each claim of international law compliance re-

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<sup>59</sup> *Id.* at 193–95.

<sup>60</sup> I am particularly indebted to PKUSTL’s Professor of Chinese Constitutional Law and Chinese Administrative Law, Professor Jin Zining, for many illuminating exchanges on the nature of constitutional interpretation, the function of judicial and administrative review, and treaty implementation under Chinese law.

<sup>61</sup> Certainly the “compliance debate” among US State Department Legal Advisers remains very much a living one. For an interesting recent tome on the roles, functions, and duties of the US State Department Legal Advisers, see MICHAEL P. SCHARF & PAUL R. WILLIAMS, *SHAPING FOREIGN POLICY IN TIMES OF CRISIS: THE ROLE OF INTERNATIONAL LAW AND THE STATE DEPARTMENT LEGAL ADVISER 1–14* (2010).

mains very much a polemical case-to-case evaluation even for us international lawyers – United States policies on the use of force and intervention,<sup>62</sup> humanitarian law and the rules governing the conduct of hostilities in a post 9/11 context,<sup>63</sup> the enforcement of multilateral trading rules,<sup>64</sup> and providing recourse for US investors against recalcitrant non-paying host States<sup>65</sup> are all complex questions that would take much longer to discuss and evaluate carefully on an individual basis than in this brief lecture.

What is crucial, for purposes of advancing my central argument in this lecture, is that, even if it has a “myth system” of contested reception of international law, one cannot deny that the United States’ “operational code” involves a well-entrenched process of international law justification as part and parcel of its authoritative decision-makers’ strategic policy-making as the unipolar hegemon in the postmodern international system.<sup>66</sup> This is where the corps of international public lawyers in the United States have spelled the difference in the trajectories of their rich

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<sup>62</sup> See CHRISTIAN HENDERSON, *THE PERSISTENT ADVOCATE AND THE USE OF FORCE: THE IMPACT OF THE UNITED STATES UPON THE JUS AD BELLUM IN THE POST-COLD WAR ERA* 205 (2010) (“...whilst Obama has made overtures to multilateralism and the standards governing the use of force, not only did he not mention the collective security system in his speeches but appeared to intentionally avoid mentioning it in the context of humanitarian interventions by stating that these actions would take place either ‘individually or in concert’...Obama has never claimed to be a pacifist and his belief that the use of force will sometimes be ‘necessary’ has been made clear...However, of concern here is the President’s refusal so far to expand upon what was meant by his use of the term ‘necessary.’ Was this to be taken to be understood as it is in traditional legal parlance of the jus ad bellum? If not, what conditions have to pertain to make the use of force ‘necessary’? What is worrying about this doctrine is not the assertion of wide rights but the complete lack of clarity as to what is permissible under it....”).

<sup>63</sup> See generally STEPHEN L. CARTER, *THE VIOLENCE OF PEACE: AMERICA’S WARS IN THE AGE OF OBAMA* (2011) (discussing at length various policies on targeting, the use of drone warfare, among others).

<sup>64</sup> CHRISTINA L. DAVIS, *WHY ADJUDICATE?: ENFORCING TRADE RULES IN THE WTO* 102–84 (2012) (providing a useful description of recent US trade and litigation policies).

<sup>65</sup> On the protection of US investors, see *The US President’s 2013 Trade Policy Agenda* 13–18, <http://www.ustr.gov/sites/default/files/Chapter%20I%20-%20The%20President's%20Trade%20Policy%20Agenda.pdf> (last visited July 1, 2013).

<sup>66</sup> Of course, this is not the first time that the pivotal role of American international lawyers has been observed in US foreign policy-making. See generally Guglielmo Verdirame, *‘he Divided West’: International Lawyers in Europe and America*, 18 EUR. J. INT’L L. 553 (2007); Laura A. Dickinson, *Military Lawyers on the Battlefield: An Empirical Account of International Law Compliance*, 104 AM. J. INT’L L. 1 (2010); HATSUE SHINOHARA, *US INTERNATIONAL LAWYERS IN THE INTERWAR YEARS: A FORGOTTEN CRUSADE* 12–63 (2012); Michael K. Young, *The Role of the Attorney-Adviser in the U.S. Department of State: Institutional Arrangements and Structural Imperatives*, 61 LAW & CONTEMP. PROBS. 133 (1998) (containing a useful synthesis of the professional line functions and advisory duties of counsels at the US State Department in the generation of legal opinions and impact on the foreign policy process).

judicial and legal discourses on international law, and where I believe the corps of international public lawyers in China will be vital to how the path of the ‘new Great Game’ will be rewritten between the United States and China.

China’s “myth system” of contested reception of international law does not yet have a counterpart “operational code” deliberately embracing an open policy of international law justification. But this is not to say that its actions *ipso facto* are non-compliant – rather, what would be more accurate to say is that its authoritative decision-makers’ engagement with the international legal community have not been as readily or positionally identifiable from the standpoint of international law assessment.<sup>67</sup> As Professor Jacques deLisle interestingly narrated in his article on the history of China’s approach towards international law,<sup>68</sup> the orthodox narrative has been one that is strictly sovereigntist and deeply consensualist, owing in large part to institutional memories of historical injustices and grievances experienced at the hands of imperial expansionism from other States before the establishment of the postmodern international system. It was not coincidental that China’s Five Principles of Coexistence was built into the Bandung Principles written at the 1955 Asian-African Conference, and which eventually paved the way for the Non-Aligned Movement of about 120 Member States within the United Nations.<sup>69</sup> Both these Five Principles of Coexistence, as well as the doctrine of unequal treaties in international law, are significantly attributed to Chinese legal scholars and jurists.<sup>70</sup>

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<sup>67</sup> Literature in English on the specific role of Chinese international lawyers remains quite scarce. *See among others* Timothy A. Gelatt, *Lawyers in China: The Past Decade and Beyond*, 23 N.Y.U. J. INT’L L. & POL. 751 (1991); RICHARD KOMAIKO AND BEIBEI QUE, *LAWYERS IN MODERN CHINA* 7–90 (2009); RONALD ST. JOHN MACDONALD, *ESSAYS IN HONOUR OF WANG TIEYA* 243–50, 359–66 (1994). Certainly very little has been documented in English about the functions and impact of Chinese international lawyers in historical narratives on the evolution of Chinese foreign policy. For some authoritative studies on the formation of Chinese foreign policies alongside debated issues of international law applicability and compliance, *see* MICHAEL H. HUNT, *THE GENESIS OF CHINESE COMMUNIST FOREIGN POLICY* (1998); DONG WANG, *CHINA’S UNEQUAL TREATIES: NARRATING NATIONAL HISTORY* (2005).

<sup>68</sup> *See generally* Jacques deLisle, *supra* note 30.

<sup>69</sup> POBZENG VANG, *FIVE PRINCIPLES OF CHINESE FOREIGN POLICIES* 166 (2008) (narrating the adoption of the Five Principles of Peaceful Coexistence by the Bandung Conference, spearheaded by Indian Prime Minister Jawaharlal Nehru and Chinese Premier Zhou Enlai).

<sup>70</sup> For various narratives on Chinese contributions to international law, *see generally* Xue Hanqin, *China’s Open Policy and International Law*, 4 C.J.I.L. 133 (2005); Christopher Holland, *Chinese Attitudes to International Law: China, the Security Council, Sovereignty, and Intervention*, N.Y.U. J. INT’L L. & POL. ONLINE FORUM (July 2012), <http://nyujilp.org/wp-content/uploads/2012/07/Christopher-Holland-China-the->



A scholar on China relations, Pittman Potter, recently observed that Deng Xiaoping's strategy of *taoguang yanghui*, or to "hide brightness and nourish obscurity," resulted in China's heavy normative engagement with international law (signing and ratifying numerous international agreements on the environment, trade, investment, finance, security, the Covenant on economic, social and cultural rights, among others), but at the same time adopting a "paradigm of selective adaptation" – where local implementation of international rules depends on the extent to which their underlying norms are received by local interpretive communities.<sup>71</sup> Interpretive communities then "selectively adapt non-local standards for local application in light of their own normative perspectives."<sup>72</sup> Assuming the accuracy of Potter's theory, one could see an explanation for why China's actions have been alternatively characterized by various scholars as "exceptionalist" or "non-conforming" with international law.<sup>73</sup> A Hans Morgenthau-resonant assertion of sovereignty,<sup>74</sup> given today's more complex interrelationships of States, does little to inspire confidence or trust in the lawfulness or legitimacy of State conduct or governmental acts.

Neither would a strict reliance on the orthodox narratives of sovereignty and consensualism be fully consistent with the actual spheres of influence occupied and economic strengths wielded by, China, within the postmodern international system. Another scholar, Justin Hempson-Jones, argues that one must use a neo-liberal institutionalist perspective, rather than a hard realist perspective, in characterizing China's international acts, maintaining that China's deep engagement with international governmental organizations in the last decade actually does reflect patterns of liberal foreign policy-making, where "the level of its liberal action has increased hand-in-hand with the increase in the number of intergovern-

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Security-Council-and-Intervention.pdf; Zhaojie Li, *Teaching, Research, and the Dissemination of International Law in China: the Contribution of Wang Tieya*, 31 CAN. Y.B. I'L L. 189 (1993); KEYUAN ZOU, CHINA'S LEGAL REFORM: TOWARDS THE RULE OF LAW 227 (2006).

<sup>71</sup> See generally Pitman B. Potter, *China and the International Legal System: Challenges of Participation*, 191 THE CHINA Q. 699 (2007).

<sup>72</sup> *Id.* at 700–1.

<sup>73</sup> On Chinese "exceptionalism" in international law, see Anu Bradford & Eric A. Posner, *Universal Exceptionalism in International Law*, 52 HARV. INT'L L. J. 3, 25–34 (2011); Benjamin Ho Tze Ern, *The Rising Chorus of Chinese Exceptionalism*, RSIS WORKING PAPER No. 256, (Apr. 15, 2013), <http://www.rsis.edu.sg/publications/WorkingPapers/WP256.pdf>.

<sup>74</sup> See generally Hans J. Morgenthau, *The Problem of Sovereignty Reconsidered*, 48 COLUM. L. REV. 341 (1948); Hans J. Morgenthau, *To Intervene or Not to Intervene*, 45 FOREIGN AFF. 425 (1967).

mental organizations [that the PRC] participates in.”<sup>75</sup> Allen Carlson has written about the emerging trends in China’s strategic abstentions at the Security Council that have enabled more humanitarian interventions and peacekeeping missions to proceed in the last decade (such as in Kosovo and East Timor), instead of vetoing such operations outright on the basis of the Chinese Constitution’s Five Principles of Coexistence and the narrow guidelines on intervention previously articulated by Chinese representatives.<sup>76</sup> (Shortly after I delivered this lecture at PKUSTL, it was certainly historic to witness China’s first public and open foreign policy shift favoring humanitarian intervention, declaring that it would, for the first time, send security and peacekeeping troops outside of Chinese borders to contribute to the ongoing UN-sanctioned humanitarian and peacekeeping intervention forces in Mali.<sup>77</sup>) Bryan Mercurio has recently written that China’s currency peg and capital controls, for all that they contain badges of potential currency manipulation, would not necessarily rise to the level of a breach of the IMF Articles of Agreement.<sup>78</sup> What might thus appear evident from the “operational code” emerging from these recent trends is that China’s authoritative decision-makers could well be shifting to softer and more cooperative versions of consensualism and sovereignty in international law, without openly subscribing to a hard and obsolete Schmittian<sup>79</sup> notion of the exception as the unremitting perpetual prerogative of a State.

This is where I do think that the 2013 June Summit between United States President Barack Obama and Chinese President Xi Jinping represents a watershed moment for narrowing the gap between myth system and operational code. As historic as these initial exploratory talks are between these Heads of State and the initial discussions on cyber-security, maritime and territorial disputes, trade and investment cooperation, I am more interested in the long-term potentials for international law evaluation, assessment, and compliance, that could ensue from the dynamics of the complex relationship between the United States (the unipolar

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<sup>75</sup> Justin S. Hempson-Jones, *The Evolution of China’s Engagement with International Government Organizations: Toward a Liberal Foreign Policy?*, 45 *ASIAN SURV.* 702, 704 (2005).

<sup>76</sup> Allen Carlson, *Helping to Keep the Peace (Albeit Reluctantly): China’s Recent Stance on Sovereignty and Multilateral Intervention*, 77 *PAC. AFF.* 1, 9–27 (2004).

<sup>77</sup> See Monish Gulati, *Chinese Troops in Mali: Strategic Change in Foreign Policy?*, *SOUTH ASIA MONITOR*, (July 5, 2013), <http://southasiamonitor.org/detail.php?type=sl&nid=5312>; Kathrin Hille, *China Commits Combat Troops in Mali*, *FIN. TIMES*, (June 27, 2013), <http://www.ft.com/intl/cms/s/0/e46f3e42-defe-11e2-881f-00144feab7de.html#axzz2ZND2NQ8D>.

<sup>78</sup> *Id.* at 41.

<sup>79</sup> See generally CARL SCHMITT, *POLITICAL THEOLOGY: FOUR CHAPTERS ON THE CONCEPT OF SOVEREIGNTY* (1985).

hegemon that incorporates international law justification as part of its operational code in international relations), and China (the rising power whose operational code in international relations remains facially deeply sovereigntist but latently appears to be shifting towards some instrumental internationalism – quite consistent with the ideological hybridity bred by “socialist modernization” or what Ronald Coase recently wrote on as “Chinese capitalism”<sup>80</sup>). Whatever will be placed on the menu of what are “lawful” and “legitimate” options for each country’s authoritative decision-makers will depend on the ethos, expertise, education, and experience of their corps of international public lawyers. In this light, let me now turn to the last part of this lecture, or what I mean by “speaking truth to power” as an international public lawyer.

#### **IV “Rule By Law” or “Rule of Law”? Lord Shawcross’ Dilemma and the Role of International Public Lawyers in this Century’s New Great Game**

Lawyers have a crucial, if not usually decisive, impact on the policies eventually taken by a State’s authoritative decision-makers. I was just about to start clerking at the International Court of Justice when I had the opportunity to attend the Yale Law School Conference on Government Lawyering and International Law,<sup>81</sup> where various academics and legal advisers debated the roles of the government lawyer in shaping a State’s compliance with international law, the comparative functional mandates of legal advisers across different States, and their particular duties in representing sovereigns in international arbitration and litigation. This was in the aftermath of the inquiries on the role of government lawyers in issuing the infamous “Torture Memoranda” during the Bush Administration,<sup>82</sup> and the parallel transatlantic inquiries on the role of government lawyers with respect to the decision taken by the States forming the “Coalition of the Willing” to launch the Iraq War on the basis of alleged weapons of mass destruction.<sup>83</sup>

<sup>80</sup> RONALD COASE & NING WANG, HOW CHINA BECAME CAPITALIST 104–203 (2012).

<sup>81</sup> Details on the 35th anniversary conference of the Yale Journal of International Law, see [http://www.yjil.org/docs/pdf/conference\\_poster.pdf](http://www.yjil.org/docs/pdf/conference_poster.pdf) (last visited July 1, 2013).

<sup>82</sup> See Terry Frieden, *Report Clears Bush Officials of Misconduct over “Torture” Memos*, CNN NEWS, (Feb. 20, 2010), <http://edition.cnn.com/2010/POLITICS/02/19/bush.administration.memos/index.html>.

<sup>83</sup> For various documents on the UK Chilcot Inquiry, see <http://www.iraqinquiry.org.uk/transcripts.aspx> (last visited July 1, 2013). On the US Senate Intelligence Committee inquiry, see *How the US Has Investigated the Iraq War*, BBC NEWS, (Nov. 24, 2009), [http://news.bbc.co.uk/2/hi/middle\\_east/8376977.stm](http://news.bbc.co.uk/2/hi/middle_east/8376977.stm).

The themes of these inquiries and conferences ultimately all still revolved around the perennial international law question I have dealt with since my first law degree all the way to my doctoral degree and post-graduate work: “what would you do if you were advising a sovereign government on this legal question?” Hard as that question was when I was first studying international law, I fully concede it is a thousand times harder now that I engage in international law teaching, writing, and occasional practice. The difficulty is not so much about defining one’s functional role in these situations, but rather, about the fundamental duties we deem inherent for any international public lawyer. Above and beyond a local code of professional responsibility owed to bar membership, do we, as international public lawyers, have a greater responsibility to resist the pull of “my country, right or wrong, my country”<sup>84</sup> when international law—and by practical extension, the gainful stability of the international system under an international rule of law—is at stake?

This reminds me of Lord Shawcross’ dilemma, and one of the first conversations I had with Professor W. Michael Reisman, Myres S. McDougal Professor of International Law at Yale Law School – when I was a Philippine law professor and law partner, using my postgraduate studies to carve out the semblance of a teaching and practice sabbatical. Professor Reisman was the Faculty Advisor assigned to me, where out of about 20 Master of Laws students, I was the one focusing on international law and comparative public and private law studies that year. When I came to his office for our initial meeting, I discovered we had a shared enthusiasm for Joseph Conrad’s *Heart of Darkness*,<sup>85</sup> and its compelling themes on witnessing conquest, colonialism, inequality and injustice, slavery, and institutionalized exploitation. Before ending our session, Professor Reisman asked me the same question I put forward to you today: “what, in your view, is the work of an international lawyer?” While I was ruminating this, he told me briefly about Lord Hartley Shawcross<sup>86</sup> – the United Kingdom’s famous legal adviser who led the British legal prosecution team at the Nuremberg Trials, and who argued for the UK in the International Court of Justice on the landmark Corfu Channel case between the United Kingdom and the Republic of Albania. As you will recall, Corfu Channel involved, among others, the UK’s claim that its navy’s passage through the Corfu Channel Straits was innocent passage,

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<sup>84</sup> REISMAN, *supra* note 10, 459.

<sup>85</sup> See generally JOSEPH CONRAD, *HEART OF DARKNESS* (1990).

<sup>86</sup> For a brief biography, see *Hartley Shawcross*, *ECONOMIST* (July 17, 2003), <http://www.economist.com/node/19228>.

and that Albania had acted in bad faith for laying mines on the Channel without notifying incoming ships.<sup>87</sup>

As Professor Reisman recounted in more detail in his Hague Academy lectures,<sup>88</sup> while proceedings were pending, the International Court of Justice requested the production of a certain document (titled XCU document). The British government decided not to produce or disclose the document because it was feared that it would cast doubt on British motives in undertaking passage. Lord Shawcross was incensed with the decision not to disclose the document, and said that he would have objected to the filing of the case had the document been disclosed to him and the UK legal team. Lord Shawcross proceeded to argue the case without producing XCU document. After the UK won the case, Lord Shawcross sent a memorandum to British Prime Minister Clement Atlee, stating in no uncertain terms that:

It is a fundamental principle of the practice of the Courts of our country and of the conduct of our legal profession that parties to litigation are not entitled to use merely those documents which they think will assist their case and to suppress others which are inimical to it. I must make it clear that neither the Solicitor General, nor myself, nor, I am sure, any of the other members of the Bar who are assisting us in this matter, would for a moment contemplate being parties to the course of conduct now forced upon us by the Admiralty's failure to procure and produce these documents earlier *had our country's international position not been so gravely involved*....<sup>89</sup>

The above memorandum—Lord Shawcross' attempt to "speak truth to power"—was only released fifty years later.

Lord Shawcross' dilemma – deciding whether as an international lawyer one had obligations to truth and justice in the international community that transcended State lines and national obligations – is a recurring dilemma for any international public lawyer who has to work at the intersection of national and international legal systems, and who has to know both systems well enough to be able to identify and prescribe what is indeed, possible, lawful, and legitimate to authoritative decision-makers of States. Beyond, for example, the traditional ethics of the

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<sup>87</sup> *Corfu Channel Case* (U.K. v. Alb.), 1949 I.C.J. 4 (Apr. 9).

<sup>88</sup> CONRAD, *supra* note 85, at 458–62.

<sup>89</sup> *Id.* at 457–58.

legal profession, there is an added dimension of complexity that makes the international public lawyer's internal struggles more difficult: States are not monolithic entities, and authoritative decision-makers in each State are a product of their times, felt experiences, and socio-historical contexts – they bear different lines of accountability and apply different degrees of public transparency to the decisions they eventually take on behalf of their respective States. It is for this reason that the International Bar Association's 2011 International Principles on Conduct for the Legal Profession<sup>90</sup> expansively cover independence, honesty, integrity and fairness, conflicts of interest, confidentiality and professional secrecy, lawyers' undertakings, among others. But this barely scratches the surface of Lord Shawcross' dilemma, and the inimitable challenges that the corps of international public lawyers around the world face anonymously every day as States' authoritative decision-makers issue policies of international consequence and impact.

The new Great Game between the United States and China in this century could very easily swerve between forcible confrontation and pragmatic cooperation. Both the unipolar hegemon and the rising power exhibit gaps between myth systems and operational codes on their reception of, and uses for, international law, and both have stood accusations, at times, of "exceptionalist" or "non-conforming" realist behavior driven by thick conceptions of sovereignty that tend to exclude and reject broader international or global interests. Both States reach for redefinitions of the spaces of sovereignty and internationalism in their legal and political discourses, and both inimitably and understandably look towards protecting their sovereign interests.

The main difference lies with how each State has been conducting this conversation with everyone else in the international community, and to what extent the "Others" have been welcomed in the decisions that also end up affecting them. The United States' corps of international public lawyers has professionalized the practice (even art form) of international law justification in public decision-making within its federal government system – these positions may be debated, vetted, and contested by other States and institutions and constituencies, but they are, for the most part, readily identifiable and openly disclosed under international lines of accountability and voice that have some suasion and impact (whether now or in the next political administration seeking to differentiate itself from its predecessor). China's corps of international public

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<sup>90</sup> See *International Bar Association Principles on Conduct for the Legal Profession and Commentary*, IBA (May 28, 2011), <http://www.ibanet.org/Document/Default.aspx?DocumentUid=1730FC33-6D70-4469-9B9D-8A12C319468C>.

lawyers, on the other hand, is spreading out and diffusing across administrative agencies, ministries, and institutions – pedestrian governmental decision-making that may touch upon or yield international legal consequences is a labyrinthine bureaucratic exercise despite the central government's exclusive competence on foreign policy-making. China's myth system abides by an absolute nationalist-sovereigntist core, but its operational code might appear to some to be quietly leaning towards more cooperative expressions of sovereignty in some areas that seem to trench only upon economic interests.

It is in this sense that the evolution of Chinese legal education towards the international, transnational, and global – as PKUSTL well embodies and represents in its pedagogic mission – is crucial for developing and professionalizing China's future corps of international public lawyers. Whether such a gap between myth system and operational code – between the fictive differences of “rule by law” and “rule of law”<sup>91</sup> – could persist and endure given the dialogue initiated this June 2013, will, I submit, eventually decide the outcome of this century's new Great Game.

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<sup>91</sup> See RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW 55–125, 343–93 (2002).

# **To Be an Aggressive but Patient Learner —Analysis of China’s Participation in Defending Anti-Dumping Challenges within the WTO Framework**

*LU Yi\**

## **ABSTRACT**

*The year of 2013 is the twelfth year of China’s membership to the World Trade Organization (WTO). In Chinese zodiac, a twelve-year period constitutes a cycle of life. During the past twelve years, China’s journey into international trade has proven arduous as it faced numerous trade remedy challenges. Standing at the switching point leading to a new cycle of life, China should look back while reconsidering its trade policy for the next cycle. What lessons has China drawn from previous experiences? What kind of strategy should China adopt in the future to defend its interest in the dynamic global trade? With these questions in mind, this note aims at reviewing China’s performance since its accession to WTO and offering advices on how to make full use of WTO legal rules to promote its legal and economic interests within the WTO framework in the future. Anti-dumping (AD) challenges, which give rise to frequent trade frictions to China, will be the starting point.*

*According to WTO reports, China has been the Top 1 victim of AD investigations/measures since 1995 and the total investigation/measure against China kept increasing annually from 1995 to 2012.<sup>1</sup> In order to change this tough trading situation, it is necessary to look into determinative factors in AD proceedings under General Agreement on Tariffs and Trade 1994 (GATT 1994) and Agreement on Implementation of Article VI of the GATT 1994. These factors are dumping, injury and causation, together with official interpretations and precedential application of these factors. Based on these legal implications,*

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<sup>1</sup> The cutting point of this paper for data collection is based on the cut-off date of WTO reports, which is 31 December 2012.



*Chinese companies could learn better how to apply these rules in specific cases to challenge inconsistency between the AD determination and WTO rules. On the other hand, they might always be able to find supportive legal arguments when studying similar cases in the past. Notably, China had two nice tries in the cases of EU–Fasteners and U.S.–Anti-dumping and Countervailing Duties. In these two cases, China consciously looked into detailed legal text, presented comprehensive supporting evidences and made powerful arguments. In the future, China should learn from these successful arguments and apply them in accordance with different situations.*

*Based on acknowledgement of China’s previous experiences, this paper will propose a new attitude in future AD proceedings. This paper tries to introduce a combination of Taoism, an ancient Chinese philosophy emphasizing patience and respect for natural progress, and “Aggressive Legalism,” which aims at active utilizing of WTO rules as both a shield and a sword. When facing future AD challenges, China should be a patient learner of WTO law package, and this process demands a lot of patience. By rigorously applying WTO legal rules, China can benefit from a more efficient learning process to build up its legal capacity and promote its economic interests. In the next 12-year cycle from 2013, it is promising for China to be a strong rule maker and a big beneficiary of WTO rules.*

## I Introduction

China has gone through a tough journey engaging in international trade after its accession to the WTO on December 11, 2001.<sup>2</sup> During the past twelve years, China has experienced great excitement by accessing WTO—the only international organization dealing with the rules of trade among nations around the world—and has expected to benefit from smooth and free trade flows. Chinese people have had confidence in a future win-win situation since the accession. They believe that it would not only “significantly expand[s] world trade, strength[es] the multilateral trade system’s integrity and credibility,” but also entitles China to “benefit from its more deep integration to the world’s economy.”<sup>3</sup> Alongside the Reform and Opening-up Policy<sup>4</sup> in the past 35 years and specifically China’s membership to the WTO in the past 12 years, China’s economy indeed enjoyed unprecedented rapid growth. China has made a successful leap from being the world’s seventh biggest economy in 2001 with GDP of USD 1.324 trillion to the world’s second biggest economy in 2012 with GDP of USD 8.227 trillion.<sup>5</sup> Constant GDP development around 8% was regarded as magic. In addition, volumes of import and export volume increase at 21.7% annually from 2001 to 2011.<sup>6</sup> China could not have maintained these amazing economic developments without a worldwide fair playground established based on the WTO principles and legal instruments, such as the Most-Favorite-Nation (MFN)<sup>7</sup> principle, the end of textile and clothing quotas based on the WTO Agreement on Textiles and Clothing (ATC), etc.

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<sup>2</sup> See General Council, *Accession of the People’s Republic of China—Decision of 10 November 2001*, WT/L/432 (Nov. 23, 2001) [hereinafter *Accession of PRC*].

<sup>3</sup> See Fan Zhai & Shantong Li, *The Implications of Accession to WTO on China’s Economy*, Address at the Third Annual Conference on Global Economy Analysis 2 (June 27–30, 2000).

<sup>4</sup> In 1978, the Communist Party of China (CPC) made a decision to launch a nation-wide reform and opening up campaign at the 3rd Plenary Session of the 11th CPC Central Committee. It was a critical choice, which eventually leads China into a brand-new development epoch. For brief introduction, see *China in Photos—Thirty Years of Reform and Opening Up*, CHINA-EMBASSY.ORG, <http://al.china-embassy.org/eng/zggk/t527777.htm> (last visited Aug. 11, 2013).

<sup>5</sup> See *World Economic and Financial Surveys—World Economic Outlook Database*, IMF, <http://www.imf.org/external/pubs/ft/weo/2012/02/weodata/index.aspx> (last visited Aug. 11, 2013).

<sup>6</sup> The volumes of import and export in 2001 and 2011 were USD 509.65 billion and USD 3,641.86 billion. See *中国统计年鉴* (2012) [CHINA STATISTICAL YEARBOOK (2012)], <http://www.stats.gov.cn/tjsj/ndsj/2012/indexeh.htm> (last visited Aug. 11, 2013).

<sup>7</sup> General Agreement on Tariffs and Trade art. 1, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT].

In the meanwhile, China has suffered great pain from being subject to various initiations<sup>8</sup> challenging its domestic trading environment and policies. These initiations create far more fierce trade frictions than those of the pre-WTO period. Take anti-dumping (AD) initiations against China launched by other WTO members as an example, the annual average number of initiations increased 55% between China's pre- and post-accession.<sup>9</sup> Apart from the increasing number of AD challenges, the range of industries subjected to AD initiations/measures has become broader. For instance, the subjected sectors in AD investigations initiated by the European Union (EU) spread from heavy industries, such as steel manufacturing and chemical industries, to a much more enlarged scope recently, including daily consumer products, like certain plastic sacks and bags<sup>10</sup>, certain candles<sup>11</sup> and wireless wide area networking modems.<sup>12</sup>

Such is the nature of international trade that for each WTO member, benefits and challenges coexist in the volatile global trading system. On one hand, Chinese enterprises and the central government should recognize the painful fact that intentional trade is a double-edged sword which challenges domestic policies from all aspects. On the other hand, they should act as water, which flows beneath the fragile skin but hides great power to rise up. To facilitate this process, it is imperative to study the rules and dispute settlement mechanism for trade frictions within the WTO framework and eventually to figure out a suitable strategy reducing obstacles to China's outbound trade.

When heading into a new 12-year-long cycle of life, this note presents four parts to rethink the previous participation in the WTO and proposes new strategies for the future. The first section will present an overview of AD challenges against China since its accession to WTO. The second section will take China's foreign trade as a basis, looking into

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<sup>8</sup> The words "initiate" and "initiation" in this note adopt the official meaning in footnote 2 of Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, which means "the procedural action by which a Member formally commences as investigations as provided in Article 5."

<sup>9</sup> World Trade Organization data, annual anti-dumping measures for the year 1995 through 2012 is 20, 43, 33, 28, 42, 44, 55, 51, 53, 49, 56, 72, 62, 76, 77, 44, 51, 60. From 1995 to 2001, there were 38 initiations against China per year on average while the number increased to 59 after China's accession.

<sup>10</sup> Investigation started on June 30, 2005 and anti-dumping measures came into implementation according to Council Regulation (EC) No. 1425/2006 of 25 Sept. 2006, 2006 O.J. (L 270) 4.

<sup>11</sup> Investigation started on February 16, 2008 and anti-dumping measures came into implementation according to Council Regulation (EC) No. 393/2009 of 11 May 2009, 2009 O.J. (L 119) 1.

<sup>12</sup> Investigation started on June 30, 2006 and is still underway.

factors applied by the dispute settlement body (DSB) when deciding the existence of dumping and the implementation of anti-dumping measures in detail. Then, this note will summarize certain general applied litigation strategies apart from specific legal requirements concerning AD. Finally, this note will propose a new attitude or thinking methodology to the Chinese legal profession in future proceedings, which may reduce continued challenges launched by other WTO members. This note tries to introduce a combination of Taoism and “aggressive legalism” in order to maintain China’s continued high-speed development.

## II Overview of Anti-dumping Investigations/Measures against China within the WTO framework

As indicated from the statistics collected by WTO,<sup>13</sup> China has been a more and more active player in international trade throughout the past years ever since the WTO came into existence in 1995. In the field of using trade remedies in cross-border trading, especially anti-dumping, China undoubtedly was the most frequently targeted country both before and after its accession to WTO. The following statistical analysis will mainly illustrate the actual status of China with regard to the anti-dumping section within the WTO framework.

### *A Top Three Victims of AD Investigations/Measures in WTO from 1995 to 2012.*

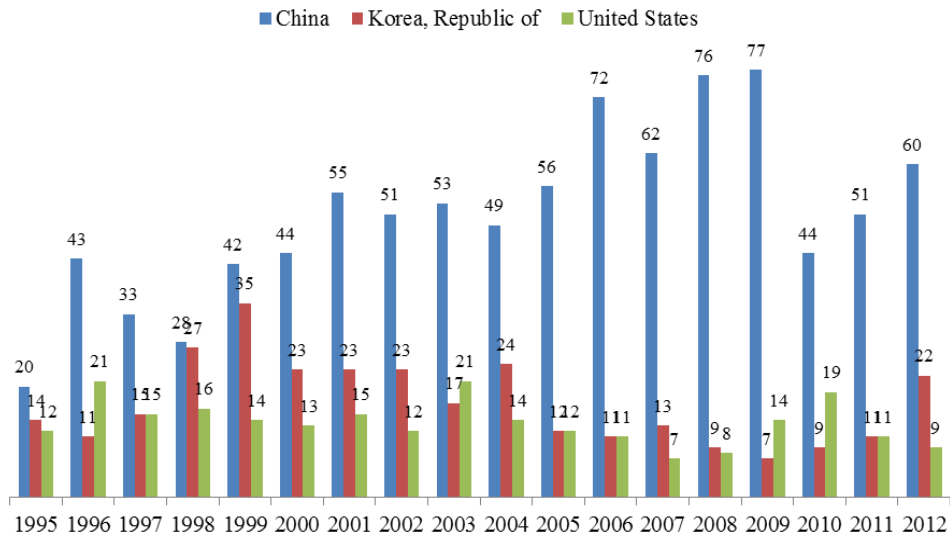
According to the WTO report, which is updated every six months, China has been the major victim of AD investigations and AD measures in the past sixteen years. As shown from Chart 1, products exported from China kept being the first target of AD investigations within the WTO framework in the past seventeen years, with numbers of investigations far more than the second and third WTO members—Republic of Korea (Korea) and the United States (U.S.). While exported goods from China were facing 51 AD investigations annually on average, Korea and U.S. were subject to 17 and 14 initiations per year on average respectively. What is more, roughly speaking, AD initiations against China kept increasing and there had been a large jump since China’s accession to WTO at the end of 2001, especially in the period from 2006 up to 2009. From the year 1995 to 2001 before China’s accession, there were 38 ini-

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<sup>13</sup> See *Anti-Dumping Initiations: By Exporting Country 01/01/1995–31/12/2012*, WTO, [http://www.wto.org/english/tratop\\_e/adp\\_e/AD\\_InitiationsByExpCty.xls](http://www.wto.org/english/tratop_e/adp_e/AD_InitiationsByExpCty.xls) (last visited Aug. 11, 2013) [hereinafter *Anti-Dumping By Exporting Country*].

tiations per year on average, while from the year 2002 to 2012 after China's accession, the number increased to 59.

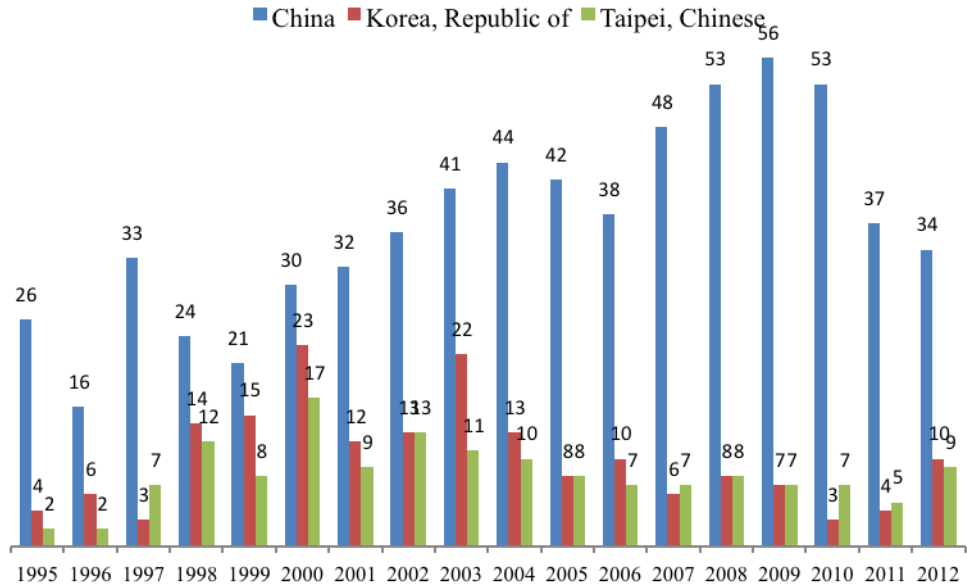
Chart 1: Top Three WTO Members Subject to Most Frequent AD Initiations (1995-2012)



Source: WTO Website

Similarly, as indicated from Chart 2, the same pattern of AD investigations shown from Chart 1 applies to AD measures against China: China was the number one subject of AD measures taken by other WTO members, and the amount increased sharply after China's accession. In contrast, as the number two and number three targets subject to most frequent AD measures, Korea together with Chinese Taipei (subject to 18 AD measures annually on average) were only subject to roughly one half AD measures of the ones faced by China (subject to 37 AD measures annually on average).

Chart 2: Top Three WTO Members Subject to Most Frequent AD Measures (1995-2012)



Source: WTO Website

### *B Annual AD Investigations/Measures against China from 1995 to 2012*

As indicated below chronologically from Table 1, standing with its more than 100 peer WTO members, China itself faced roughly one seventh of total AD investigations and measures within the WTO framework before 2002. Even more shockingly, this amount increased to more than one fourth of the total after China's accession to WTO at the end of 2001.

Table 1: Annual AD Investigations/Anti-dumping Measures against China (1995–2012)

Year	The World's Total AD Investigations	AD Investi- gations Against Chi- na	Percentage (%)	The World's Total AD Measures	AD Measures Against China	Percentage (%)
<b>Before Accession to WTO</b>						
1995	157	20	12.7	119	26	21.8
1996	226	43	19.0	92	16	17.4
1997	246	33	13.4	127	33	26.0
1998	266	28	10.5	181	24	13.3
1999	358	42	11.7	190	21	11.1
2000	298	44	14.8	237	30	12.7
2001	371	55	14.8	171	32	18.7
Mean	275	38	13.8	159	24	15.1
<b>After Accession to WTO</b>						
2002	315	51	16.2	218	36	16.5
2003	234	53	22.6	224	41	18.3
2004	220	49	22.3	154	44	28.6
2005	202	56	27.7	138	42	30.4
2006	203	72	35.5	142	38	26.8
2007	165	62	37.6	108	48	44.4
2008	213	76	35.7	139	53	38.1
2009	209	77	36.8	141	56	39.7
2010	172	44	25.6	123	53	43.1
2011	166	51	30.7	98	37	37.8
2012	208	60	28.8	117	34	29.1
Mean	210	59	28.1	146	44	30.1

Source: WTO Website

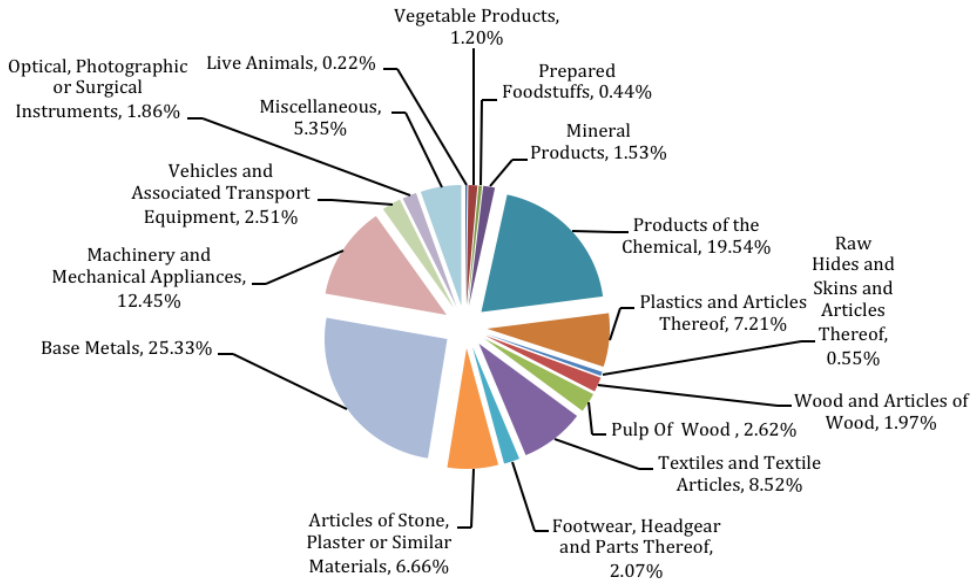
### *C Sectoral Distribution of AD Investigations Measures against China from 1995 to 2012.*

An analysis of the sectoral distribution of targeted products presents an enlightening landscape showing AD challenges faced by various industries. According to the harmonized system section headings,<sup>14</sup> which report AD initiations/measures on a sectoral basis, the main products made in China most frequently subject to AD challenges are base metals and articles of base metals. Charts 3 and 4 below indicate detailed

<sup>14</sup> See *id.*

sectoral distributions of initiations and measures. The total amount of AD challenges against based metals takes up more than one fourth of the total AD investigations and measures against China.

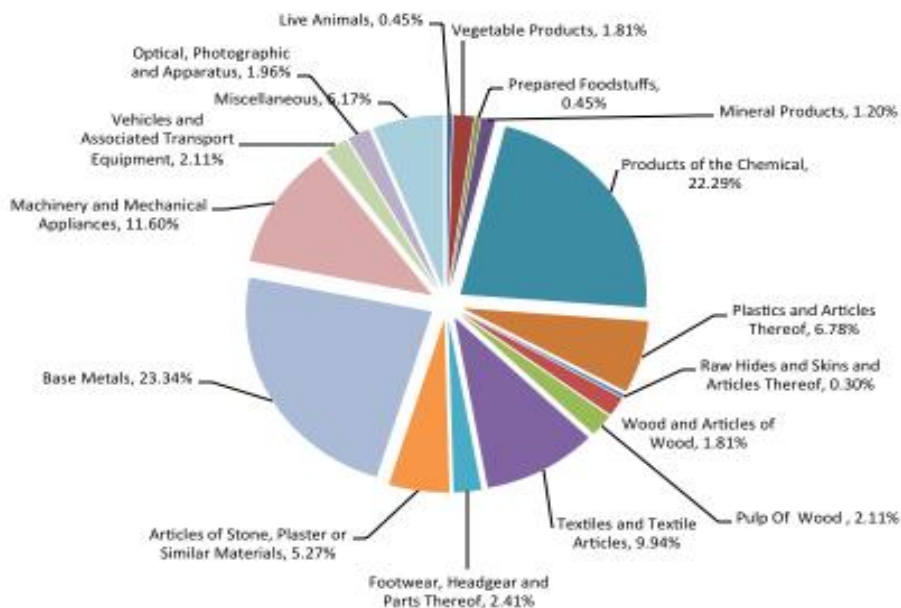
Chart 3: AD Sectoral Distribution of Initiations against China (1995-2012)



Source: WTO Website



Chart 4: AD Sectoral Distribution of Measures against China (1995-2012)



Source: WTO Website

It is a widespread phenomenon that products like base metal are frequent subjects of anti-dumping investigation and measures around the world.<sup>15</sup> According to WTO report, base metals are the number one AD target of reporting members, with the total number amounting to 27.9%<sup>16</sup> of total AD investigations, and chemical products are the number two target amounting to 20.3%.<sup>17</sup> Both of the base metal and chemical product industries are capital intensive and require large-scale productions, which make it very difficult for the manufacturers to adapt to changing demands and supplies of the market. Necessarily, governments would adopt certain protective measures for such industries in order to keep the

<sup>15</sup> 周灏 (Zhou Hao), WTO 时代中国遭受反倾销的国别和商品结构分析 [Research of Countries and Commodities Structure of China's Suffered Anti-Dumping in the WTO Era], 财贸经济 [FINANCE AND TRADE ECONOMICS], vol. 2, at 91 (2007).

<sup>16</sup> See *Anti-Dumping By Exporting Country*, supra note 12. During the reporting period from 1 Jan. 1995 to 31 Dec. 2012, 1181 AD initiations out of a total of 4230 were against base metal.

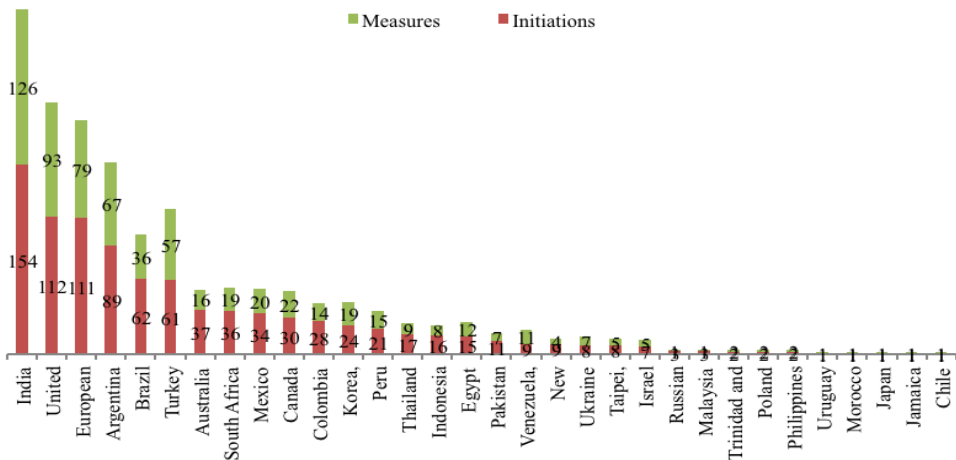
<sup>17</sup> See *id.* During the reporting period from 1 Jan. 1995 to 31 Dec. 2012, 858 AD initiations out of a total of 4230 were against products of the chemical and allied industries.

companies functioning smoothly.<sup>18</sup> When it comes to the case of China, since these industries are classic AD areas, and because China is a main producer of many of these products globally, there are more chances for such companies in China to be involved in AD investigations/measures than their foreign counterparts.

### *D WTO Members Initiating AD Investigations/Measures against China.*

To understand the geographical distribution of China's "rivals," it is helpful to take a full view of all WTO members initiating AD investigations and taking measures against China ever since 1995. As indicated by Chart 5, India, U.S. and the EU are the top three active WTO members initiating AD investigations and measures against China. Besides, the number of WTO members that apply AD as their trade remedy against China, keeps increasing.

Chart 5: AD Initiations/Measures Taken by Reporting Members (1995–2012)



Source: WTO Website

#### *a) Bilateral Trade between China and India*

With its aggressive AD policy, India has been the most active AD user against China. From 1995 to 2012,<sup>19</sup> India has initiated 677 AD

<sup>18</sup> Zhou Hao, *supra* note 14, at 91.

<sup>19</sup> See *Anti-Dumping By Exporting Country*, *supra* note 12.

investigations and 508 AD measures against its trading partners in total, which is the number one WTO member applying AD as its trade policy to protect cross-border trade. Out of the 677 AD investigations, 22.7% were against China, and 24.8% of its 508 AD measures were adopted against China.<sup>20</sup> What is more, the AD investigations and AD measures taken by India against China account for 16.8% and 19.0% of the total AD investigations and AD measures against China initiated by all WTO members from 1995 to 2012.<sup>21</sup>

Besides China, many other WTO members, such as Korea, the EU, Chinese Taipei, Thailand, and the U.S.,<sup>22</sup> are the main “target” countries or districts subject to AD investigations initiated by India. One reason why India initiates AD investigations so actively is that India’s AD law is very loosely drafted, therefore it leads to a lot of administrative discretion, apart from normal politics. Second, along with the rapid increase of import volume from China, it is inevitable that trade frictions between these two trading partners happen more often.<sup>23</sup> During the recent five years, annual rate of import growth from China leaps almost every year: 63.2% in 2006, 64.9% in 2007, 31.3% in 2008, and 37.9% in 2010, with the exception of 0.06% of decrease.<sup>24</sup> Third, both India and China are direct competitors in key industries, which also partly explains India’s aggressive attitude towards Chinese exportation.

#### *b) Bilateral Trade between China and U.S./EU*

Following India closely are the next two active anti-dumping users: the U.S. and the EU. The total number of AD investigations against China initiated by these two members, as shown from Chart 5, is 223, which amounts to one fourth of all the investigations against China. Similarly, the number of total AD measures finally taken by the U.S. and the EU is 172, which also accounts for one quarter of all the measures against China.

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<sup>20</sup> According to WTO, India initiated 154 AD investigations against China from 1995 to 2012 and 126 AD measures in total.

<sup>21</sup> According to WTO, China was subject to 916 AD investigations and 664 AD measures from 1995 to 2012 in total.

<sup>22</sup> According to WTO, the top-exporting members targeted by India from 1995 to 2010 are China (142 initiations), Korea (48 initiations), the EU (47 initiations), Chinese Taipei (45 initiations), Thailand (36 initiations) and the U.S. (33 initiations).

<sup>23</sup> Zhou Hao, *supra* note 14, at 90.

<sup>24</sup> Calculated based on data from INTERNATIONAL MERCHANDISE TRADE STATISTIC, IMTS, <http://imts.wto.org/> (last update: Mar. 21, 2013).

When it comes to the reasons why the U.S. and the EU are the top active anti-dumping users against China, the longstanding trade relations between China and the two members could explain. Based on data presentation from the U.S. Department of Commerce, China was the number one importer of the U.S. and the importing volumes was 424,874 million USD, amounting to 18.9% of the total merchandise import volumes of U.S.<sup>25</sup> China has also been the biggest trading partner with the EU. According to Eurostat<sup>26</sup>, a Directorate-General of European Commission, the import volumes from China in 2012 was 289.7 billion EURO, amounting to 18.7% of total import volumes between extra EU 27 and their global trading partners.<sup>27</sup> Also from Chinese perspective, China exports more goods to the EU and the U.S. than to other markets.

*c) More Developing Countries Began to Take AD Investigations/Measures against China*

Taking a look at the current WTO members initiating AD investigations against China from a large scale, one may find that more and more developing countries step into this group. For example, as shown from Chart 5, Argentina, Turkey, Brazil, and South Africa are close followers in AD challenges towards China.

*E Conclusion*

Based on the above statistical layout of current AD investigations and measures in the WTO framework, four preliminary conclusions are drawn to describe the harsh situation that China has gone through. First, China has been the number one victim of both AD investigations and AD measures since WTO came into existence in 1995, and these numbers were far higher than those of the other WTO members in this regard. Second, based on a chronological analysis on AD investigations and measures against China from 1995, the rate of annual growth for China kept increasing sharply after China's accession into WTO. Third, analyzing the sectoral distribution of AD investigations and measures against China, the most frequent subject industries are base metals and articles of base metals due to the inherent characteristics of this industry and the

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<sup>25</sup> *U.S. Imports for Consumption for Selected World Areas and Top Ten Countries—2012*, U.S. CENSUS BUREAU, [http://www.census.gov/foreign-trade/Press-Release/2012pr/aip/related\\_party/rp12-exh-1.pdf](http://www.census.gov/foreign-trade/Press-Release/2012pr/aip/related_party/rp12-exh-1.pdf) (last visited June 9, 2013).

<sup>26</sup> *European Statistics*, EUROPEAN COMMISSION, <http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/> (last visited Feb. 15, 2012).

<sup>27</sup> *Facts and Figures on EU-China Trade*, EUROPEAN COMMISSION (Apr. 2013), [http://trade.ec.europa.eu/doclib/docs/2009/september/tradoc\\_144591.pdf](http://trade.ec.europa.eu/doclib/docs/2009/september/tradoc_144591.pdf) (last visited June 9, 2013).

large export volume from China. Finally, although the most active AD initiators against China are still those strong economies, such as India, the EU, and the U.S., more and more developing countries began to use AD measures as remedies for trade conflicts with China. In one word, the current anti-dumping situation towards China is not optimistic. This explains why it is imperative for China to figure out how to defend its interests in dealing with this situation in the future.

### III Factors Analysis of “Dumping”

With the purpose of looking for a way out of the pressing trade situation, learning the basic legal instruments within the WTO would be a useful starting point. The current governing agreements on AD within the WTO framework are Article VI GATT 1994, Agreement on Implementation of Article VI of the GATT 1994 (ADA), Interpretative Note ad Article VI GATT and China Accession Protocol Section 15. ADA regulates the contracting parties’ rights to apply AD measures, if existence of dumping is confirmed. Dumping exists where the aimed product causes “injury” to certain domestic industry of the reporting party where the export price is lower than its “normal value,” which is based on the domestic market of the exporting party.<sup>28</sup>

There are a lot of scholarships and cases on the relationship between Article VI and ADA.<sup>29</sup> From a general point of view, Article VI provides the baseline requiring that dumping should be rectified with a legally proper method. As for ADA, it continues to function as a “framework agreement leaving substantial discretion to the WTO members.”<sup>30</sup> The ADA provisions contain more details on dumping and have been clarified a lot by various WTO and appellate body reports.<sup>31</sup> The reports of panels and the appellate body provide some guidance to figure out this relationship. In *US–1916 Act*<sup>32</sup>, when examined whether the U.S. 1916 Anti-dumping Act was consistent with Article VI of GATT, the Panel emphasized the “close link” between Article VI and ADA: ADA is

<sup>28</sup> See *Anti-Dumping By Exporting Country*, *supra* note 12.

<sup>29</sup> E.g., Henrik Andersen, *EU Dumping Determination and WTO law*, Kluwer Law International BV. The Netherlands 17 (2009); Rüdiger Wolfrum, Peter-Tobias Stoll, Michael Koebele, *WTO—Trade Remedies*, Koninklijke Brill NV, Leiden, The Netherlands, 4 (2008); Dispute Settlement Reports 2001, vol. 4, WTO.

<sup>30</sup> EDWIN VERMULST, *THE WTO ANTI-DUMPLING AGREEMENT—A COMMENTARY* 8 (2005).

<sup>31</sup> *Id.*

<sup>32</sup> Panel Report, *United States—Anti-Dumping Act of 1916*, WT/DS136/R (Mar. 31, 2000), [http://www.wto.org/english/tratop\\_e/dispu\\_e/7542d.pdf](http://www.wto.org/english/tratop_e/dispu_e/7542d.pdf) [hereinafter *U.S. AD Act of 1916*].

“essential for the interpretation of Article VI. Articles 1 and 18.1 [of ADA] confirm the close link between Article VI and the Anti-dumping Agreement.”<sup>33</sup> Moreover, the Panel held that Article 18.1 of the ADA should be read as “part of the context of Article VI”<sup>34</sup> for two reasons: one is that “the WTO Agreement is a single treaty instrument” and according to Article 31.2 of the Vienna Convention, interpretation of a treaty should comprise its preamble and annexes. Although it is arguable whether the Panel has correctly stated the status of Article 18.1 of the ADA, this article presents an obvious principle in international trade, which is to prohibit dumping among WTO members.

According to ADA, there are three requirements to be satisfied in order to justify an anti-dumping investigation<sup>35</sup>, including dumping, injury and causation between the dumped imports and injury.<sup>36</sup> The following sections will discuss WTO rules concerning these factors in detail.

### A Determination of “Dumping”

Four important concepts are introduced by Article 2 in defining dumping, which are like product, export price, normal value (NV), and ordinary course of trade.<sup>37</sup> The following part will analyze these factors.

#### a) Like Product

As defined by Article 2.6 ADA, like product refers to “a product which is identical, i.e. alike in all respects to the products under consideration.”<sup>38</sup> If there is no such a product, it refers to “another product which, although not alike in all respect, has characteristics closely resembling those of the product under consideration.”<sup>39</sup> The Panel in *U.S.—Softwood lumber II* regards this provision as a definitional article, which does not create obligations on WTO Members in itself, or it could not be the basis

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<sup>33</sup> *Id.* ¶6.195.

<sup>34</sup> *Id.*

<sup>35</sup> See generally SIMON LESTER, BRYAN MERCURIO, ARWEL DAVIES & KARA LEITNER, *WORLD TRADE LAW—TEXT, MATERIALS AND COMMENTARY* (2008).

<sup>36</sup> Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 art. 3.5, Mar. 14, 1994, 1868 U.N.T.S. 201, [http://www.wto.org/english/docs\\_e/legal\\_e/19-adp.pdf](http://www.wto.org/english/docs_e/legal_e/19-adp.pdf) [hereinafter ADA].

<sup>37</sup> VERMULST, *supra* note 29, at 9.

<sup>38</sup> ADA, *supra* note 35, art. 2.6.

<sup>39</sup> *Id.*

for an independent violation.<sup>40</sup> The accuracy of the definition of the product is important because “it sets the parameters of the investigation” and limits the scope of the application of AD measures.<sup>41</sup>

*b) Export Price*

After specifying like product for the product under consideration, authorities shall establish its export price. As export price is the actual price charged by the producer to the importer, determination of export price is not a problem.<sup>42</sup>

*c) Normal Value*

To establish the existence of dumping, a difference between the export price discussed in the above section and the NV (NV) of the product under consideration is the touchstone. Unlike the easiness of establishing the export price of the product, in order to determine the NV of such product two different scenarios needs to be distinguished. When there are sales of the like product in the domestic market, Article 2.1 ADA indirectly defines NV as “the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.”<sup>43</sup> Otherwise, Article 2.2 ADA directs that NV may base on third country exports or constructed NV.

There are three methods to determine the NV of a subject product. The first way is to determine the NV according to domestic sales. Article 2.1 ADA provides that if there are sufficient domestic sales of the like product, NV shall be the comparable price in the ordinary course of trade of such like product. The next method is to refer to constructed NV. Where no suitable domestic sales of the like product exist, Article 2.2 ADA comes into play. This article provides that the NV may base on third country exports or constructed NV in three situations. Specifically speaking, constructed NV equals to the cost of production in the country of origin plus a reasonable amount of cost for administrative, selling and general costs and profits.

The third category, which is also a disputable legal issue for China, is about NV in non-market or market economies. Whether China can be

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<sup>40</sup> Panel Report, *United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R (Aug. 29, 2003) [hereinafter *Softwood Lumber*].

<sup>41</sup> VERMULST, *supra* note 29, at 11.

<sup>42</sup> *Id.* at 14.

<sup>43</sup> ADA, *supra* note 35, art. 2.1.

recognized as market economy and if not, how should Chinese exporters be treated in specific cases is a disputed issue for many years. Article 2.7 ADA provides that Article 2 is without prejudice to the second Supplementary Provision to paragraph 1 of Article VI in Annex I to GATT 1994, i.e. Article 2 maintains the standing of what constitutes a non-market economy (NME) and does not take account of prices and costs in such NME. The most widely accepted theory justifying refusal to recognize an economy as a market economy is that prices and costs in such economies are not set by market forces<sup>44</sup> but due to government involvement.<sup>45</sup> Therefore, to make a fair comparison,<sup>46</sup> the authorities introduce the export price of like product in a surrogate country or analogue country<sup>47</sup> as the basis for NV.

When China signed the WTO's Accession Protocol (the Protocol), one of China's great concessions is that accepting the status as a NME up to sixteen years.<sup>48</sup> However, China has been making great efforts trying to obtain recognition of market economy status (MES) from other WTO members these years, and the good news is that more than 150 countries in the world and more than 80 WTO members (out of 159) have recognized China's MES by November 2011.<sup>49</sup> Still three-fourths of the "high-income countries" refuse to recognize China's MES, which are China's major trading partners, e.g. the U.S., the EU, India and Brazil<sup>50</sup>. When we take a look at the recent attitude of these major economies, it is predictable that these WTO members will not voluntarily recognize China's MES until the status takes effect after the 16-year transitional period ends.<sup>51</sup> How to deal with the MES in three years before 2016 shall be discussed separately in another paper. This note will only focus on the current tough situation presenting in front of China.

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<sup>44</sup> VERMULST, *supra* note 29, at 44.

<sup>45</sup> JUDITH CZAKO, JOHANN HUMAN & JORGE MIRANDA, A HANDBOOK ON ANTI-DUMPING INVESTIGATIONS 35 (2003).

<sup>46</sup> *Id.* at 35.

<sup>47</sup> VERMULST, *supra* note 29, at 44.

<sup>48</sup> *Accession of PRC, supra* note 1.

<sup>49</sup> 马艺文 (Ma Yiwen), 入世十周年“关键词”: 81 国承认中国市场经济地位 [The Keyword of China's 10th Anniversary for WTO Membership: 81 Members Acknowledge China's Market Economy Status], 中国网 [CHINA.COM.CN] (Nov. 10, 2011), [http://www.china.com.cn/economic/txt/2011-11/10/content\\_23870240.htm](http://www.china.com.cn/economic/txt/2011-11/10/content_23870240.htm).

<sup>50</sup> *Id.*

<sup>51</sup> 欧盟“断然拒绝”中国市场经济地位 [The EU “Flatly Refused” China's MES], 中国企业家网 [CCIPEN.COM] (May 31, 2010), <http://sc.ccipen.com/news/focus/201005/201005311133572.html>; 美国官员暗示不会立即承认中国市场经济地位 [U.S. Officials Implied No Immediate Acknowledgement of China's MES], 中国企业家网 [CCIPEN.COM] (May 28, 2010), <http://sc.ccipen.com/news/focus/201005/201005281414011.html>.



As an NME, China's domestic companies face great obstacles in defending its trade rights against an AD challenge. Recognition as a NME will lead to inapplicability of Article VI of the GATT.<sup>52</sup> The reason for not applying Article VI base on the idea that if the market does not actually set the prices, comparing market prices on different markets would be meaningless.<sup>53</sup> On this point, an interpretative note adding to the first paragraph of Article VI GATT in 1995 explained as follows:

It is recognized that, in case of imports from a country which has a complete or substantially complete monopoly of trade and all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purpose of paragraph 1, and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.<sup>54</sup>

In interpreting this provision, scholars recognized two important points. The first point is that strictly speaking, this provision only applies to countries where there is a *complete or substantially* complete monopoly of trade and *all* domestic prices are fixed by the State. However, there is no such pure country where the state does not influence operation of economy at all in reality.<sup>55</sup> In the original words of Detlof and Fridh, “[e]ven before the decline of Soviet Union, such countries are hard to find, and it is unlikely that any of the countries classified as non-market economies today fit this description.”<sup>56</sup> Despite of this, practitioners still recognize a state as an NME although not all the price is controlled by the government. This situation happens when the WTO member agreed otherwise.<sup>57</sup> Legally speaking, Section 15 of the Protocol is vaguely drafted. This Section is potentially disadvantageous to China and it might be one of the reasons explaining why so many disputes arise under the

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<sup>52</sup> YAN LUO, ANTI-DUMPING IN THE WTO, THE EU AND CHINA—THE RISE OF LEGALIZATION IN THE TRADE REGIME AND ITS CONSEQUENCES 162 (2010); see Francis Snyder, *The Origins of “Nonmarket Economy”: Ideas, Pluralism and Power in EC Anti-Dumping Law about China*, 7 EUR. L.J. 369, 381 (2001); FRANCIS SNYDER, THE EU, THE WTO AND CHINA: LEGAL PLURALISM AND INTERNATIONAL TRADE REGULATION 209–64 (2010).

<sup>53</sup> *Id.* at 162.

<sup>54</sup> GATT, art. VI, para. 1.

<sup>55</sup> HELENA DETLOF & HILDA FRIDH, THE EU TREATMENT OF NON-MARKET ECONOMY COUNTRIES IN ANTI-DUMPING PROCEEDINGS 7 (2006).

<sup>56</sup> *Id.* at 10.

<sup>57</sup> LUO, *supra* note 51, at 163; see also J. Maloney & G. Horlick, *Market Economy Status of Ukraine in Anti-Dumping Cases in the United States and European Union*, 1 GLOBAL TRADE & CUSTOMS J. 49, 49 (2006).

NME issue. On one hand, this section does not simply signify China's commitment to NME treatment in certain years. On the other hand, this section provides a dangerous legal ground for investigating authorities to explore ambiguous text to justify unreasonable AD measures. Section 15 does not set the criteria on the establishment of market economy or methodology for price comparison. Instead, it only permits an importing country to disregard Chinese domestic prices and costs and use its own NME methodology (with the obligation to notify the WTO), on the condition that Chinese producers cannot demonstrate that market economic conditions prevail in the industry producing the like product.<sup>58</sup> When reading section 15 and paragraph 151 together, one may reasonably consider that in handling cases involving China, an investigation authority is free to abuse discretion by referring China as an NME as a whole.

The second important point emphasized by scholars is, this provision simply does not affirm that the prices set by the State is appropriate for comparison, and does not introduce alternative solutions, let alone an analogue country as the basis for calculating NV thereof.<sup>59</sup> However, based on ADA, one can introduce an analogue country on the condition that an exporting country is determined as a NME. In most cases, India is chosen for China.<sup>60</sup> So far, there is no explicit guidance as to what exactly constitute NMEs and how to treat NMEs in anti-dumping proceedings according to the WTO agreement. Specific treatments depend on different anti-dumping initiators.<sup>61</sup> In fact, to categorize a country as a NME is rather discretionary.

#### i. U.S. Practice

The U.S. Department of State defines an NME as follows: "...In a nonmarket economy, production targets, prices, costs, investment allocation, raw materials, labor, international trade, and most other economic aggregates are manipulate within a national economic plan drawn up by a central planning authority. Hence the public sector makes major decisions affecting demand and supply within the national economy."<sup>62</sup>

A specific example for China being treated as an NME is *U.S.—Continued Dumping and Subsidy Offset Act of 2000*. The U.S. de-

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<sup>58</sup> LUO, *supra* note 51, at 162.

<sup>59</sup> DETLOF & FRIDH, *supra* note 54, at 10.

<sup>60</sup> *Id.* at 21.

<sup>61</sup> *Id.* at 2.

<sup>62</sup> U.S. Department of State International Information Programs, *The Language of International Trade—Glossary*, UNITED STATES DIPLOMATIC MISSION TO GERMANY (Oct. 23, 2001), <http://usa.usembassy.de/etexts/econ/language.pdf>.

scribed a three-step determination process in its First Written Submission to the Panel in US-AD and CVD on Chinese Products as follows: “First, in determines the quantities of the factor of production (essentially, inputs) used to produce the product subject to investigation... Second, [c]ommerce values these inputs in the surrogate, market economy country... Third, [c]ommerce adds amounts for factory overhead, selling, general and administrative (“SG&A”) expenses, and profit, calculated on the basis of the ratios of these costs to the costs of the other inputs in the surrogate country.”<sup>63</sup>

The U.S. Department of Commerce (DOC) has a long-standing practice not to assign all exporters in NME cases their individual duties.<sup>64</sup> The standard adopted by the U.S. DOC to qualify an exporter for an individual dumping margin is to have “sufficient autonomy over [its] export activities.”<sup>65</sup> A separate rate test is usually applied by the U.S. DOC, which essentially requires an exporter to demonstrate that “its export activities, on both a *de jure* and *de facto* basis, are not subject to government’s control.”<sup>66</sup> Evidence for no control from governments includes a finding of *de jure* absence of government control over export activities without “restrictive stipulations associated with ... business and export licenses” and “any legislative enactments devolving central control of export trading companies.”<sup>67</sup> Evidence supporting a finding of a *de facto* determination includes the involvement of a government authority in export price determination, the authority in negotiating and signing contracts and the respondent’s autonomy from the government in selecting of management, etc.<sup>68</sup>

As scholars have realized, although the U.S. NME criteria and methodology have been fiercely criticized as unfair, it seems very difficult to challenge in the DSM since the U.S. kept pushing China to accept most of its practices in the Protocol and U.S.–China bilateral agreement. Hence, although it is arguable that the U.S. DOC practice on the selection

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<sup>63</sup> First Written Submission of the United States, *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, ¶ 450, WT/DS379 (May 27, 2009), [http://www.ustr.gov/webfm\\_send/1028](http://www.ustr.gov/webfm_send/1028).

<sup>64</sup> LUO, *supra* note 51, at 171.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.* (citing Final Determination of Sales at Less than Fair Value: Sparklers from the People’s Republic of China, 56 Fed. Reg. 20588 (May 6, 1991); Final Determination of Sales at Less than Fair Value: Silicon Carbide from the People’s Republic of China (“Silicon Carbide”), 59 Fed. Reg. 22585 (May 2, 1994)).

<sup>67</sup> *Id.*

<sup>68</sup> Floor-Standing, Metal-Top Ironing Tables and Certain Parts Thereof From the People’s Republic of China: Preliminary Results of Antidumping Duty Administrative Review, 76 Fed. Reg. 50 (Sept. 7, 2011).

of surrogate values and calculation of the countrywide rate in NME cases are discriminatory, China did not challenge the US practice.<sup>69</sup>

## ii. EU Practice

Looking into the EU practice in handling AD cases, the EU adopts a similar system as the U.S. in treating NME countries.<sup>70</sup> As regulated in Article 2(A)(7)(a) of the Basic Regulation, if imports are from an NME, NV shall be determined on the basis of the price or constructed value in a market economy third country, the price from such a third country to other countries, or on any other reasonable basis.<sup>71</sup> In other words, the EU methodology of calculating an NV in an NME case is also based on the price or constructed NV in an analogous country. Moreover, the EU system nevertheless ends here. In the system, no factors of production approach are used to calculate the NV, i.e. the quantity of inputs used to produce the product concerned by an exporter in an NME country is irrelevant to the calculation of the NV in an EU investigation.<sup>72</sup>

Although the five MET criteria look straightforward, the EU authorities have “broad administrative discretion to interpret whether a company meets each of the conditions, particularly with respect to the first three.”<sup>73</sup> In numerous cases, the Commission has applied these criteria to examine hundreds of Chinese companies and rejected the MET for the majority of them.<sup>74</sup> In addition, the Commission has developed a few practices associated with its MET methodology, such as individual treatment and sampling, and consistently applies them in AD investigations involving Chinese products.

The first established practice associated with the MET is the individual treatment, as provided by Art. 9(5) of the Basic Regulation. As another important exception to the one-country-one-duty rule, if a company does not qualify for MET, it can apply for individual treatment, which allows their own export prices to be used to calculate the dumping margin. Individual treatment is similar to the U.S.’s separate rate test,

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<sup>69</sup> E.g., J. Greenwald & G. Horlick, *Dumping Margin Calculation Problems in the United State*, 2 GLOBAL TRADE & CUSTOM J. 67, 68–69 (2007).

<sup>70</sup> LUO, *supra* note 51, at 173.

<sup>71</sup> Council Regulation (EC) No. 1225/2009 of 30 November 2009, 2009 O.J. (L 343) 51.

<sup>72</sup> See Regulation (EC) No.216/2008 of the European Parliament and of the Council of 20 February 2008, art. 2(7)(c), 2008 O.J. (L 79) 1.

<sup>73</sup> E. Vermulst & F. Graafsma, *Recent EC Anti-dumping Practice Towards China and Vietnam: The Great Leap Backward?* International Trade Law Review 5 (2006) 124.

<sup>74</sup> DETLOF & FRIDH, *supra* note 54, at 276.

although with slightly different condition. The second practice that often arises in an NME investigation is sampling. This step is sometimes a problem for China due to the large number of producers and exporters in China. In cases where a large number of respondents are involved while the Commission does not have the resources to conduct the investigation, it resorts to sampling techniques.<sup>75</sup> However, the Commission stopped applying the MET desk-check system after the *EU–Footwear (China)*<sup>76</sup> case. In this case, it granted only one MET among 154 cooperating Chinese exporting producers and rejected the MET application from all non-sampled companies, which were up to 140 companies.<sup>77</sup>

### B Determination of “Injury”

Article VI (6)(a) of GATT 1994 stipulates that unless the effect of the dumping is determined as to “cause or threaten material injury to an established domestic industry, or is such as to retard materially the established of a domestic industry,”<sup>78</sup> no AD duty could be levied on the exporter. As for detailed determination of material injury, Article 3, associated with Articles 2.6 and 4 ADA present three interrelated concepts.

#### a) Like Product

According to Article 2.6 ADA, like product refers to a like product or in absence of such a product, the product has characteristics closely resembling those of the product under consideration.<sup>79</sup> Determination of like product also leaves the authorities plenty of room for discretion. Since in practice, concrete economic data in all respects regarding the like product may not be available and Article 3.6 ADA grants the authorities freedom to assess the dumped imports by examining “the production of the narrowest group or range of products.”<sup>80</sup>

#### b) Domestic Industry

According to Article 4 ADA, domestic industry refers to all domestic producers of the like product or those of them accounting for a major proportion of its total domestic production. An implicit restraint of this

<sup>75</sup> Vermulst & Graafsma, *supra* note 72, at 128.

<sup>76</sup> See Panel Report, *European Union—Anti-Dumping Measures on Certain Footwear from China*, WT/DS405/R (28 October 2011) [hereinafter *EU–Footwear (China)*].

<sup>77</sup> Council Regulation (EC) No. 1472/2006 of 5 October 2006, 2006 O.J. (L 275) 1.

<sup>78</sup> GATT, art. VI (6)(a).

<sup>79</sup> ADA, art. 2.6.

<sup>80</sup> ADA, art. 3.6.

definition is its interrelation with injury. For example, Panel in *Mexico–Corn Syrup* stated, “the domestic industry with respect to which injury is considered and determined must be the domestic industry defined in accordance with Article 4.1.”<sup>81</sup> The Panel in *Argentina–Poultry* held that term “a major proportion” does not mean more than 50 per cent of domestic production<sup>82</sup> since it would clearly require an absolute majority otherwise.

According to Article 6.10 ADA, where there are a high number of domestic producers, the authorities may decide sampling in order to make a representative assessment of the companies’ situation in the exporting country. However, whether determination is required to be based on the sampling is not clear from this article. In *EC–Bed linen*, the Panel disagreed with India’s argument that where a sampling is selected, the Panel is implicitly required to close their eyes to “ignore other information available to it concerning the domestic industry it has defined.”<sup>83</sup> The Panel’s reasoning is that the above conclusion would be inconsistent with the fundamental underlying principle, which requires a fair anti-dumping investigation and an objective evaluation of the evidence.<sup>84</sup>

### i. Injury

As defined in footnote 9 of Article 3 ADA, there are three types of injuries might leading to anti-dumping investigation: material injury to a domestic industry, threat of material injury to a domestic industry, and material retardation of the establishment of such an industry. Since the third injury—material retardation—“have ha[s] been extremely rare in anti-dumping history,”<sup>85</sup> this section only discusses the first two kinds of injury.

### ii. Material Injury

As an overarching provision, the appellate body often emphasizes Article 3.1 because of the basic requirement as to positive evidence and

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<sup>81</sup> Panel Report, *Mexico—Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States*, ¶ 7.147, WT/DS132/R (Jan. 28, 2000) [hereinafter *Mexico Corn Syrup*].

<sup>82</sup> Panel Report, *Argentina—Definitive Anti-Dumping Duties on Poultry from Brazil*, ¶7.341, WT/DS241/R (Apr. 22, 2003).

<sup>83</sup> Panel Report, *European Communities—Anti-Dumping on Imports of Cotton-Type Bed Linen from India*, ¶ 6.181, WT/DS141/RW (Nov. 29, 2002) [hereinafter *EC Bed Linen*].

<sup>84</sup> *Id.*

<sup>85</sup> VERMULST, *supra* note 29, at 74.

an objective examination in injury determination.<sup>86</sup> For example, in *U.S.—Hot-Rolled Steel*, the appellate body held that the term positive evidence indicates that the evidence must be of an “affirmative, objective and verifiable character and that it must be credible.”<sup>87</sup> In addition, the appellate body in *Thailand—H-Beams* held that injury determination shall be based on all relevant reasons and facts before it, and such facts are not limited to information only disclosed to the parties to the investigation.<sup>88</sup>

Second, as for the meaning of dumped imports, the Panel in *EC—Bed linen*, endorsed EU’s argument that once a product in question has been determined as dumped products, this conclusion will apply to all imports of that product from that source, i.e. particular producers/exporters.<sup>89</sup>

Third, as for what constitutes an objective examination of two key aspects: the volume of the dumped imports and the effect on prices of such dumped imports in domestic market and the consequent impact of these imports on domestic producers of such products. On one hand, Article 3.2 requires the authorities to consider whether there has been a significant increase in dumped imports. However, the Panel in *Thailand—H-Beams* held that the textual term *consider* does not require the authorities to conduct an explicit finding or determination as to whether there is indeed significant increase in volume of dumped imports.<sup>90</sup> On the other hand, Article 3.4 further elaborates how to examine consequent impact on domestic industry. Article 3.4 requests the authorities to evaluate all relevant economic factors and indices related to the state of industry. In addition, this article includes a non-exclusive list including actual and potential decline in sales, profits, output, market share, productivity, return on investment, or utilization of capacity; factors affecting domestic prices; the magnitude of the margin of dumping; actual and potential negative effects on cash flow, inventories, employment, wastes, growth, and ability to raise capital or investments.<sup>91</sup> As the Panel in *EC—Bed Linen* and the Panel in *Mexico—Corn Syrup* analyzed, considering the

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<sup>86</sup> *Id.*

<sup>87</sup> Appellate Body Report, United States—Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan, ¶ 192, WT/DS184/AB/R (July 24, 2001) [hereinafter *U.S.—Hot-Rolled Steel*].

<sup>88</sup> Appellate Body Report, *Thailand—Anti-Dumping Duties on Angles, Shapes and Section of Iron or Non-Alloy Steel and H-Beams from Poland*, ¶¶ 106, 108–10, WT/DS122/AB/R (Mar. 12, 2001).

<sup>89</sup> *EC Bed Linen*, *supra* note 82, ¶ 6.136.

<sup>90</sup> Panel Report, *Thailand—Anti-Dumping Duties on Angles, Shapes and Section of Iron or Non-Alloy Steel and H-Beams from Poland*, ¶ 7.161, WT/DS122/R (Sept. 28, 2000) [hereinafter *Thailand H-Beams (Panel)*].

<sup>91</sup> ADA, art. 3.4.

phrase “shall include an evaluation of all relevant factors” and the change of wording introduced in the Uruguay Round, the factors enumerated in the list are of mandatory nature and each of sixteen factors shall be evaluated in each case.<sup>92</sup> Furthermore, examination of relevant economic factors other than these listed ones could also be required.<sup>93</sup> On the question of to what extent the examination leads to satisfaction of the requirements of Article 3.4, the Panel in *EC–Bed Linen* and the Panel in *Guatemala–Cement II* both held that the consideration of the factors must be apparent so that the Panel may assess whether the authorities acted in accordance with Article 3.4.<sup>94</sup> Therefore, a simple “checklist” approach or mere presentation of tables of data is not enough; rather, the above factors must be analyzed in an economically and factually correct manner.<sup>95</sup>

### iii. Threat of Material Injury

Considering the speculative nature of the determination of threat of material injury, Article 3.7 presents four extra conditions to be satisfied for determining threat of material injury.<sup>96</sup> First, the determination must have a factual basis, not merely according to allegation, conjecture, or remote possibility.<sup>97</sup>

Second, the change in circumstances that would create injurious dumping must be “clearly foreseen and imminent.”<sup>98</sup> As the Panel in *U.S.–Softwood Lumber* observed, it might well be possible that the change in circumstance results from a series of events or development relating to domestic industry and/or the dumped imports rather than one single event.<sup>99</sup>

Third, four specific factors are included in a threat determination in Article 3.7, which is connected with the word *and*, meaning that all of the four factors shall be considered during the determination. When address-

<sup>92</sup> *EC Bed Linen*, *supra* note 82, ¶¶ 6.154–6.159; *See also Mexico Corn Syrup*, *supra* note 80, ¶7.128; *Thailand H-Beams (Panel)*, *supra* note 89, ¶7.225.

<sup>93</sup> *Mexico Corn Syrup*, *supra* note 80, ¶ 7.128; *see Thailand H-Beams (Panel Report)*, ¶7.225; Panel Report, *Guatemala—Definitive Anti-Dumping Measure on Grey Portland Cement from Mexico*, ¶ 8.284, WT/DS156/R (Oct. 24, 2000) [hereinafter *Guatemala Cement II*].

<sup>94</sup> *EC Bed Linen*, *supra* note 82, ¶6.163.

<sup>95</sup> VERMULST, *supra* note 29, 89–90 (summarizing *Thailand H-Beams (Panel)*, ¶¶ 7.236–.237 and Panel Report, *Egypt—Definitive Anti-Dumping Measures on Steel Rebar from Turkey*, ¶¶7.41–.51, WT/DS211/R (Aug. 8, 2002)).

<sup>96</sup> VERMULST, *supra* note 29, at 94.

<sup>97</sup> ADA, art. 3.7.

<sup>98</sup> *Id.*

<sup>99</sup> *Softwood Lumber*, *supra* note 39, ¶7.53.



ing the question whether these four factors are enough to entitle a threat determination, two Panels offered two completely different opinions. In *Mexico–Corn Syrup*, the Panel held that, besides consideration of the four factors in Article 3.7, a threat determination shall also cover the 15 factors enumerated in Article 3.4 about injury determination, since “[the Article 3.7] analysis alone is not a sufficient basis of a determination of threat of injury... [and] an analysis of the consequent impact on imports is required.”<sup>100</sup> On the contrary, the Panel in *Unites States–Softwood Lumber I* opined that the wording *should* and *consider* in Article 3.7 indicates that the authorities are not required to “make an explicit ‘finding’ or ‘determination’ with respect to the four factors,” and therefore, even failure to consider one or more of them would not constitute a violation of Article 3.7.<sup>101</sup>

### C Causation

Article 3.5 ADA covers the requirement of a demonstration of a causal link between dumping, injury and the non-attribution requirement<sup>102</sup>, which examines any other known factors cutting off the causal link. Both of the Panels in *U.S.–Hot-rolled Steel* and *Thailand–H-Beams from Poland* viewed Article 3.5 as not presenting an obligation on authorities of proactively finding the factors enumerated where they are not clearly raised by the interested parties.<sup>103</sup> These panels also evaded discussing the question as of whether the authorities would be compelled to examine the factors known to the investing authorities while not known to the interested parties.<sup>104</sup>

### D Conclusion

Based on the above factors relied on investigating authorities to determine the final AD measures, Chinese companies may find that WTO agreements provide detailed rules at each step. Reading these rules and case opinions will help China understand the WTO legal requirements on AD into more details.

## IV Selected Unresolved Issues to Work on in Future Cases

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<sup>100</sup> *Mexico Corn Syrup*, *supra* note 80, ¶¶7.126–.127.

<sup>101</sup> *Softwood Lumber*, *supra* note 39, ¶7.68.

<sup>102</sup> VERMULST, *supra* note 29, at 91.

<sup>103</sup> *Thailand H-Beams (Panel)*, *supra* note 89, ¶7.273

<sup>104</sup> *Id.*

Apart from the abovementioned substantive legal provisions concerning determination of dumping and application of anti-dumping measures, there are still several other approaches to attack an AD measure in dispute. Sometimes certain aspect of the challenged AD measure cannot be justified within the WTO framework, because domestic legislation is inconsistent with WTO agreement and obligations of an interested party *per se*. In addition, in cases where a legal requirement is ambiguous and there is large discrepancy among member states about which interpretation should be adopted by the investigating authority, there are chances for arguments from both sides to succeed. What is more, improper procedures adopted by the investigating authorities could also be a ground to challenge the disputed AD measure. To make it simpler, as a respondent against an AD measure, China should figure out every possible supporting argument by looking into the entire determination process of the investigation authorities. These approaches involve litigation strategies, which are also very imperative in a comprehensive case like the ones submitted to the WTO DSB. This section will enumerate certain methods that could challenge legal grounds other than the abovementioned specific factors provided in Article VI of GATT 1994.

#### *A Inconsistency of the Relied Regulation with WTO Agreements*

Sometimes, trade disputes between WTO members end before reaching the DSB. In this way, despite there is an obligation on each WTO member to ensure conformity between domestic laws and the WTO agreements, there is still inevitably existing discrepancy between them. When it comes to the origin of anti-dumping law, such differences among different trading partners are justified since anti-dumping law initially targets at providing ordinary protection to domestic industry<sup>105</sup> irrespective of the impact on other countries. Ever since Jacob Viner<sup>106</sup> noted the first AD measure in the sixteenth century used by an English writer, who charged foreign merchants selling paper at a loss for the sake of smothering the arising paper industry in England, AD has been recog-

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<sup>105</sup> J. M. FINGER & NELLIE T. ARTIS, *ANTI-DUMPING: HOW IT WORKS AND WHO GETS HURT* 14 (1993).

<sup>106</sup> Jacob Viner (May 3, 1892–September 12, 1970), a Canadian economist and is considered one of the "inspiring" mentors of the early Chicago School of Economics in the 1930s. He is the first scholar to collect previous writings on the subject of anti-dumping. One of Viner's greatest accomplishments is his book *Studies in the Theory of International Trade*. This work is not just a history of the theory of international trade but also a guidebook that tells where the early economists who studied trade were wrong and where they were right.

nized as an accepted protective tool for promoting domestic industry.<sup>107</sup> Doubtlessly, speaking in the modern understanding, this is not really an AD measure since these measures are limited to governments.

Another reason why anti-dumping law came into existence is the necessity to regulate imports, or in a more straightforward expression, to limit imports.<sup>108</sup> This necessity is in nature the extension of antitrust law.<sup>109</sup> Taking the U.S. anti-dumping law as an example, Section 73 of Wilson Tariff Act of 1894 aims at regulating such kind of imports by making unlawful conspiracy or combination that was intended to restrain trade or to increase the U.S. price of an imported article,<sup>110</sup> which is the uncovered area of the Sherman Antitrust Act of 1890.<sup>111</sup>

Based on the above two reasons, it is reasonable to regard anti-dumping law as an ordinary protection for only domestic industry and without any doubt, regulations on anti-dumping among different countries have large discrepancy. After the WTO came into existence, in order to promote free trade flows around the world, every country should sacrifice certain legislative power and amend its anti-dumping regulations in accordance with WTO agreements. To make it clear, the WTO law does not require a Member to have its anti-dumping regulations. However, if a Member does so, its anti-dumping regulations should be bound by the WTO law.

The above need to promote free flow of international trade is supported by the Marrakesh Agreement Establishing the World Trade Organization (the “Marrakesh Agreement”). The Marrakesh Agreement provides that each WTO member has a principal obligation to “ensure the conformity of its laws, regulations and administrative procedure with its obligations as provided in the annexed Agreements,”<sup>112</sup> among which there are GATT 1994 and ADA. ADA reiterates this obligation and “imposes an additional obligation”<sup>113</sup> by providing that “[e]ach [m]ember shall take all necessary steps, of a general or particular character, to ensure ... the conformity of its laws, regulations and administrative procedures with the provisions of [ADA] as they may apply to the Member in

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<sup>107</sup> FINGER & ARTIS, *supra* note 104, at 14.

<sup>108</sup> *Id.* at 18.

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> Sherman Antitrust Act of 1890 only prohibits contracts or combination in restraint of commerce, monopolization and attempts to monopolize such commerce.

<sup>112</sup> Marrakesh Agreement Establishing the World Trade Organization, art. XVI:4, Apr. 15, 1994 1867 U.N.T.S. 154.

<sup>113</sup> *U.S. AD Act of 1916*, *supra* note 31, ¶6.282.

question.”<sup>114</sup> Again, although there is no requirement that each WTO member should adopt its own anti-dumping law, if it does, breach of a provision of GATT or ADA will immediately give rise to a breach of the conformity obligation under the Marrakesh Agreement<sup>115</sup>. For example, the appellate body in *U.S.—Offset Act (Byrd Amendment)* upheld the Panel’s opinion that the U.S. measure was inconsistent with the ADA and the ASCM, thereby violating Article XVI: 4 of Marrakesh Agreement.<sup>116</sup> The reasoning is that the U.S. measure at issue was a specific action against dumping of exports and structured to dissuade the practice of dumping or subsidization other than one of those permissible under WTO agreements.<sup>117</sup>

As a frequent target in AD measures, China should always prepare to look into the original legal text by means of the WTO agreements. Actually, China has such a successful experience once in the case of *EC—Fasteners*. The appellate body in *EC—Fasteners* upheld the Panel’s findings that Article 9(5) of the European Union’s Basic Anti-dumping Regulation (the “Basic AD Regulation”)<sup>118</sup> was inconsistent *as such*, and *as applied* in the fasteners investigation, with Articles 6.10 and 9.2 of the ADA. The reason is that this article conditions the determination of individual dumping margins and the imposition of individual anti-dumping duties, on the fulfillment of an Individual Treatment (IT) Test.<sup>119</sup> The relevant provisions in this case are Articles 2(7) and 9(5) of the Basic AD Regulation, which regulates market economy treatment (NMT) and IT test separately.<sup>120</sup> The appellate body focused on the presumption of the articles of the Basic AD Regulation in dispute. Similarly as noted by the Panel, the appellate body considered that Article 9(5) of the Basic AD Regulation<sup>121</sup> established a presumption that “the producers or exporters

<sup>114</sup> ADA, art. 18.4.

<sup>115</sup> Appellate Body Report, *United States—Anti-Dumping Act of 1916*, ¶¶ 134–35, WT/DS136/AB/R (Aug. 28, 2000).

<sup>116</sup> Appellate Body Report, *United States—Continued Dumping and Subsidy Offset Act of 2000*, ¶¶ 269–74, WT/DS217/AB/R (Jan. 16, 2003).

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

<sup>118</sup> Council Regulation (EC) No. 1225/2009 of 30 November 2009, o2009 O.J. (L 343) 51.

<sup>119</sup> Appellate Body Report, *European Communities—Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China*, WT/DS397/AB/R (July 15, 2011), at 38 [hereinafter *Iron or Steel Fasteners*].

<sup>120</sup> *Id.*

<sup>121</sup> Article 9(5) of the Basic AD Regulation provides that “an anti-dumping duty shall be imposed in the appropriate amounts in each case, on a non-discriminatory basis on imports of a product from all sources found to be dumped and causing injury except, except for imports from those sources form which undertakings under their terms of this Regulation have been accepted. The Regulation imposing the duty shall specify the duty for each supplier or, if that is impracticable, and in general where Articles 2(7)(a)

that operate in NMEs are not entitled to individual treatment, in order to qualify for such treatment, NME exporters bear the burden to demonstrate that they satisfy the criteria of the IT test.”<sup>122</sup> Under the WTO agreements, the investigating authority also need to consider other evidences that demonstrate that certain exporters or procedures are in a sufficiently close relationship and should be considered as a single entity so that a single dumping margin and anti-dumping duty should follow.<sup>123</sup> However, Article 9(5) of the Basic AD Regulation applies countrywide dumping margins and countrywide anti-dumping duties for all exporters from the NME WTO member, unless such exporters request individual treatment and demonstrates that all criteria of the IT test are satisfied.

The appellate body further supported China’s submission and explained that Article 9(5) places the burden on NME exporters to rebut an improper presumption. This presumption is the NME exporters are related to the State and should demonstrate that they are entitled to individual treatment.<sup>124</sup> This treatment runs counter to Article 6.10, and this article “as a rule” requires that individual dumping margins be determined for each known exporter or producer.<sup>125</sup> By looking into the function of Article 9(5), the appellate body opined that the IT test provided in Article 9(5) aims at overcoming the improper “presumption of singularity, such that they should be entitled to individual treatment pursuant to Article 9(5).”<sup>126</sup> Therefore, according to the appellate body, the EU did not fulfill its conformity obligation under the WTO agreements by setting up an improper presumption and laying down regulations accordingly.

China’s arguments in *EU–Fasteners* about conformity obligation according to Article XVI: 4 of the Marrakesh Agreement, along with more specific requirements in Article 18.4 of ADA, is an instructive successful trial experience. In this case, China successfully applied Article

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applies, the supplying country concerned. Where Article 2(7)(a) applies, an individual duty shall, however, be specified for the exporters which can demonstrate, on the basis of properly substantiated that: (a) in the case of wholly or partly foreign owned firms or joint venture, exporters are free to repatriate capital and profits; (b) export prices and quantities, and conditions and terms of sale are freely determined; (c) the majority of the shares belong to private persons; state officials appearing on the board of directors of holding key management position shall either be in minority or it must be demonstrated that the company is nonetheless sufficiently independent from State interference; (d) exchange rate conversions are carried out at the market rate; and (e) State interference is not such as to permit circumvention of measures if individual exporters are given different rates of duty.”

<sup>122</sup> *Iron or Steel Fasteners*, *supra* note 118, ¶363.

<sup>123</sup> *Id.*

<sup>124</sup> *Id.* ¶364.

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

<sup>126</sup> *Iron or Steel Fasteners*, *supra* note 118, ¶377.

XVI: 4 and Article 18.4 of ADA as useful legal grounds to refute the initiator's challenge. China should bear this successful experience in mind and consciously resort to these articles in future AD proceedings.

### *B Ambiguity in Legal Interpretation*

Legal words of anti-dumping regulations could be interpreted in different ways and therefore could be argued from both sides. In such situation, emphasizing on certain ambiguous legal language and attacking the loopholes of one particular interpretation of the investigating authority could be a creative way to turn disadvantageous situation into a favoring one.

Take *U.S.—Anti-dumping and Countervailing Duties* as an example, in which China has had another successful try. In this case, China argues that a violation of Article 19.3<sup>127</sup> of Agreement on Subsidies and Countervailing Measures by U.S. DOC's failure "to establish whether or to what degree it would offset the same subsidies twice by imposing anti-dumping duties calculated under its NME methodology, concurrently with countervailing duties."<sup>128</sup> This dispute concerns countervailing and anti-dumping duties simultaneously imposed by U.S. DOC on four products originating in China following concurrent countervailing duty and anti-dumping investigations. China appealed the Panel's finding about double remedies, which refers to two situations: (1) where both an anti-dumping and a countervailing duty are imposed on the same product; and (2) where the simultaneous application of anti-dumping and countervailing duties on the same imported products results, at least to some extent, in the offsetting of the same subsidization twice.<sup>129</sup>

The key legal words on this issue are "appropriate amount" in Article 19.3 of ASCM, to which extent a countervailing duty could be levied on imported products. When the appellate body interpreted this legal term

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<sup>127</sup> Agreement on Subsidies and Countervailing Measures, art. 19.3, Apr. 15, 1995, 1869 U.N.T.S. 14 ("When a countervailing duty is imposed in respect of any product, such countervailing duty shall be levied, in the appropriate amounts in each case, on a non-discriminatory basis on imports of such product from all sources found to be subsidized and causing injury, except as to imports from those sources which have renounced any subsidies in question or from which undertakings under the terms of this Agreement have been accepted.")

<sup>128</sup> Appellate Body Report, *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, ¶604, WT/DS379/AB/R (Mar. 11, 2011) [hereinafter *U.S.—AD and Countervailing Duties*].

<sup>129</sup> *Id.* ¶¶541–43.

to decide whether the countervailing duty levied by U.S. DOC is inconsistent with this article, the appellate body examined dictionary meaning, turned to the context of Article 19 of SCM and other contextual support in other article of SCM and ADA, and prior cases<sup>130</sup> concerning interpretation of meaning of “appropriate.” Finally, the appellate body explained that “the requirement that any amounts be ‘appropriate’ means, at a minimum, that investigating authorities may, not in fixing the appropriate amount of countervailing duties, simply ignore that anti-dumping duties have been imposed to offset the same subsidization.”<sup>131</sup> It further held that since SCM and ADA set up different appropriate standards and a ceiling for the respective duties, interpretation of the “appropriate” standards could not be used to circumvent the rules in each agreement by understanding the appropriate amounts should not exceed the combined amount of dumping and subsidization found.<sup>132</sup> Since the amount of the countervailing duty imposed by DOC represents the full amounts of the subsidy, and at the same time, the AD duty disputed was levied at least on the basis of the same subsidization,<sup>133</sup> the appellate body reversed the Panel’s interpretation and found in favor of China on this issue.

This successful experience of arguing from interpretation of legal words in WTO agreements provides another model, which could be copied in future AD proceedings. When interpreting legal words, China could learn from how the appellate body did in this case, such as resorting to dictionary meaning, contextual meaning, legislative purpose, and how prior cases interpret the same language.

### C Conclusion

From the selected successful experiences discussed above, China looked into detailed legal text and had nice tries by making powerful arguments based on the legal requirements. In future cases, Article XVI: 4 and Article 18.4 of ADA are still basic legal requirements and China may continue its strategy in *EU–Fasteners* to challenge AD initiations. In addition, applying different legal interpretations as China argued in *U.S.–Anti-dumping and Countervailing Duties* is another common practice but demands comprehensive supporting evidence. China should also pay attention to the argument that the initiators’ interpretation of WTO

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<sup>130</sup> Panel Report, *European Communities—Anti-Dumping Measure on Farmed Salmon from Norway*, ¶14.128, WT/DS337/R (Nov. 16, 2007).

<sup>131</sup> *U.S.—AD and Countervailing Duties*, *supra* note 127, ¶570.

<sup>132</sup> *Id.* ¶¶570–72.

<sup>133</sup> *Id.* ¶¶582–83.

law is not in conformity with the way it should have been interpreted. It is doubtless that besides these two specific cases, there are still other successful tries by China and other WTO members in defending its/their legal rights in AD cases. These successful experiences CAN BE applied in accordance with different situation.

## V Theories of Strategic Thinking of China

Equipped with the above knowledge and experiences, the author proposes a combined strategy in defending trade interests from AD challenges. Chinese government always emphasizes the extreme important function of guiding strategic principle in directing actions. Stepping into 2011, Chinese Central Government implemented the 12<sup>th</sup> Five-Year Plan (12<sup>th</sup> FYP),<sup>134</sup> and entered a brand new strategic development period. The 12<sup>th</sup> FYP from 2011 to 2015 is a key period as for accelerating the transformation of the mode of economic development, deepening reform and opening, promoting economic impact on long-term stable and rapid development and social harmony, and building a comprehensive well-off society of decisive significance.<sup>135</sup> Considering that more and more trade conflicts are arising, it is pressing for Chinese enterprises to adjust their strategy when dealing with future fierce trading situation. This is also one of the Chinese government's basic responsibilities during the 12<sup>th</sup> FYP, which is to keep promoting international trade and comprehensive integration with the world trade. Improving the ability of responding to trade frictions and promoting international trade or similar expressions appear frequently in recent FYPs<sup>136</sup>, but what solutions shall China adopt in the 12<sup>th</sup> five year in order to achieve this goal? Shall China continue to follow the past path or should it try out a new strategy? In order to facilitate the goals of the 12<sup>th</sup> FYP, this section proposes two strategic thinking modes for China when facing with trading remedy challenges. One is the

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<sup>134</sup> 中华人民共和国国民经济和社会发展第十二个五年规划纲要 [The PRC's 12th Five-Year Plan for the National Economy and Social Development] (Mar. 16, 2011), [http://www.gov.cn/2011lh/content\\_1825838.htm](http://www.gov.cn/2011lh/content_1825838.htm) [hereinafter *The 12th Five-Year Plan*].

<sup>135</sup> 十二五计划第一篇：转变方式，开创科学发展新局面 [The 12th Five-Year Plan Chapter 1: Transformation of Mode and Initiation of Scientific Development], [http://www.gov.cn/2011lh/content\\_1825838\\_2.htm](http://www.gov.cn/2011lh/content_1825838_2.htm).

<sup>136</sup> 中华人民共和国国民经济和社会发展第十个五年计划纲要 [The PRC's 10th Five-Year Plan for the National Economy and Social Development] (Mar. 5, 2001), [http://www.npc.gov.cn/wxzl/gongbao/2001-03/19/content\\_5134506.htm](http://www.npc.gov.cn/wxzl/gongbao/2001-03/19/content_5134506.htm); 中华人民共和国国民经济和社会发展第十一个五年规划纲要 [The PRC's 11th Five-Year Plan for the National Economy and Social Development] (Mar. 14, 2006), [http://www.gov.cn/gongbao/content/2006/content\\_268766.htm](http://www.gov.cn/gongbao/content/2006/content_268766.htm); *The 12th Five-Year Plan*, *supra* note 133.



deeply rooted philosophy in Chinese ancient culture—Taoism,<sup>137</sup> and the other is a recently popular legal theory proposed by many foreign scholars, which is aggressive legalism.

### *A Natural Progression of Taoism*

China is one of the four cradles of civilization. Some ancient Chinese philosophical theories are rooted deeply in the mind of Chinese people, affecting Chinese people's model of behavior for more than 2,000 years. This section will talk about application of canons from Taoism in directing China's attitude towards dealing with AD challenges.

#### *a) Keep Learning from the Past Failure and Be Patient*

In traditional Chinese culture, Tao Te Ching<sup>138</sup> is a renowned masterpiece of Lao Tzu, the greatest philosopher and thinker in ancient China and the founder of the only indigenous religion -- Taoism. Notions, such as *action through non-action* or *Wu Wei* (无为) and emphasis on harmony between humanity and the universe, are deeply rooted in Chinese culture and play a magic role in providing invisible influence on people's lifestyle. Unexceptionally, these concepts also function well in dealing with trade fractions arising from cross-border trade.

Among 81 canons of Tao Te Ching, Chapters 8 and 78 could be the ones most directly applicable to the situation where China is subject to frequent AD investigations. These two chapters talk about water: Chapter 8 analyses the nature of water, which is most delicate and highly variable: "the highest excellence is like (that of) water. The excellence of water appears in its benefiting all things, and in its willingness to occupy the low place, without striving (to the contrary). Hence (its way) is near to (that of) the Tao."<sup>139</sup> Chapter 78 talks about the behavior of *yielding*, which is doomed to winning. Chapter 78 describes water as a metaphor: "there is nothing in the world more soft and weak than water, and yet for attacking things that are firm and strong there is nothing (so effectual) for which it can be changed. Everyone in the world knows that the soft

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<sup>137</sup> Taoism (also spelled Daoism) refers to a philosophical or religious tradition in which the basic concept is to establish harmony with the Tao (道), which is everything that exists, the origin of everything and because of the latter it is also nothing. Taoism had not only a profound influence on the culture of China, but also on neighboring countries. Taoist philosophy is deeply rooted in contemporary China, and is unavoidable part of modern Chinese life; YOU-SHENG LI, *THE ANCIENT CHINESE SUPER STATE OF PRIMARY SOCIETIES: TAOIST PHILOSOPHY FOR THE 21ST CENTURY* 300 (2010).

<sup>138</sup> 老子 (Lao Tzu), 道德经 [TAO TE CHING].

<sup>139</sup> TAO TE CHING (James Legge trans., 2d ed. 2008).

overcomes the hard, and the weak that strong, but no one is able to carry it out in practice.”<sup>140</sup> Lao Tzu presents his profound insights of human virtue and war strategy among states by simply describing the nature of water. The appearance of weakness of everything in the universe does not necessarily prove its frailty. Instead, beneath this appearance there might be power and strength strong enough to defeat any proud enemy.

China is like water described by Lao Tzu, which might be fragile at the current moment, but it can keep reserving its energy through daily practicing and learning from the past failure. Eventually, China will face less and less obstacles to its outbound trade.

*b) Do Not Give Up Learning from Past Failures in AD Proceedings*

Lao Tzu discussed the negative outcome of indulgence in Chapter 24<sup>141</sup> of Tao Te Ching, saying that “he who stands on his tiptoes does not stand firm; he who stretches his legs does not walk (easily). (So), he who displays himself does not shine; he who asserts his own views is not distinguished; he who vaunts himself does not find his merits acknowledged; he who is self-conceited has no superiority allowed to him. Such conditions, viewed from the standpoint of the Tao, are like remnants of food, or a tumor on the body, which all dislike. Hence those who pursue (the course) of the Tao do not adopt and allow them.”<sup>142</sup> Through the six vivid examples of people who pride themselves too much but do not end up with a satisfactory situation, Lao Tzu expressed his view of the *Tao* (道), which is not to make blind aggression and not to use false pride, self-righteousness, and bragging.<sup>143</sup> From the basic idea of natural progress (自然发展), or *wuweierzhi* (无为而治), two meanings could be drawn from Chapter 24. The first is where a person does not have the ability to achieve something, what he needs to do is not to advance rashly,

<sup>140</sup> *Id.* at 43.

<sup>141</sup> “企者不立，跨者不行；自见者不明；自是者不彰；自伐者无功；自矜者不长。其在道也，曰余食赘形。物或恶之，故有道者不处。” [He who stands on his tiptoes does not stand firm; he who stretches his legs does not walk easily. He who displays himself does not shine; he who asserts his own views is not distinguished; he who vaunts himself does not find his merit acknowledged; he who is self-conceited has no superiority allowed to him. Such conditions, viewed from the standpoint of the Tao, are like remnants of food, or a tumor on the body, which all dislike. Hence those who pursue the course of the Tao do not adopt and allow them].

<sup>142</sup> COLIN BRADSHAW-JONES & JAMES LEGGE, *THE TAO TE CHING, EIGHTY-ONE MAXIMS FROM THE FATHER OF TAOISM* 38 (2007).

<sup>143</sup> See STEFAN STENUDD, *TAO TE CHING: THE TAOISM OF LAO TZU EXPLAINED* 121–22 (2011).

like standing on his tiptoes to achieve a little more height or stretching his legs in order to walk a little more faster. Before the person grasps adequate knowledge and gains sufficient experience to achieve the expected goal, it would be better for him to strive for accumulating experiences and prepare for expected achievements. Marching forward gradually and leading his life in accordance with the ruling law of nature will finally leads to the goal.

The other implication of Chapter 24 roots where a person has already accomplished his goal. In this situation, the person should stay humble and strive for continued excellence, rather than being boastful and demanding praise without restraint. Being conceited will not only blind oneself of what is imperative to do the next step, but also lose the others' faith and would get the person isolated at the end. In this sense, Chapter 9 of Tao Te Ching carries the same message, which reads, "it is better to leave a vessel unfilled, than to attempt to carry it when it is full. If you keep feeling a point that has been sharpened, the point cannot long preserve its sharpness. When gold and jade fill the hall, their possessor cannot keep them safe. When wealth and honors lead to arrogance, this brings its evil on itself. When the work is done, and one's name is becoming distinguished, to withdraw into obscurity is the way of Heaven." ("持而盈之，不如其已；揣而锐之，不可长保。金玉满堂，莫之能守；富贵而骄，自遗其咎。功成身退，天之道也。") The moderation to all suggested in this maxim also demonstrates Lao Tzu's appreciation of the virtue of modesty. Lao Tzu emphasizes the attitude to live a humble life sort of discreetly because he realizes that the reward lies in peace and harmony of the mind, but not quick gains with anxiety all day long<sup>144</sup>. Based on the above two maxims, followers of Lao Tzu believe that to live in accordance with the ruling laws of nature, and to raise the heart high but to put the feet on the earth, is what guidance Tao Te Ching offers everyone longing for success. This also applies to current Chinese situation in responding to AD investigations within the WTO framework. International trade is complicated and dynamic all the time. Chinese government should be patient in developing its ability to lead Chinese exporters into more smooth outbound trade, which might take a long time.

There is a normal misunderstanding of Tao Te Ching in this context, which might leads to a possible negative effect by just waiting for an outcome without making efforts. Based on the principle proposed by Lao Tzu, wuwei (无为) or no action could be understood as a very negative attitude towards extraneous interference. This could be one way of un-

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<sup>144</sup> *Id.* at 67.

derstanding Lao Tzu's theory. However, the strategic thinking discussed in this section focuses more on the other part of Lao Tzu's theory—natural progression instead of rashly advancing in pursuit of instant success. To express it in a much more detailed way, in order to promote more peaceful foreign trade without threatening other WTO members by resorting to AD measures, China should keep actively studying WTO agreements and anti-dumping regulations of major trading partners. In addition, China should reasonably foresee that within five or even more years, the current situation will not be utterly changed, since Chinese companies need time to adapt to the WTO practice and litigation tactics. In this way, in the five or so years to come, China should keep a peaceful heart to accumulate its experience to integrate international trade within the WTO framework, rather than taking an impatient and irritable attitude towards international trading competition. This process must be painful, but as the ruling law of nature or Tao (道) proposed by Lao Tzu, this process is inevitable if China wants to deepen its participation within global trade. Needless to say, not being irritable does not direct China to go to the other extreme, which is really being wuwei (无为) or taking no action. In the coming five years, China should even more actively bring in what it needs in order to stand up firmly with extraneous challenges. This includes comprehensive studies on WTO agreements, relevant anti-dumping regulations of trading partners, widespread legal and economic education of WTO for Chinese youth and Chinese companies, and transformation of economic increasing mode in certain industries, etc. In a word, China should be patient in terms of waiting for the day when it has full capacity to give the constant AD investigations a perfect counter-attack.

There is one type of voice inside China, which harshly criticizes the protectionism from China's importing trading partners. Admittedly, frequent AD challenges originate from the trade protection policy from the AD initiators. However, only criticizing the outside world and waiting for their friendly cooperation with China can never benefit China's cross-border trade. What the domestic media and certain scholars should focus on at the moment should be picking up more patience and studying how to build up Chinese enterprises' capacity to defend such challenges. Such behavior can be alike movement of peaceful water—never stop moving forward and finally become a powerful strength.

### *B Aggressive Legalism*

While being a patience learner, China should also be active or even rigorous in the learning process to build up its capacity in order to

achieve the above goal, according to Aggressive Legalism. The concept of Aggressive Legalism was first brought by Saadia M. Pekkanen<sup>145</sup> in her article *Aggressive Legalism: The Rules of the WTO and Japan's Emerging Trade Strategy*<sup>146</sup> in 2001. When describing Japan's emerging trade strategy of deliberately and strategically using WTO rules, Saadia Pekkanen defines Aggressive Legalism as follows: "a conscious strategy where a substantive set of international legal rules can be made to serve as both 'shield' and 'sword' in trade disputes among sovereignty states."<sup>147</sup> This section will discuss whether it is a proper time for China to apply this methodology by comparing the level of development and domestic situations between Japan and China.

### a) *Japan's History of Applying Aggressive Legalism*

When discussing the formation of Aggressive Legalism in Japan, Saadia Pekkanen thinks that a 1988 winning case against Canada<sup>148</sup> under the GATT dispute settlement system signifies the turning point of Japan's attitude in applying a rule-based approach.<sup>149</sup> Before 1988, the Japanese had a general nature of "reluctant litigants" according to Ichiro Araki<sup>150</sup>, and ever after winning *Canada-SPF Lumber (GATT)*, Japan's domestic perception about GATT's fairness and utility of GATT as a legal weapon against foreign complaints and procedures was deeply affected.<sup>151</sup> On its appearance, Japan became active involving in the GATT system and the WTO system ever since its accession. For example, Japan paid full diplomatic attention to ongoing Uruguay Round talks, held overall ambition to push its international economic power status as well as in multiple international organizations, and emphasized on analysis of the WTO consistency of Japan's trading partners by drawing on leading legal professionals and trade experts. After evaluating these practices from an internal perspective, Saadia Pekkanen says that the driving force of key Japanese officials is realization that international legal rules could

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<sup>145</sup> Job and Gertrud Tamaki Associate Professor, Henry M. Jackson School of International Studies; and Adjunct Professor, School of Law, University of Washington, 2004–Present.

<sup>146</sup> Saadia M. Pekkanen, *Aggressive Legalism: The Rules of the WTO and Japan's Emerging Trade Strategy*, 24 THE WORLD ECON. 707, 707–37 (2001).

<sup>147</sup> *Id.* at 708.

<sup>148</sup> Panel Report, *Canada/Japan: Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber*, L/6470-36S/167 (Apr. 26, 1989) [hereinafter *Canada-SPF Lumber (GATT)*].

<sup>149</sup> Pekkanen, *supra* note 145, at 709–10.

<sup>150</sup> See HENRY S. GAO, AGGRESSIVE LEGALISM: THE EAST ASIAN EXPERIENCE AND LESSONS FOR CHINA 316 (2005).

<sup>151</sup> Pekkanen, *supra* note 145, at 710.

be a strategic source of national power, thus, the vision of these officials was legal.<sup>152</sup>

In the middle of her article, Saadia Pekkanen extends her discussion to the double-edged nature of Aggressive Legalism. On one hand, benefits of Aggressive Legalism are obvious: with this strategy, Japan can come up with legitimate legal actions to defend its trade policies that it deems legitimate without considering impact on its trading partners and say no to any request it deems as unreasonable.<sup>153</sup> In addition, since Aggressive Legalism is a rather open and transparent strategy, Japan can deal with trade issues with marked independence in the international context.<sup>154</sup> However, on the other hand, application of Aggressive Legalism might also hurt Japan itself because its trading partners may also turn around and expose controversial aspects of Japan's political economy to the full glare of WTO dispute settlement system.<sup>155</sup> Take Japan's loss to a case to U.S. concerning restrictions on imports of 12 agricultural products as an example, this case set up a precedent, which is advantageous to the U.S. for the 1988 liberalization of the beef and citrus quotas. Therefore, the disadvantage of Aggressive Legalism may emerge when the "legal hardball ... turn around and expose controversial aspects of Japan's political economy to the full glare of the WTO DSM."<sup>156</sup>

At the end, Saadia Pekkanen concluded that Japan has benefited a lot both domestically and internationally from applying Aggressive Legalism. According to Saadia Pekkanen, as for the international impact of Aggressive Legalism on a large scale Japan shows power of international law and facilitates diffusion of international legal rules across both developed countries and developing countries.<sup>157</sup>

#### b) *Future Application of Aggressive Legalism in China*

The concept of Aggressive Legalism draws huge responses from scholars and arouses heated discussion as for rationality of Aggressive Legalism and whether it is suitable for other arising economies,<sup>158</sup> such

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<sup>152</sup> *Id.* at 711.

<sup>153</sup> *Id.* at 733.

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

<sup>155</sup> *Id.* at 734–35.

<sup>156</sup> *Id.* at 734.

<sup>157</sup> *Id.* at 736.

<sup>158</sup> See GAO, *supra* note 149, at 315–51; Youngjin Jung, *China's First Safeguard Measure*, 36(6) J. WORLD TRADE 1037 (2002); Ichiro Araki, *Beyond Aggressive Legalism: Japan and the GATT/WTO Dispute*, WTO AND EAST ASIA 149 (2004); Ichiro Araki, *The Evolution of Japan's Aggressive Legalism*, 29 THE WORLD ECON. 783 (2006).

as China.<sup>159</sup> Actually, many scholars observe that the recent China is similar to Japan in the 1980s in terms of economic development.<sup>160</sup> It is worth considering whether Aggressive Legalism is suitable for current China.

China's economy grows at a high speed in recent years,<sup>161</sup> which is similar to the Japanese case in 1980s. In addition, it overtook Japan as the largest economy in Asia in 2010.<sup>162</sup> Some scholars consider now as a proper moment to apply aggressive legalism<sup>163</sup> following Japan's path. Just as Japan, there was a similar litigation culture for Chinese being a reluctant litigator. Whether it is a perfect time for China to fully apply its strategy depends on the current attitude of Chinese companies towards foreign AD initiations, the extent of involvement in multilateral talks at a governmental level and cost of applying this strategy. Taking AD initiations towards other countries is another aspect of using this strategy as a "sword." However, this topic is beyond the scope of this article.

First, Chinese companies' attitude towards increasing AD initiations is a main force to adopt Aggressive Legalism since they have defending interest if no AD measures are taken. According to recent feedback of Chinese companies targeted in AD initiations, they are enthusiastic to respond to such challenges and make every effort to defend their interest. Although there are only two AD cases brought by China to the WTO DSB so far, there is a fair amount of information about how Chinese companies treat this situation. What is more, before going to the DSB, many AD initiations are settled between China and the importing countries, and attitude of Chinese companies involved in these cases could help us to understand the current situation.

Second, the Chinese Central Government has also realized how urgent it is for Chinese companies to build up their capacity to defeat AD

<sup>159</sup> GAO, *supra* note 149; Jung, *supra* note 157; Araki, *supra* note 157.

<sup>160</sup> 松本健一 (Kenichi Matsumoto), 日本泡沫经济破灭 20 年祭: 与中国如此相似 [Memorial for 20th Anniversary of End of Japanese Bubble Economy: Extreme Similarity with China], 东方早报 [EAST DAILY] (Mar. 16, 2010), <http://finance.people.com.cn/GB/11146925.html>; 木下俊彦 (Toshihiko Kinoshita), 不会患上“日本病” [China will not Get Japan's Disease], 人民网 [PEOPLE] (Feb. 22, 2011), <http://world.people.com.cn/GB/14662076.html> (last visited Feb. 15, 2012).

<sup>161</sup> Based on data provided by National Bureau of Statistics of China, China's growth of GDP in 2011, 2010, 2009, 2008 and 2007 was 9.3%, 10.4%, 9.2%, 9.6%, and 14.2%.

<sup>162</sup> See *World Economic and Financial Surveys—World Economic Outlook Database*, IMF, <http://www.imf.org/external/pubs/ft/weo/2012/02/weodata/index.aspx> (last visited Aug. 11, 2013).

<sup>163</sup> See Pekkanen, *supra* note 145, at 735; Araki, *supra* note 157, at 171.

challenges by actively applying WTO rules and for the government to establish a thorough system. This system may provide early warning, legal and diplomatic support and a platform for companies to share information. The Ministry of Commerce of China (MOFCOM) has set up a subsidiary called Bureau of Fair Trade for Imports and Exports (BFT),<sup>164</sup> which is responsible for administration, investigations and defense of trade remedies including anti-dumping, anti-subsidies and countermeasures involving Chinese imports and exports.<sup>165</sup> Officials of BFT paid special attention to trade remedy investigations in the 11<sup>th</sup> five-year, and achieved great improvement in the following aspects. First, they strengthened the existing system in accordance with the current external situation of AD investigations.<sup>166</sup> A four-sector linkage system was set up for early warning and information communication, including MOFCOM, municipal bureau of commerce, industrial associations, and companies involved. Moreover, when it comes to division of function of the above sectors, MOFCOM reiterates that companies involved are the principal actors when responding to trade remedy challenges. At the same time, industrial associations are responsible for coordination of responding matter under guidance of central and local governments. Second, China adjusted and issued relevant laws and regulations in respect of initiating AD investigations against imported products<sup>167</sup>. Meanwhile, Chinese government actively took part in negotiations of multilateral

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<sup>164</sup> See MINISTRY OF COMMERCE OF THE PEOPLE'S REPUBLIC OF CHINA BUREAU OF FAIR TRADE FOR IMPORTS AND EXPORTS, <http://gpj.mofcom.gov.cn>.

<sup>165</sup> 国务院办公厅关于印发商务部主要职责内设机构和人员编制规定的通知 [Notice of General Office of the State Council on Distributing the Department of Commerce's Main Functional Internal Organs and Staffing Requirements] (promulgated by the General Office St. Council, Apr. 25, 2003, effective Apr. 25, 2003) CLI.2.46450 CHINALAWINFO.

<sup>166</sup> “十一五”期间我国公平贸易工作回顾和展望 [Review and Prospects of The Fair Trade Work of the 11th Five-Year], 商务部进出口公平贸易局 [BUREAU OF FAIR TRADE FOR IMPORTS AND EXPORTS] (Oct. 28, 2010), <http://gpj.mofcom.gov.cn/aarticle/subject/mymcyd/subjectrr/201012/20101207295576.html> [hereinafter *Review and Prospects*].

<sup>167</sup> *Id.*; these laws and regulations include: 对外贸易法 (2004 修订) [Foreign Trade Law (2004 Revision)] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 6, 2004, effective July 1, 2004) CLI.1.52228 CHINALAWINFO; 出口产品反倾销案件应诉规定 [Provisions on Responding to Anti-Dumping Cases concerning Export Products] (promulgated by the Ministry of Commerce, July 14, 2006, effective Aug. 14, 2006) CLI.4.78438 CHINALAWINFO; 反倾销产业损害调查规定 [Provisions on the Anti-Dumping Investigation of Industry Damage] (promulgated by the Ministry of Commerce, Oct. 17, 2003, effective Nov. 17, 2003) CLI.4.50257 CHINALAWINFO; 反倾销调查立案暂行规则 [Interim Rules on Placing Cases on File for Anti-Dumping Investigations] (promulgated by the Ministry of Foreign Trade and Econ. Coop., Feb. 10, 2002, effective Mar. 13, 2002) CLI.4.38552 CHINALAWINFO; 反倾销调查听证会暂行规则 [Interim Rules on the Hearing of Anti-Dumping Investigations] (promulgated by the Ministry of Foreign Trade and Econ. Coop., Jan. 16, 2002, effective Jan. 22, 2002) CLI.4.39774 CHINALAWINFO.



agreements.<sup>168</sup> Third, the Chinese government made a strong presence in various multilateral talks seeking opportunities to build up trust and clear up doubts by trading partners.<sup>169</sup>

The official BFT website keeps updating specialized knowledge and trade news. For example, the Guidance of Responding Foreign Trade Remedies Investigations edited by BFT, updated foreign investigations towards China, recent news of meetings about defending trade interests and industrial development attended by MOFCOM officials, monthly reports of trade conflicts among other countries, notice of periodical training of WTO rules and a platform for information exchange among companies, industrial associations and scholars, etc. To some extent, these active preparations serve the purpose to fulfill transparency responsibility requested by Trade Policy Review Mechanism. Specifically speaking, the transparency responsibility aims at contributing to improved adherence by all Members to rules, disciplines commitments made under the Multilateral Trade Agreement.<sup>170</sup> In this way, transparency can lead to the smoother functioning of the multilateral trading system, by achieving greater transparency in, and understating of, the trade policies and practices of Members.<sup>171</sup> Moreover, to observe these efforts made by MOFCOM from a domestic perspective, MOFCOM is eager to change the current situation as the most frequently targeted country of AD initiations in WTO.

Furthermore, taking recent success against EU in *EC-Fasteners* in July 2011 for a concrete example, from the decision of submitting the dispute to the WTO DSB to the recent exciting outcome, the Chinese

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<sup>168</sup> *E.g.*, Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation Between the People's Republic of China and the Association of Southeast Asian Nations, 商务部中国自由贸易区服务网 [MOFCOM-FREE TRADE AGREEMENTS], <http://fta.mofcom.gov.cn/dongmeng/annex/xieyi2004en.pdf> (last visited on June 26, 2013); Free Trade Agreement Between The Government of the People's Republic of China And The Government of New Zealand, 商务部 [MOFCOM] <http://images.mofcom.gov.cn/gjs/accessory/200804/1208158780064.pdf> (last visited on June 26, 2013). For more information, see China's Free Trade Agreements, MOFCOM-FTA, [http://fta.mofcom.gov.cn/english/fta\\_qianshu.shtml](http://fta.mofcom.gov.cn/english/fta_qianshu.shtml) (last visited on June 26, 2013).

<sup>169</sup> *Review and Prospects*, *supra* note 165; *e.g.*, China's participation in Trade Policy Review Mechanism and responding to specific questions; international seminar on 10th anniversary of China's anti-dumping legislation and practice in June 2007; seminars on trade remedies to officials from developing countries; official trade remedies cooperation mechanism with more than 10 countries, including U.S., Australia, South Africa, Korea, etc.; prosperity in legal and economic education on anti-dumping.

<sup>170</sup> Marrakesh Agreement Establishing the World Trade Organization, Annex 3, art. 1(i), Apr. 15, 1994 1867 U.N.T.S. 154.

<sup>171</sup> *Id.*

government presented a positive gesture to offer great political support and professional legal support to the companies involved. Ever since the EU launched AD investigation against Chinese fasteners in 2008, Jiaying Industrial Association of Fasteners<sup>172</sup> responded the investigation actively.<sup>173</sup> Geographical concentration of producers of specific products is a great advantage in disputes since coordination of companies from the same industry is much easier than companies scattered all over China. In addition, MOFCOM gave strong support in consultations with EC.<sup>174</sup> After EU made its decision of applying AD duty of 87% to Chinese fasteners, spokesperson of MOFCOM expressed extreme anger at EU's imposition of such a high AD duty because of inconsistency with WTO rules in notification of investigation, investigation and decision-making.<sup>175</sup> Six months later, China made official request of consultation to the WTO<sup>176</sup>, which is China's first resort to WTO rules against the EU's trade remedy. Throughout the whole decision-making process of EC, the Panel and the appellate body, Jiaying Bureau of Commerce kept facilitating organization of responding by the involved companies.<sup>177</sup> These efforts included declaring no existence of martial injury for four

<sup>172</sup> Most of the companies targeted in *EC Fasteners* case were from Jiaying city, Zhejiang Province, and the value involved was \$97 million, see 欧盟紧固件反倾销, 浙24家企业首次赴欧游说 [*EU Initiating Anti-Dumping Investigations over Fasteners, 24 Zhejiang Companies Went to Lobby in Europe for the First Time*], 新华网 [XINHUA.NET] (Feb. 28, 2008), [http://www.zj.xinhuanet.com/newscenter/2008-02/28/content\\_12569228.htm](http://www.zj.xinhuanet.com/newscenter/2008-02/28/content_12569228.htm). More information about the Jiaying Industrial Association of Fasteners is available at <http://www.jxfastener.org/>.

<sup>173</sup> 积极应对欧盟对我钢铁紧固件的反倾销调查 [*Actively Responding to the Anti-Dumping Investigations over the Steel Fasteners Initiated by the EU*], 嘉兴紧固件协会 [JIAXING FASTENER ASSOCIATION] (Dec. 8, 2008), <http://www.jxfastener.org/news.asp?sid=5YA7D3%3FNS%3F38%3FWL%3F36>.

<sup>174</sup> 中国紧固件代表团出席欧盟紧固件反倾销案听证会 [*Chinese Fasteners Delegation Attended the EU Hearings on Anti-Dumping Investigation over Fasteners*], 嘉兴紧固件协会 [JIAXING FASTENER ASSOCIATION] (Dec. 8, 2008), <http://www.jxfastener.org/news.asp?sid=4BVZV%3FLT%3F38%3FYY%3F39>.

<sup>175</sup> 雷敏 (Lei Min), 中方对欧盟对华紧固件采取反倾销措施表示强烈不满 [*China Expressed Strong Dissatisfaction Towards the EU's Anti-Dumping Measures Against Fasteners*], 新华网 [XINHUA.NET] (Jan. 28, 2009), [http://big5.xinhuanet.com/gate/big5/news.xinhuanet.com/newscenter/2009-01/28/content\\_10729710\\_1.htm](http://big5.xinhuanet.com/gate/big5/news.xinhuanet.com/newscenter/2009-01/28/content_10729710_1.htm) (reporting China's reaction to the EU's decision of imposing AD duty of 87%).

<sup>176</sup> Request for Consultations by China, *European Communities—Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China*, G/ADP/D79/1, WT/DS397/1 (July 31, 2009).

<sup>177</sup> 张峰 (Zhang Feng), 穷尽法律手段维护我紧固件在欧盟市场利益 [*Exhaust Legal Means to Safeguard The Interest of the Fasteners Industry in the EU Market*], 嘉兴市商务局 [JIAXING MUNICIPAL BUREAU OF COMMERCE] (Aug. 5, 2009), <http://www.jxfet.gov.cn/news.php?id=13082>.

times to the EU in 2008 and providing WTO rules training to all interested parties, etc.<sup>178</sup>

Based on the current attitude of both Chinese companies and Chinese government, China should move forward and apply Aggressive Legalism. Comparing with Japan's situation of 1988, situations of China are mature from every aspect. Success in *EC-Fasteners* is a remarkable turning point as *Canada-SPF Lumber (GATT)*. First, it is the first time when China brings a case against the EU—China's top trading partner—to the WTO DSB and gets a favorable ruling<sup>179</sup>. Second, similar to Japan's active foreign policy establishment,<sup>180</sup> Chinese government realized the importance of participating in multilateral negotiations and tried hard to show its competence and capacity in rules renegotiation. Third, growing domestic attention, enhancing WTO rules learning and trade policy studies from trading partners, plus relocation of administrative power in dealing with AD challenges, is also similar as the trend of promoting sense of utilizing WTO rules in order to defend Japanese companies' interests.<sup>181</sup> Forth, just as Japan's intentional utility of WTO rules as a sword towards foreign practices it thinks controversial,<sup>182</sup> China's AD initiations against imported products increased at a high speed recently.<sup>183</sup>

In conclusion, China's success in *EC-Fasteners* could be an historic moment to mark a sharp change in China's trading policy. With great passion and notice of necessity in learning and utilizing WTO rules in promoting domestic economic development, China could take a more active role in participating in WTO negotiations and defending economic and political interests through full use of WTO legal rules. Actually, alongside its excitement in winning the case against the EU, Chinese government picks up great confidence in its legal capacity to use WTO rules as both a shield and a sword.

### *C Reconcile Taoism and Aggressive Legalism in AD investigations*

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<sup>178</sup> *Id.*

<sup>179</sup> See Pekkanen, *supra* note 145, at 710.

<sup>180</sup> *Id.*

<sup>181</sup> *Id.* at 711.

<sup>182</sup> *Id.* at 713.

<sup>183</sup> As indicated by the number of AD initiations against imported products from the MOFCOM website, see 反倾销调查 [Antidumping Investigation], 商务部进出口公平贸易局 [BUREAU OF FAIR TRADE FOR IMPORTS AND EXPORTS], Sept. 19, 2011, <http://gpj.mofcom.gov.cn/article/Nocategory/201109/20110907745531.shtml> (last visited Feb. 15, 2012).

The above two methodologies seem to be contrary to each other, since Tao emphasizes natural building up of legal capacity while Aggressive Legalism aims at active utility of WTO rules as both a shield and a sword. However, one can strike a perfect balance between these two in the context of Chinese strategy formulation. On one hand, China should continue to be patient in accumulating experiences in dealing with AD disputes with the initiators, and this cries for a great amount of cost in both learning and practicing. At the same time, China should become an energetic user of WTO legal rules to defend its interest during the process of responding to external challenging. During this process, it is worthwhile to draw Chinese enterprises' attention to two extremes, which shall be avoided.

First, the respect to patience and natural progress does not mean passively waiting for exportation of Chinese products complying with AD rules in different countries or within the WTO. As discussed above in Part III, not every AD initiation is justified under the WTO criteria. Without active response and rule learning, passive attitude can only give China's trading partners the opportunity to abuse AD rules. If Chinese enterprises unfortunately follow this path, it would be impossible for China to defend its own trade interest. From its appearance, failure in responding an AD challenge is payment of huge AD taxation by the targeted company. Nevertheless, it has a more profoundly harmful impact to Chinese cross-border trade due to the image of passive self-deference.

Second, when it comes to aggressive legalism, the author does not recommend the Japanese practice, which is too "aggressive" literally. This refers to the second meaning of using as a "sword." It is not proper to use the rules simply as a weapon to defend one's own interest in international trades, sometimes even amounting to protectionism. A better way as the author proposes, China should learn from Japan's attitude about legal rules but practice this principle in a moderate way. Without any doubt, applying AD rules should serve the purpose of protecting trade interest and maintaining normal trade relationship. In a word, application of the legal rules should be justified rather than adopting it as a lethal weapon blindly.

Another clarification also needs to be laid down before practicing this strategy. By pointing out Taoism when dealing with future trading frictions, the author does not indicate to apply these two principles at the same time in specific cases. The concept of respecting natural process should come into play when the Chinese government (most frequently the MOFCOM), the industrial associations, the entities and other related

stakeholders formulate its long-term plan in capacity building. The goal for this plan is to accumulate knowledge and experiences in defending trade interests when facing AD challenges. Acknowledgement of hardships and a long learning process is necessary. The current domestic public opinion is following a trend of anxiously striving for easy success and exaggerating China's rising image in the world trade. Frequent criticism the importing countries' protectionism is not a proper attitude in international trade. Instead, China's attitude should be a patient learner with a learning schedule in the next 12 years. However, in specific cases, the Chinese respondents shall dig into the WTO rules aggressively. They shall actively involve in the dispute solving process and figure out favorable arguments with supportive evidences. The process could be assisted by involving more legal experts, investing more money in evidence collection and promoting communication with the interested parties.

How to apply the AD rules in a reasonable way is an art, which needs a long period of time in learning and practicing. On one hand, one should actively defend its trade interest in responding frequent challenges, and on the other hand, initiating challenges to trade partners to the extent that maintain normal trade relationship. Admittedly, a long term of learning process and capacity building could not be finished within one day, which still needs time and painful process to achieve. An encouraging point is that applying Aggressive Legalism could facilitate the process of learning. In addition, using the WTO rules should be regraded as a learning process without over-emphasis on its outcome. When facing further AD challenges what China needs is practicing: adopting the idea of natural progress and aggressive legalism.

#### *D Conclusion*

Comparing with being a constant victim within the WTO framework in the past 12 years after accession to WTO, in the next 12 years, China should pick up its confidence in rapid economic and legal capacity growth. The timing is perfect now for China to take advantage of the two strategies. By practicing, it will eventually reconcile Taoism and Aggressive Legalism in promoting continuous economic development.

## **VI Conclusion**

A 12-year cycle of life has almost passed since China's accession to WTO. In Chinese zodiac, a new cycle of life always marks a new stage of life with a new vision. At this historic moment, Chinese enterprises

should reconsider its strategy in participating in multinational trade to promote continuous development. Based on previous extensive failures in AD proceedings initiated by other WTO members, now is a perfect time for China to change its strategic policy from being a reluctant litigant into an aggressive actor applying WTO legal rules. Undoubtedly, WTO legal rules are rather complicated and prior cases are numerous. However, in order to change the current situation of being the most frequent target of AD measures, China should keep learning the WTO law package. Together with learning legal rules, China can also cultivate its legal thinking through litigation strategies when responding AD challenges. This whole learning process cannot finish within one day, so China should stay patient during this learning process. In conclusion, when facing future AD challenges, China should act as a patient participant in the WTO through rigorously applying WTO rules to protect and promote its interests. In the next 12-year cycle from 2013, it is promising for China to be a powerful rule maker and a great beneficiary of the WTO rules.

# **A Way Out for “Detroit” in China?— The Advantage and Feasibility of Starting Sub-national Bond Issuance in China**

*QIU Lige\**

## **ABSTRACT**

*China started a trial program recently, allowing four sub-national governments to issue bond directly for the first time after an eighteen-year ban. In this paper, the author will discuss why, compared with the existing financing channels, sub-national bond issuance is preferable for China's economy. Further, the author will refer to international practice to see what prerequisites are for a successful sub-national bond market and how China measures up on those prerequisites. The author believes there are still many obstacles to overcome before China could develop sub-national bond market well and the main problems lie in regulatory framework.*

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## I. Introduction

On October 17th, 2011, the Ministry of Finance (MOF) of the People's Republic of China (PRC) officially released *The 2011 Measures on Trial Program for Local Governments to Issue Bonds* ("the 2011 Measures").<sup>1</sup> The Measures for the first time allowed certain local governments to issue bonds on their own.<sup>2</sup>

Local governments in China have been barred from tapping the bond market since the 1994 *PRC Budget Law*, which banned direct sub-national bond issuance unless approved by the State Council or authorized by other laws.<sup>3</sup> Some commentators believe that the current trial is an effort to prevent China's local governments from defaults since local governments are in urgent need of new funding to repay their debt soared after the global financial crisis.<sup>4</sup> In addition, the new funding channel will bring many advantages as we will see in the discussion later. For these reasons, during the amending process of the Budget Law in 2012, there was hot debate on whether the prohibitive provision in the Budget law should be repealed. But the National People's Congress finally decided not to do so at the moment.<sup>5</sup>

According to the 2011 Measures, the State Council would set an upper limit for the amount of bonds to be issued, and the MOF would pay

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<sup>1</sup> 财政部关于印发《2011年地方政府自行发债试点办法》的通知 [Circular of the Ministry of Finance of Printing and Distributing the 2011 Measures for Experiment on Local Government Unauthorized Bond Issuance] (promulgated by the Ministry of Fin., Oct. 17, 2011, effective Oct. 17, 2011) CLI.4.159824 Chinalawinfo. This article will use "sub-national government" and "local government" interchangeably.

<sup>2</sup> The sub-national governments in the trial are two municipalities (Shanghai, Shenzhen) and two provinces (Zhejiang, Guangdong). Before this trial, the MOF has issued sub-national bond on behalf of local governments since 2009. Those bonds were named "local government bonds," but the issuer was in fact the central government.

<sup>3</sup> Jamil Anderlini, *China Municipalities to Issue Bonds*, FIN. TIMES (Oct. 20, 2011), <http://www.ft.com/intl/cms/s/0/0640aaf2-fb20-11e0-bebe-00144feab49a.html#axzz2TQ8Ft7g6> (the ban in 1994 Budget Law arose out of concerns about local governments' ability to repay the huge debt they owed).

<sup>4</sup> Lingling Wei & Aaron Back, *China to Let Local Governments Issue Bonds*, THE WALL ST. J. (Oct. 21, 2011), <http://online.wsj.com/article/SB10001424052970204485304576642470825957018.html>.

<sup>5</sup> 王姝 (Wang Shu), 我国拟禁止地方政府自行发债 [China Plans to Ban Unauthorized Bond Issuance by Local Governments], 人民网 [PEOPLE.COM], June 27, 2012, <http://finance.people.com.cn/n/2012/0627/c70846-18388384.html>.



principal and interests on behalf of the issuing governments.<sup>6</sup> The issuing governments shall follow an accompanying circular, *2011 Measures for the Issuance and Honor of Bonds by the MOF on Behalf of Sub-national Bonds*, to pay the principal and interest to the central budget special account within certain time limit.<sup>7</sup> The bonds in the trial have maturities of 3 and 5 years, and the issuing governments could choose their own underwriters for the issuances.<sup>8</sup> The trial issuance and repayment arrangement showed a very prudent attitude of the central government. Later on, the central government promulgated a new circular, *the 2012 Measures on Trial Program for Local Government to Issue Bonds*,<sup>9</sup> which was almost identical with the 2011 Measures, only adding a new maturity of 7 years.<sup>10</sup> Until now, each of the four governments in the trial has issued bonds several times.

With the above background in mind, this thesis aims to explore why sub-national bond is a preferable financing channel, and whether it is the right time for China to start sub-national bond issuance. The thesis would also tentatively suggest some policy improvement to develop such a bond market. In the first part, the author will discuss whether it is necessary for China to end the 18 years' ban on sub-national bond issuing now and start to use such market as a new and enduring public finance channel. In particular, it will highlight the characteristics of fiscal system in China, review the sustainability of existing public financing channels in the past and compare the advantages and disadvantages of sub-national bond issuance with these financing channels.

The second part will discuss what the prerequisites are for starting a sub-national bond market in China. Because the World Bank and regional development banks have extensive experience in helping developing countries to build up markets of this kind in the past, this thesis will take

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<sup>6</sup> 2011 年地方政府自行发债试点办法 [2011 Measures for Experiment on Local Government Unauthorized Bond Issuance] (promulgated by the Ministry of Fin., Oct. 17, 2011, effective Oct. 17, 2011) art. 2, CLI.4.159824 CHINALAWINFO.

<sup>7</sup> *Id.* art. 14; 财政部代理发行 2011 年地方政府债券发行兑付办法 [The Ministry of Finance to Issue the 2011 Payment Methods of Local Government Bond Issuance] (promulgated by the Ministry of Fin., Apr. 7, 2011, effective Apr. 7, 2011).

<sup>8</sup> 2011 年地方政府自行发债试点办法 [2011 Measures for Experiment on Local Government Unauthorized Bond Issuance] (promulgated by the Ministry of Fin., Oct. 17, 2011, effective Oct. 17, 2011) art. 4–5, CLI.4.159824 CHINALAWINFO.

<sup>9</sup> 财政部关于印发《2012 年地方政府自行发债试点办法》的通知 [Circular of the Ministry of Finance of Printing and Distributing the "2012 Measures for Experiment on Local Government Unauthorized Bond Issuance"] (promulgated by the Ministry of Fin., May 8, 2012, effective May 8, 2012) CLI.4.173753 CHINALAWINFO.

<sup>10</sup> 2012 年地方政府自行发债试点办法 [2012 Measures for Experiment on Local Government Unauthorized Bond Issuance] (promulgated by the Ministry of Fin., May 8, 2012, effective May 8, 2012) art. 4, CLI.4.173753 CHINALAWINFO.

the literature and experience of those institutions as reference to summarize prerequisites for the establishment of sub-national bond market in China. In the third part, the author will look into the macro-economic environment, regulatory framework and financial management ability in China, in order to answer whether China has met these prerequisites, and if not, what improvement could be made.

## II. Advantage of Starting Sub-national Bond Issuance in China

### A *Significant Fiscal Difficulty for Local Governments in China*

In the public financing sector, it is the “workings of the myriad of intergovernmental relations that constitutes the essence of the public sector in all countries.”<sup>11</sup> Thus before our discussion about bond financing as a potential public financing channel for local governments in China, it is necessary to have a big picture of the Chinese fiscal system at the beginning so as to understand the serious fiscal capacity constraints for local governments.

China’s market-oriented reform started in 1978. Before the reform, the fiscal system was highly centralized under the planned economy scheme. All revenue and expenditures of local governments were under the state budget of the central government. The central government decided what revenue to be collected and how to reallocate those revenues. As a result, local governments lacked incentives to develop local economies, and the whole national economy worked inefficiently. To improve the situation, China began fiscal decentralization reform at the beginning of the 1980s.<sup>12</sup> It adopted a fiscal contracting system (*Caizheng Baogan*) to share revenues and divide expenditure responsibilities between the central and local governments. Under this arrangement, local governments whose revenues exceed their expenditures would share the excess

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<sup>11</sup> Richard M. Bird, *Intergovernmental Finance and Local Taxation in Developing Countries: Some Basic Considerations for Reformers*, 10 PUB. ADMIN. & DEV. 277, 281 (1990), <http://onlinelibrary.wiley.com/doi/10.1002/pad.4230100304/pdf>.

<sup>12</sup> Ming Su & Quanhou Zhao, *The Fiscal Framework and Urban Infrastructure Finance in China* 4 (World Bank, Working Paper No. 4051, 2006), [http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/10/26/000016406\\_20061026113712/Rendered/PDF/wps4051.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/10/26/000016406_20061026113712/Rendered/PDF/wps4051.pdf).

with the central government based on the negotiated sharing ratio between them.<sup>13</sup>

The deregulation efforts did create desired incentives, yet it also brought significant problems. First, the central and local governments were constantly bargaining for the shares since local governments may get higher shares if their revenues increased during the term.<sup>14</sup> Second, the different contracting formula were "complicated and inequitable, enlarging the fiscal differentials between regions."<sup>15</sup> Third, the most serious problem was the steep declines of the total revenue (revenues of both the central government and local governments) as percentage of GDP and the central government revenue as percentage of the total revenue.<sup>16</sup> The percentage of the central government's revenue of the total revenue fell from 34.8% in 1985 to 22% in 1992.<sup>17</sup>

In the early 1990s, the central government fell into serious financial difficulty and was losing control over the macro economy. The situation lead to the 1994 "tax assignment system reform" (*Fenshuizhi Gaige*), which fundamentally established the intergovernmental fiscal framework today. The aims of the 1994 reforms were tax modernization, tax administration, and most importantly, tax sharing,<sup>18</sup> and the government reached these ends by shifting from a negotiated revenue sharing system to a tax assignment system.

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<sup>13</sup> 国务院关于实行“划分收支、分级包干”财政管理体制的通知 [Circular of the State Council Concerning the Implementation of "Division of Revenue and Expenditure between the Central and Local Governments and with Contracts at Different Levels" Financial Management System] (promulgated by the St. Council, Feb. 1, 1980, effective Feb. 1, 1980) para. 2, CLI.2.48790 CHINALAWINFO.

<sup>14</sup> Jia Kang, *People's Republic of China*, in LOCAL GOVERNMENT FINANCE AND BOND MARKETS 63 (Yun-Hwan Kim ed., 2003), [http://www.perpustakaan.depkeu.go.id/FOLDEREBOOK/loc\\_govt\\_fin\\_bond\\_mkts.pdf](http://www.perpustakaan.depkeu.go.id/FOLDEREBOOK/loc_govt_fin_bond_mkts.pdf).

<sup>15</sup> Su, *supra* note 12, at 5.

<sup>16</sup> The decline of revenue/GDP is partly because of the fact that local governments gamed the system by producing just enough on budget shared revenue to satisfy their contract obligation. *See id.* at 4; in fact, extra-budgetary revenue grew at the same time, but these revenue is more decentralized than budgetary revenues. *See* Richard M. Bird & Christine C.P. Wong, *China's Fiscal System: A Work in Progress* 5, (Georgia State Univ. Sch. Pol'y Stud., Working Paper No. 05-20, 2005), <http://ideas.repec.org/p/ays/ispwps/paper0520.html>(this was because local governments would produce just enough on budget shared revenue to meet their negotiated obligations by putting additional revenue to off-budget or to the categories that did not have to be shared) [hereinafter Bird & Wong].

<sup>17</sup> Su, *supra* note 12.

<sup>18</sup> Bird & Wong, *supra* note 16, at 6; ROY W. BAHL, FISCAL POLICY POLICY IN CHINA: TAXATION AND INTERGOVERNMENTAL FISCAL RELATIONS (1999).

The tax revenues fall into three categories: (1) taxes exclusively assigned to the central government, (2) taxes exclusively assigned to the local governments, and (3) taxes shared between the two. Under this system, local governments have their own exclusive revenue sources, while at the same time, significant portion of taxes were reassigned to the central government, and new intergovernmental transfer system was established.

Table 1: 1994 Tax Sharing Scheme<sup>19</sup>

The Central Revenues	<ul style="list-style-type: none"> <li>- import tariff;</li> <li>- consumption tax;</li> <li>- income taxes and profits of centrally owned SOEs;</li> <li>- import-related consumption taxes and value added tax;</li> <li>- taxes imposed on banks, nonbank financial institutions and insurance companies (including business taxes, income taxes, and Urban Maintenance and Development Tax);</li> <li>- taxes on railroads</li> </ul>
Local Governments' Revenues	<ul style="list-style-type: none"> <li>- business tax (excluding banks, nonbank financial institutions and insurance companies, and railroads);</li> <li>- company income tax (excluding local banks, foreign banks, and nonbank financial companies);</li> <li>- profits of locally owned SOEs;</li> <li>- personal Income Tax;</li> <li>- urban Land Use Tax;</li> <li>- urban maintenance and development tax (excluding banks, nonblank financial institutions and insurance companies, and railroads);</li> <li>- fixed assets capital gains tax;</li> <li>- house property tax;</li> <li>- stamp tax;</li> <li>- agriculture and related taxes;</li> <li>- tax on contracts;</li> <li>- land value increment tax;</li> </ul>
Shared Revenues	<ul style="list-style-type: none"> <li>- value added tax (central 75%, sub-national governments 25%);</li> <li>- stamp taxes on security exchange (50%-50%);</li> <li>- resource tax</li> </ul>

This system reduced local governments' share of revenues while left their expenditure responsibilities unchanged. It created a fiscal gap for local governments, and the gap has been enlarging day by day. Below are some prevailing explanations:

<sup>19</sup> 国务院关于实行分税制财政管理体制的决定 [The State Council's Decision on Implementing Tax Assignment Management System] (promulgated by the St. Council, Dec. 15, 1993, effective Jan. 1, 1994) §3(2), CLI.2.8852 CHINALAWINFO.

1. Gradual changes have been made in the intergovernmental revenue system after 1994. Most of the changes either increased the central government's portion of shared taxes and the rates on the taxes exclusively assigned to the central government, or eliminated certain local governments' taxes and fees.<sup>20</sup> For example, according to the 1994 tax assignment scheme, local governments had the exclusive right to collect personal income tax and company income tax, which grew fast after the 1994 reform. However, the central government started to share both company (except for certain industries) and personal income taxes with local governments in 2002, and the central government would receive the majority share.<sup>21</sup> Another example is that in 2006, China completely abolished the agriculture taxes,<sup>22</sup> which traditionally had been collected by local governments. Changes like these effectively converted local revenues to the central and thus cut sharply into local governments' share of revenue distribution.

2. While their share of total revenue is decreasing, local governments' expenditure as a percentage of the country's total expenditure (expenditure of both the central government and local governments) remains stable, at roughly 70%.<sup>23</sup> Due to the very high speed and large scale of urbanization, local government spending keeps growing. In 1978, only 17.9% of population lived in urban areas; in contrast, the number in 2010 reached 49.68%.<sup>24</sup>

Urbanization leaves local governments with heavy fiscal burden. Based on the rough division of responsibilities between the central and local governments, local governments are responsible for basic public services, maintenance and operation of urban infrastructure, science, education, cultural and health undertakings (*Kejiaowenwei*), price subsidies, management of local state-owned enterprises (SOE) (most of which are under deficit) and social protection of those lay-offs by local SOEs, pov-

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<sup>20</sup> Su, *supra* note 12, at 10.

<sup>21</sup> Su, *supra* note 12, at 11.

<sup>22</sup> 全国人大常委会关于废止《中华人民共和国农业税条例》的决定 [The Standing Committee of NPC's Decision on Abolishing the Regulation of the People's Republic of China on Agriculture Tax] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 2005, effective Jan. 1, 2006).

<sup>23</sup> Su, *supra* note 12, at 14.

<sup>24</sup> 国家统计局 [NAT'L BUREAU OF STAT. OF CHINA], 2010年第六次全国人口普查主要数据公报 [PUBLICATION OF THE MAIN DATA OF THE SIXTH NATIONAL CENSUS IN 2010] (Apr. 28, 2011), [http://www.stats.gov.cn/tjgb/rkpcgb/qgrkpcgb/t20110428\\_402722232.htm](http://www.stats.gov.cn/tjgb/rkpcgb/qgrkpcgb/t20110428_402722232.htm).

erty alleviation, and so on.<sup>25</sup> Moreover, research shows that China has industrialized much faster than it has urbanized, and has urbanized faster than it has invested in urban infrastructure.<sup>26</sup> Urbanization is and will still be an extremely important policy for China's economic development. Accordingly, there will be a continuing demand for infrastructure investment, and local governments' expenditure is expected to grow continuously in the future.

3. China's fiscal decentralization, in combination with its officials' promotion system, contributes to the widening of local governments' fiscal gap. To explain why China has achieved great economic success in the past decades, many scholars looked into China's fiscal system. Originally the focus was mainly on China's "fiscal federalism," which effectively gives the local governments economic incentives to develop the economy.<sup>27</sup> Since 2001, however, political incentives for local officials have attracted more academic attention.<sup>28</sup>

In contrast with economic federalism, China's political system is highly centralized. Since 1980s, the standard of promotion has shifted from political performance to economic performance. To get promoted in the political hierarchy, local officials have to work as hard as possible to demonstrate economic achievements in their localities.<sup>29</sup> They have been engaging in a "promotion tournament" that centers mainly on regional GDP growth rate.<sup>30</sup> For China's economy, investment, export and con-

<sup>25</sup> 国务院关于实行分税制财政管理体制的决定 [The State Council's Decision on Implementing Tax Assignment Management System] (promulgated by the St. Council, Dec. 15, 1993, effective Jan. 1, 1994) §3(1), CLI.2.8852 CHINALAWINFO.

<sup>26</sup> Industrialization rate: value-added of industry as percent of GDP; Urbanization rate: urban resident as percent of total population. See 谢伏瞻 (Xie Fuzhan), 加快城市基础设施发展应有紧迫感 [It Should Be Urgent to Speed Up City Infrastructure Development], 中国网 [CHINA.COM.CN], Dec. 23, 2003, <http://www.china.com.cn/chinese/OP-c/466537.htm>.

<sup>27</sup> Hehui Jin, Yingyi Qian & Barry R. Weingast, *Regional Decentralization and Fiscal Incentives: Federalism, Chinese style*, 89(9-10) J. PUB. ECON. 1719 (2005).

<sup>28</sup> Blanchard and Sheleifer in 2001, compared China and Russia, and reached to the conclusion that the fact that political centralization and fiscal decentralization worked together makes the two countries economy development differently. See Oliver Blanchard & Andrei Shleifer, *Federalism with and without Political Centralization: China versus Russia* (IMF Staff Paper, vol.48, 2001), <http://www.imf.org/External/Pubs/FT/staffp/2001/04/pdf/blanchar.pdf>.

<sup>29</sup> 徐现祥、李郁、王美今 (Xu Xianxiang, Li Xun & Wang Meijin), 区域一体化、经济增长与政治晋升 [Regional Economic Integration, Economic Development and Political Promotion], *经济学(季刊)* [CHINA ECON. Q.], issue 4, at 1075-96 (2007).

<sup>30</sup> 周黎安 (Zhou Li'an), 中国地方官员的晋升锦标赛模式研究 [Governing China's Local Officials: An Analysis of Promotion Tournament Model], *经济研究* [ECON. RES. J.], issue 7, at 36-50 (2007).

sumption are three main forces of GDP growth. Since it is not easy to improve the export/import or consumption structure in a short time, local officials in China are extremely interested in investment, which inevitably results in the expansion of expenditure at the local level.

The above reasons have explained the serious mismatch of responsibility and fiscal capacity of local governments. In order to obtain enough finance to make up the gap between revenue and expenditure, local governments have developed many off-budget channels in the past few decades, which have generated huge amount of hidden debt. An audit report conducted by the National Audit Office showed that local governments' debt in China stood at 10.717491 trillion *yuan* (roughly 1.72 trillion USD) by 2011.<sup>31</sup>

### *B Problems in Existing Financing Channels for Local Governments to Solve Fiscal Discrepancy*

In order to reduce the fiscal discrepancy faced by local governments, the 1994 Reform set certain intergovernmental transfer mechanisms along with the Tax Sharing Scheme. However, these transfer mechanisms are far from solving the problem. Therefore, in addition to the intergovernmental transfers, local governments have created many other financing channels.

#### *a) Intergovernmental Transfer System*

Intergovernmental fiscal transfer system in China mainly consists of the following three forms<sup>32</sup>: (1) The tax rebating system (*Shuishou fanhuan*). The system takes the 1993 revenue as a base. As long as incremental growth of VAT and consumption tax revenue of a local government increases by 1%, the central government would increase tax rebating by 0.3%.<sup>33</sup> As a result, richer localities get more rebates because they could collect more taxes. (2) Standardized fiscal transfer system (*Yibanxing zhuanyi zhifu*). The system aims to narrow regional fiscal differences by granting money to poor and remote areas. Notably, in some poor areas, the transfer of this kind may exceed the fiscal revenues of their own. (3) Earmarked grants. These transfers have certain policy

<sup>31</sup> 审计署 [National Audit Office], 2011 年第 35 号: 全国地方政府性债务审计结果 [No.35 of 2011: Audit Findings on China's Local Government Debts], <http://www.cnao.gov.cn/UploadFile/NewFile/2011121620816635.pdf> (last visited Feb. 1, 2013).

<sup>32</sup> Ming Su & Quanhou Zhao, *China's Fiscal Decentralization Reform* 16-24 (The Research Institute for Fiscal Science, MOF, 2004), <http://www.econ.hit-u.ac.jp/~kokyo/APPPsympo04/PDF-papers-nov/Zhao-China.pdf>.

<sup>33</sup> *Id.* at 4.

objectives, such as to increase lower classes' income, to develop minority areas, or to provide price subsidies (usually for agricultural products, international trade or public transportation).

The transfer payment system is important, but the limited amount of the transfers is far from sufficient to narrow the vertical (central-local) and horizontal (regional) fiscal disparity. It also causes moral hazard problems because local officials may have incentives to use the grants for purpose different from the designated purpose. They may also not use the money efficiently since there is no refinancing pressure if they default. In addition, the system is facing persistent political pressure from the rich regions, which have been reluctant to pay for poor regions.

### b) *Land Financing*

Budget revenues for local governments in China include: (1) general budget revenue (*Yiban Yusuan*), which mainly consists of tax revenues (detailed tax power is based upon the 1994 Tax Sharing Scheme), and (2) fund budget revenue (*Jijin Yusuan*), which mainly consists of land transfer fees. It is widely believed that China's sub-national fiscal situation overly relies on land financing.<sup>34</sup>

Land-based financing in China consists of both land-related taxes (such as real estate tax, construction tax), and non-taxable revenues (such as land leasing fee, land transfer fee, plow-land cultivation fee).<sup>35</sup> Since the establishment of the compensated use of land system (*Tudi Youchang Shiyong*) in the late 1980s, the main source of land financing has been land transfer fee, the fee local governments charge through selling the land use right. Under the Chinese Constitution, all land belongs to the state and there is no private ownership of land. Thus to make commercial use of land by private individuals, the state needs to grant the land use right and charge land transfer fee (*Tudi Churangjin*). Currently the land transfer fee has reached around half of the budget revenue of local governments.<sup>36</sup> In many cases, local governments use land transfer fee to repay debt or use the land use right as guaranty of bank loans.<sup>37</sup> At the

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<sup>34</sup> 殷泓、王逸吟 (Yin Hong & Wang Yiyin), 过度依赖土地财政 10 万亿地方政府债将何来何去 [Over Reliance on Land Financing, what Course to Follow the 10 trillion Local Government Bond], 人民网 [PEOPLE.COM], July 4, 2011, <http://finance.people.com.cn/GB/15065597.html>.

<sup>35</sup> 黄小虎 (Huang Xiaohu), 解析土地财政 [Analysis on Land Financing], 红旗文稿 [HONGQI WENGAO], issue 20, at 13–16 (2010).

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*



end of 2010, the debt balances whose sources of repayment were revenue from land transfer fee reached 2.547 trillion *yuan*.<sup>38</sup>

Land financing has several problems. First, land transfer fee is not a sustainable source because the amount of land is limited and the cost for land development is increasing.<sup>39</sup> Local governments have to develop the land to certain standards before they transfer the land use right. The land use right on most good quality lands has already been sold, and local governments have to spend more and more to develop the rest of the lands. However, land transfer fee cannot increase at the same rate because otherwise private entities would not be able to afford. Second, land market is volatile and sensitive to policy changes.<sup>40</sup> For example, to relieve excessive speculation and inflation pressure, the Chinese government has issued many administrative orders to cool down the real estate market in recent years. The restrictions on the real estate market have directly affected the price of land transfer fee because real estate developers were unable to pay high price for the right to use land. Third, there is also a concern that land sales often lack transparency and accountability,<sup>41</sup> which results in rent seeking activities and difficulties in monitoring local governments' fiscal performance.

As a result, land financing, which contributes a significant portion to local governments' revenues, is not a sustainable and desirable financing channel in the future.

### c) *Bank Loans*

The primary extra-budgetary financing sources to fill the fiscal gap for local governments in China are borrowings, among which borrowing from banks has the largest percentage (See Table 2).

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<sup>38</sup> National Audit Office, *supra* note 31, at 10.

<sup>39</sup> 周沅帆 (Zhou Yuanfan), 城投债: 中国式市政债券 [CITY CONSTR. INV. BOND, CHINESE MUN. BOND], at 82 (2010).

<sup>40</sup> George E. Peterson, UNLOCKING LAND VALUES TO FINANCE URBAN INFRASTRUCTURE 110 (2009), available at <https://www.ppiaf.org/sites/ppiaf.org/files/publication/Trends%20Policy%20Options-7-Unlocking%20Land%20Values%20GPete%20rson.pdf>.

<sup>41</sup> *Id.*

Table 2: Source of borrowing of local governments at the end of 2010<sup>42</sup>Unit: 100 million *yuan*

<i>Funding Resources</i>	<i>Debt vol.</i>	<i>Ratio</i>
Bank loans	84679.99	<b>79.01%</b>
Loans from higher level fiscal authorities	4477.93	4.18%
Bond issuances	7567.31	7.06%
Other borrowings, e.g. trust, payables to UDIVs, etc.	10449.68	9.75%
Total	107174.91	100.00%

Bank lending is a worldwide practice for public finance. However, local governments in China could not borrow from bank directly under applicable laws. According to General Rules for Loans, the governing law on the qualification of bank borrowers, “borrower” shall be an enterprise legal person, institution legal person or other economic organization, individual industrialist or merchant approved and registered by the administrative authorities for the administration of industry and commerce (or the authorities-in-charge), or a natural person with full capacity for civil acts and a PRC national.<sup>43</sup> A local government does not fit in the definition of “borrower.”

To circumvent the rule, Chinese local governments established Urban Development Investment Vehicles (“UDIVs”) to borrow money from banks and the borrowings through UDIVs have soared since the 2008 financial crisis. The central government implemented a “four trillion stimulus plan” to boost the economy, requiring local governments to provide matching funds at the same time.<sup>44</sup> As a result, 40% of the new bank loans (3.7 trillion *yuan*) in 2009 went to UDIVs.<sup>45</sup> There were

<sup>42</sup> National Audit Office, *supra* note 31.

<sup>43</sup> 贷款通则 [General Rules for Loans] (promulgated by the People’s Bank of China, June 28, 1996, effective Aug. 1, 1996) art. 17, CLI.4.18161 CHINALAWINFO.

<sup>44</sup> Barry Naughton, *Understanding the Chinese Stimulus Package*, 28 CHINA LEADER MONITOR (2009), <http://media.hoover.org/sites/default/files/documents/CLM28BN.pdf>.

<sup>45</sup> 周沅帆 (Zhou Yuanfan), *supra* note 39, at 6.

10,000 UDIVs<sup>46</sup> and the total amount of UDIV borrowing reached 10.7 trillion *yuan* at the end of 2010.<sup>47</sup>

Yet borrowing through UDIVs could be subject to legal challenges. Because UDIVs are owned by local governments and execute governments' policies, lending banks are in fact looking to local governments' credit when lending money to the UDIVs. Local governments do provide certain informal guarantees, such as issuing comfort letters, pledging fiscal tax revenues or state-owned assets of local SOEs. However, according to PRC Guarantee Law, "State organs cannot act as guarantors, except for sub-lending of loans from foreign governments or international economic organization."<sup>48</sup> Thus direct government guarantee is forbidden and unenforceable.

Except for legal challenges, bank lending has inherent disadvantages in public financing. First, commercial bank loans usually are short-term, and can hardly match the characteristics of long-term cash return and low profit level of infrastructure projects.<sup>49</sup> Policy banks, such as the China Development Bank and the Export-Import Bank of China, could provide long-term loans. However, policy bank lending is usually used for national level/cross-provincial infrastructure projects.<sup>50</sup>

Second, the large amount of lending to UDIVs has raised significant non-performing loans (NPL) risks in China's banking sector. In August 2011, Standard & Poor estimated that 30% of UDIV debt may go sour.<sup>51</sup> "It is undeniable that the lack of supervision and management of local government financing vehicles have created some hidden risks,"

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<sup>46</sup> 中国人民银行货币政策分析小组 [PEOPLE'S BANK OF CHINA MONETARY POL'Y ANALYZING GROUP], 2010 年中国区域金融运行报告 [2010 REPORT ON CHINA'S REGIONAL FINANCIAL OPERATION], at 6 (June 1, 2011), [http://www.pbc.gov.cn/image\\_public/UserFiles/zhengcehuobisi/upload/File/2010%E5%B9%B4E4%B8%AD%E5%9B%BD%E5%8C%BA%E5%9F%9F%E9%87%91%E8%9E%8D%E8%BF%90%E8%A1%8C%E6%8A%A5%E5%91%8A%E4%B8%BB%E6%8A%A5%E5%91%8A.pdf](http://www.pbc.gov.cn/image_public/UserFiles/zhengcehuobisi/upload/File/2010%E5%B9%B4E4%B8%AD%E5%9B%BD%E5%8C%BA%E5%9F%9F%E9%87%91%E8%9E%8D%E8%BF%90%E8%A1%8C%E6%8A%A5%E5%91%8A%E4%B8%BB%E6%8A%A5%E5%91%8A.pdf).

<sup>47</sup> *China Starts Municipal Bond Sale Trial in Shanghai, Shenzhen*, BLOOMBERG (Dec. 1, 2012), <http://Bloomberg.com/news/2011-10-20/china-starts-municipal-bond-sale-trial-in-shanghai-shenzhen-1-.html>.

<sup>48</sup> 担保法 [Guarantee Law] (promulgated by the Standing Comm. Nat'l People's Cong., June 30, 1995, effective Oct. 1, 1995) art. 8, CLI.I.12418 CHINALAWINFO.

<sup>49</sup> Jia Kang, *People's Republic of China*, in LOCAL GOVERNMENT FINANCE AND BOND MARKETS 71 (Yun-Hwan Kim ed., 2003), [http://www.perpustakaan.depkeu.go.id/FOLDEREBOOK/loc\\_govt\\_fin\\_bond\\_mkts.pdf](http://www.perpustakaan.depkeu.go.id/FOLDEREBOOK/loc_govt_fin_bond_mkts.pdf).

<sup>50</sup> *Id.*

<sup>51</sup> *Local Government Debt Risks Controllable: China*, BLOOMBERG (Aug. 16, 2011), [http://articles.economicstimes.indiatimes.com/2011-08-16/news/29892441\\_1\\_new-debt-standard-poor-loans](http://articles.economicstimes.indiatimes.com/2011-08-16/news/29892441_1_new-debt-standard-poor-loans).

said Liu Mingkang, China's banking regulator.<sup>52</sup> To reduce the growing risk of the banking system, the State Council started to clean up UDIVs in 2010. Through issuing "Notice on Strengthening Management of Local Government Financing Platform" (*Guofa* 2010(19)),<sup>53</sup> the central government started to regulate the growth and operation of UDIVs and seriously forbid any direct or indirect local government guarantee to these vehicles. In addition, the China Banking Regulatory Commission (CBRC) issued detailed guidelines to banks to clean some local government debt made through UDIVs.<sup>54</sup> It will strictly control the use of UDIV loans, monitor the risk of UDIVs and restrict new loans to UDIV.<sup>55</sup> Consequently, financing through bank borrowing through UDIVs will be unsustainable and very limited in the future if CBRC's policies work out as intended.

In addition, since banks have been more independent from local governments, local governments could no longer obtain bank loans as easily as before. Previously, banks were to a large extent under local governments' control.<sup>56</sup> But such control has been decreasing as a result of the heightened standard for risk-control management by the banking industry and the promotion of spirit of "law-based administration." Therefore, the scale of bank lending has been decreasing.

#### d) *Bond Financing*

Local governments were forbidden to issue bonds on their own under the 1994 Budget Law. There are typically two ways, however, for local governments to tap the bond market: (1) the central government issues bonds and on-lends (*Zhuan dai*) to local governments, or central government issue bond on behalf of local governments (*Dai fa*); and (2) local governments get bond financing through UDIVs. Each of these approaches is problematic.

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<sup>52</sup> BLOOMBERG, *supra* note 47.

<sup>53</sup> 国务院关于加强地方政府融资平台公司管理有关问题的通知 [Circular of the State Council Concerning Strengthening the Management of Local Government Financing Vehicle] (promulgated by the St. Council, June 10, 2010, effective June 10, 2010), CLI.2.134044, CHINALAWINFO.

<sup>54</sup> Lu Jianxin & Fayen Wong, *China Issues Guidelines to Clean Up Local Govt Debt-Paper*, REUTERS (Mar. 19, 2012), <http://uk.reuters.com/article/2012/03/19/china-loans-idUKL3E8EI0JE20120319>.

<sup>55</sup> *China to Boost Local Govt Debt Clean-Up*, CHINA DAILY (Mar. 2, 2012), [http://www.chinadaily.com.cn/china/2012-03/02/content\\_14735361.htm](http://www.chinadaily.com.cn/china/2012-03/02/content_14735361.htm).

<sup>56</sup> It was the local governments that appointed the secretary of party committee (the top leader) of the bank branches within their localities. Local governments could also influence the banks' operation through other methods, such as steering fiscal deposit, or obstructing land transfer for banks' operation.

The central government started to on-lend national bonds to local government in 1998.<sup>57</sup> It generally issues two types of bonds: a "construction bond," which is used to raise fund for economic construction, and a "deficit bond," which is issued to offset budget balances.<sup>58</sup> During 1998 to 2004, a period of proactive fiscal policy, the central government issued a large amount of construction bonds and passed on the proceeds to local governments.<sup>59</sup> In such on-lending arrangements, local governments are responsible for the repayment of principal and interest, although the central government will take the responsibility if local governments default.<sup>60</sup> The central government does not list the bond payment obligation in the budget, and does not treat the funds as part of fiscal deficit.<sup>61</sup> In 2009, to cope with the global financial crisis, the central government started to issue bonds on behalf of local governments. At this time, the local governments were the issuer and debtor, but the central government was supposed to pay the issuance cost, and principal and interests on behalf of local governments.<sup>62</sup>

This type of financing channel induces moral hazard problems by local governments because the lenders will turn to the central government for repayments whether local governments default or not. As a result, local governments do not have the incentives to spend the money efficiently since there is no refinancing pressure even if they default. For the on-lending arrangements, because the funds are listed in neither the central nor local governments' budgets, it increases hidden risk of the whole fiscal system.

Another type of bond financing for local governments is UDIV bond. In 1992, the Shanghai municipal government established the first UDIV, Shanghai City Construction and Development Corporation, which

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<sup>57</sup> 财政部关于制发《国债转贷地方政府管理办法》的通知 [Circular of the Ministry of Finance of Producing and Distributing the Management Measures on Transfer Lending from National Bonds to Local Government] (promulgated by the Ministry of Fin., Aug. 14, 1998, effective Aug. 14, 1998) CLI.4.21240 CHINALAWINFO.

<sup>58</sup> 财政部预算司 [Budget Division of Ministry of Finance], 财政部代理发行 2009 年地方政府债券问题解答 [Questions and Answers of 2009 Sub-National Government Bonds], at 21 (China Financial and Economic Publishing House, English version, 2009) [hereinafter Questions and Answers]

<sup>59</sup> Ming Su & Quanhou Zhao, *The Fiscal Framework and Urban Infrastructure Finance in China* 40 (World Bank, Working Paper No. 4051, 2006), [http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/10/26/000016406\\_20061026113712/Rendered/PDF/wps4051.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/10/26/000016406_20061026113712/Rendered/PDF/wps4051.pdf) (from 1998 to 2004, China issued RMB 910 billion long term construction bonds).

<sup>60</sup> Questions and Answers, *supra* note 58.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

issued the first UDIV bond in China the next year.<sup>63</sup> Although closely related to local government, it is an enterprise in the legal sense, and its bond is treated as corporate bond. Through UDIV, local governments successfully circumvent the Budget Law's prohibition on sub-national bonds. The practice was quickly followed by other local governments and the number of UDIVs multiplied after the 2008 stimulus plan.<sup>64</sup> As of June 2010, the total amount of UDIV bonds reached 434.2 billion *yuan*.<sup>65</sup> In general, UDIV bonds do not have high ratings because they are used to provide public services, which usually do not generate much profit.<sup>66</sup>

The worries of UDIV bond financing is quite similar to those of bank borrowing through UDIVs. The financing channel is sensitive to policy changes, and causes difficulty in monitoring local governments' deficit. Moreover, UDIV bonds are subject to Regulation on Administration on Enterprise Bonds, which is designed for ordinary commercial enterprises. Considering the quasi-sub-national bond nature, many rules in the Regulation are not fit for UDIV bonds, such as tax treatment, regulating authorities, and issuing thresholds.

### *C Advantages of Sub-national Bond as a Major Financing Channel*

As previous discussion has shown, local governments in China are facing serious fiscal difficulties. The revenues they are able to collect simply cannot meet the growing expenditures. The financing channels they have been using also have various problems. The ban of direct bond issuance has not generated its intended benefit. Rather, the current system has created a huge amount of visible and hidden risks. In this context, direct bond issuance, with its potential advantages over all the existing financing channels, could serve as a desirable and necessary supplement.

First, compared with taxation, moderate borrowing can promote intergenerational equity. It is equitable to have future generations who benefit from the investments financed by the bonds pay for associated debt servicing costs, rather than to leave the entire financial burden to the early users of these infrastructure investments.<sup>67</sup> In addition, only borrowing could provide a lump sum of money to finance new large capital

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<sup>63</sup> 周黎安 (Zhou Li'an), *supra* note 30 at 66.

<sup>64</sup> *Id.* at 68.

<sup>65</sup> *Id.* at 9.

<sup>66</sup> *Id.* at 69.

<sup>67</sup> George Peterson, *Building Local Credit Systems* 5, (World Bank, Background Series No. 3, 2000), <http://web.worldbank.org/archive/website01061/WEB/IMAGES/BUILDING.PDF>.

investments whereas the tax revenue could only flow in at a stable speed. This is especially important for China because China is undergoing a rapid urbanization process, during which large investment and construction demands will sustain in the future.

Second, when borrowing is appropriate, local governments have the options of direct financing, usually bond issuance, and indirect financing, usually bank loans. Many countries use both instruments simultaneously although they place different emphasis on developing the two channels. Thus we should take a country's context in mind in our discussion. In China, indirect financing through banks has been the major financing channel for quite a long history although the proportion of bank loans as to other financing channels is declining.<sup>68</sup> However, this enormous big sector continuously faces NPL problems. In the past, local governments usually exerted political pressure on banks to lend money to SOEs and government-backed projects, many of which were running under deficit. China established four asset management corporations in 1999 to solve the NPL problem that existed at the time. However, under the tough economic environment after the recent global financial crisis, real estate loans, UDIV loans, and declining exports added on new threats to the banking industry.<sup>69</sup> Local governments' political influence and their financing instruments lead to the continuing deterioration of the NPL situation. Moreover, in the trend of interest rate liberalization as part of China's financial deregulation process, bank lending will gradually shift away from lending to inefficient government-backed companies and projects. Bond financing not only provides local governments with new financing channel, but could also gradually relieve banks from local governments' pressure to lend capital, thus avoid adding NPL risk on the banking sector.

Third, while direct borrowing is necessary, we have to decide further the exact issuer of sub-national bond. Granting local government the autonomy to issue bond could also overcome the moral hazard problems in, as Noel named it, "monopolistic sub-national bond financing."<sup>70</sup> In a

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<sup>68</sup> The amount of bank loans as to the aggregate amount of all financing channels declines from over 90% in 2002 to around 60% in 2012. See 统计数据 [Statistical Data], 中国人民银行 [THE PEOPLE'S BANK OF CHINA], <http://www.pbc.gov.cn/publicsh/diaochatongjisi/133/index.html>.

<sup>69</sup> Dinny McMahon, *Impending Bad Debt Headache Likely Bigger than Expected*, THE WALL ST. J. Nov. 15, 2012, [http://www.cn.wsj.com/gb/20121115/rec170002\\_ENversion.shtml](http://www.cn.wsj.com/gb/20121115/rec170002_ENversion.shtml).

<sup>70</sup> Michel Noel, *Building Sub-National Debt Markets in Developing and Transition Economies, A Framework for Analysis, Policy Reform and Assistance Strategy 3* (World Bank Policy Research Working Paper No. 2339, 2000), <http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2000/06/09/0000949460005270530524>

monopolistic sub-national debt market, central government is the issuer and is responsible for allocating the amount among sub-national entities so as to transfer the capital to local governments. As discussed in the previous section, in China, the practice is that the central government on-lends the bond to local governments, or issues bond on behalf of local governments. Due to asymmetric information, the central government may make uneconomic allocation. Meanwhile local governments may misuse the fund for purposes other than those intended by the central government or will not work to use their best efforts on projects. In contrast, by direct bond financing, local governments may use fund more efficiently because the capital market rather than the central government is supervising and monitoring. Thus with sufficient disclosure, their credibility, fiscal performance, and project profitability will be reflected in the pricing. Once default, it is hard for them to get refinancing since investors look to their credit rather than that of the central government.

Compared with borrowing or bond issuance through UDIVs, sub-national bond issuance will reduce the hidden risk of local government debt because these bond issuances will be listed on the budget of the issuing governments. Therefore, it is easier for the central government to monitor and audit local borrowings and to effectively regulate the macro economy. In addition, because local officials in China are overly interested in infrastructure investment, they tend to have short-term behavior in spending (spend on projects that maybe wasteful or inefficient) if there is no restriction. However, because bond issuance is listed on the budget, and local people's congresses at corresponding levels have the power to approve the scale of budget,<sup>71</sup> this financing channel can partly restrict the officials' short-term behavior, which is usually related to the time the local leaders are in office, usually 5 years.<sup>72</sup>

Finally, allowing sub-national bonds has additional benefits. First, China has a very high savings rate.<sup>73</sup> Because the stock market is quite

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7/additional/104504322\_20041117154007.pdf.

<sup>71</sup> 预算法 [The Budget Law] (promulgated by the Nat'l People's Cong., Mar. 22, 1994, effective Jan. 1, 1995) art. 13, CLI.1.8925 CHINALAWINFO.

<sup>72</sup> Jia Kang, *People's Republic of China*, in LOCAL GOVERNMENT FINANCE AND BOND MARKETS 75 (Yun-Hwan Kim ed., 2003), [http://www.perpustakaan.depkeu.go.id/FOLDEREBOOK/loc\\_govt\\_fin\\_bond\\_mkts.pdf](http://www.perpustakaan.depkeu.go.id/FOLDEREBOOK/loc_govt_fin_bond_mkts.pdf).

<sup>73</sup> 国家统计局 [NAT'L BUREAU OF STAT. OF CHINA], 中华人民共和国 2011 年国民经济和社会发展统计公报 [2011 REPORT ON NATIONAL ECONOMIC AND SOCIAL DEVELOPMENT STATISTICS], at Table 14, [http://www.stats.gov.cn/tjgb/ndtjgb/qgndtjgb/t20120222\\_402786440.htm](http://www.stats.gov.cn/tjgb/ndtjgb/qgndtjgb/t20120222_402786440.htm) (China's household savings reaches to 35.2 trillion yuan); 孙晓光、陷艳婷 (Sun Xiaoguang & Xian Yanting), 居民储蓄转化为投资的可行性探讨 [Discussion on the Feasibility of Transferring Household Savings to Investment], 中国国情国力 [CHINA NAT'L CONDITIONS AND STRENGTH], issue 12, at



risky, and less volatile investing channels are very limited, households do not have many choices but to deposit money in the banks or to buy treasury bonds. Sub-national bond financing provides a new and desirable investing channel for ordinary households because of its relative safety and higher return comparing with deposits or treasury bonds. In addition, institutional investors are the dominant players in China's bond market, and they all have huge demand for products like sub-national bonds to diffuse risks and get stable returns. Second, the Chinese bond market would benefit because a new type of bond could help complete the investment spectrum and enhance the effectiveness of pricing. Third, through sufficient disclosure, sub-national bond financing could cultivate a more transparent and responsible government.

Actually there has been a consensus among the top policymakers that it is only a matter of time before local governments can take advantage of sub-national bond financing. "Five or ten years from now, local governments will borrow very, very little from banks. Their debt structure will be almost entirely bonds," said Fan Jianping, chief economist of the State Information Centre.<sup>74</sup>

### III. Prerequisites for Establishing a Sub-national Bond Market

Although sub-national bond financing will bring many benefits, it could also introduce new risks to the stability of China's economy. Therefore, the government has to be very cautious in evaluating whether the country has met the basic conditions that are critical to the success of sub-national bond financing. In this field, the World Bank, IMF and some regional development organizations have helped many developing countries to build local credit markets and have accumulated some experience that China might draw upon in its policy-making process. Among the limited literature, some of which may be out of date or region-specific, the work of Lili Liu, Michel Noel, Samir Daher, and James Leigland has presented the most systematic analysis on prerequisites for establishing sub-national market and is most relevant to China's specific situation.<sup>75</sup>

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19 (2011) (the household saving rate has been increasing continuously since the 1978 Reform and Open Policy).

<sup>74</sup> Simon Rabinovitch, *China Extends Loans to Avoid Mass Default*, FIN. TIMES (Feb. 12, 2012), <http://www.ft.com/cms/s/0/08d45414-553c-11e1-b66d-00144feabdc0.html#axzz25eWtO4ee>.

<sup>75</sup> Notably, the scholars have different focus. (1) Noel's analysis is about building sub-national debt market, which exceeds the scope of sub-national bond market, and his analysis is relatively abstract. He discussed the following points: moral hazard, market transparency, market governance, fair treatment for market participants, and financial

Taking the international experience and China's context in mind, the author believes that China has to measure up on the prerequisites presented below for the successful establishment of its sub-national bond market. These prerequisites fall into three categories: macro-economic environment, regulatory conditions, and financial management abilities.

### A *Macroeconomic Conditions*

Macro-economic conditions for the establishment of sub-national bond market include: sufficient development of capital market, stable economic growth, controllable inflation, liberalized interest rate for efficient pricing, and controllable consolidated government debt.

Market maturity is closely related with investor's familiarity with and confidence in the capital market and such investor attraction will influence the demand of sub-national bond. Leigland found that many emerging economies do not have benchmark yield curve for pricing long-term municipal bonds, that their investment intermediaries are unable to distinguish credits of municipal issuers, and that investors' confidence in municipal bonds is low, all of which could highly probably damage nascent bond market activities.<sup>76</sup>

A stable macroeconomic framework is also crucial. Liu believes that "economic growth is a key determinant of debt sustainability."<sup>77</sup> Also, on the market demand side, the inflation of the country should be controllable because the income from municipal bond is fixed, thus the bond will become valueless if inflation rate goes too high.<sup>78</sup> In addition, the consolidated debt of central and local government debt should adhere

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management capacity. (2) Daher listed a set of concrete prerequisites covering macro-economic issues, institution and regulatory issues, credit issues, and pricing issue. The list is quite complete, but he did not discuss them in great detail. (3) Liu's papers focus on the building of laws and regulations re *ex ante* and *ex post* supervising mechanism, and bring in some countries' practice. This area is probably the weakest part in the current China's performance. (4) Leigland's research suggested a framework for assessing municipal bond market development, by taking U.S. muni bond market as a model. His research focuses more on the maturity of capital market, and some factors are probably ahead of time for our discussion.

<sup>76</sup> James Leigland, *Accelerating Municipal Bond Market Development in Emerging Economies: An Assessment of Strategies and Progress*, 17(2) *Public Budgeting & Finance* 57, 62 (1997).

<sup>77</sup> Lili Liu, *Strengthening Sub-National Debt Financing and Managing Risks* 36, THE WORLD BANK (2010), [http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt\\_English.pdf](http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt_English.pdf).

<sup>78</sup> Samir EL Daher, *Municipal Bond Markets: Prospects for Developing Countries* (World Bank Infrastructure Notes, Urban NO. Fm-8b, 1997), <http://siteresources.worldbank.org/INTMF/Resources/fm8b.pdf>.

to macroeconomic fiscal policies so as to keep the stability of the national economy.<sup>79</sup> Lastly, market-determined interest rate is the basis for efficient pricing. To develop sub-national bond, the short term base rate set by authority shall be consistent with the country's monetary policy goal and the long term interest rate shall reflect the true inflation expectation by the market.<sup>80</sup>

### B Regulatory Conditions

Relevant ex ante conditions for the establishment of sub-national bond market include: clear and fixed intergovernmental fiscal relations, efficient monitoring and supervising scheme including experienced regulatory institutions, transparent approval criteria and process (including clear rules on who could issue, what bond could be issued and under what fiscal condition the bond could be issued), and sufficient disclosure. Ex post condition focuses on the insolvency mechanism for the issuing governments.

Clear and fixed intergovernmental fiscal relation is critical in reducing moral hazard of local governments. The fact that local governments have the expectation of a bail-out or intervention by the central government if they default usually increases their incentive to borrow excessively.<sup>81</sup> The lack of fiscal autonomy combined with huge mandatory expenditures on local governments generate moral hazard behavior of local governments because they believe the central government would take the responsibility of mandatory expenditures when they fail to do so.<sup>82</sup> In addition, opaque and loosely followed intergovernmental transfers and grants would worsen the problem.<sup>83</sup> Moreover, the lack of clarity of the scope of local debt, and investor's interpretation of approval of sub-national borrowings by the sovereign as implicit sovereign guarantee would increase the expectation of a bail-out.<sup>84</sup> Therefore, a clear and fixed intergovernmental fiscal relation, combined with explicit denial of sovereign guarantee by the central government could relieve the moral hazard problem.

Effective monitoring institutions and approval mechanisms would reduce the fiscal risk of bond financing. These ex ante rules should lay out procedures of bond issuance, issuing purposes, types, amount, ap-

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<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 4.

<sup>81</sup> Noel, *supra* note 70, at 8.

<sup>82</sup> *Id.* at 9.

<sup>83</sup> *Id.* at 10.

<sup>84</sup> *Id.* at 11.

proval and monitoring process.<sup>85</sup> Many major developing countries strengthened these ex ante rules on sub-national debt market after they went through the widespread sub-national debt crisis in 1990s. Their practice provides beneficial lessons for China. Their practices include: (1) adopting “golden rule” for debt financing, which means countries should have explicit fiscal requirement of balancing budget of public investment.<sup>86</sup> The purpose of borrowing should be largely limited to financing long-term capital investments rather than to financing deficits, and short-term borrowing should be strictly controlled;<sup>87</sup> (2) adopting critical fiscal indicators, and develop appropriate evaluation methods and standard thresholds for these indicators.<sup>88</sup>

On the ex post regulation side, a predictable and workable solution for default could help reduce moral hazard, otherwise local governments will highly probably turn to the central government for a bail-out. Also, such a mechanism would protect creditors’ credit rights while at the same time, maintain social stability and help the issuing government to restore its situation and reenter the market.<sup>89</sup>

### *C Financial Management Abilities*

This part focuses on the conditions of budgeting, accounting and auditing ability, credit rating and credit enhancement mechanism, equal treatment on the debt market, and effective supplementing institutions for service deliveries.

A weak budgeting, accounting and auditing framework would lead to the lack of market transparency and inadequacy of local governments’ fiscal management capacity. Many countries that went through sub-national fiscal crisis in the last century have set requirements for medium term fiscal framework, such as preparing medium term method to deal with economic shocks, or preparing a multiyear budgetary requirement to promote a more sustainable debt account.<sup>90</sup> Transparency also requires independent audit of local governments’ fiscal accounts, periodical disclosure of key fiscal data, and exposure of hidden fiscal liabilities.<sup>91</sup> By adopting the accrual accounting method, many hidden liabilities.

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<sup>85</sup> Liu, *supra* note 77, at 3.

<sup>86</sup> *Id.* at 5.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* at 8.

<sup>89</sup> *Id.* at 9.

<sup>90</sup> *Id.* at 8.

<sup>91</sup> *Id.*

ties could be revealed, and the public would get more accurate information about the issuing governments' fiscal performance.

To improve the market acceptance of sub-national bonds, the market also requires independent credit ratings and effective credit enhancement mechanisms. The measurement on local governments' creditworthiness is different from typical commercial entities, thus it takes time for credit rating agencies to gain experience and competence to rate the governments. To enhance credit, issuing governments may adopt a series of mechanisms, such as guarantees, insurance, securitization and derivatives. For example, bond insurance is widely seen in American municipal bond market and plays a significant role in attracting investors.<sup>92</sup>

Finally, China should establish a level playing field for market participants. In some countries, certain institutions have privileged status in financing local governments, thus reduce competition for municipal credit and distort effective pricing for sub-national bonds.<sup>93</sup> Therefore, equal treatment in local governments' credit market is necessary. Also, freedom to invest and trade for a wide range of investors is also important as it could promote an active secondary market.

#### **IV Evaluation of China's Performance and Policy Suggestions**

Part III has set out the prerequisites that China has to meet before establishing a successful sub-national bond market. In this part, the author would have a detailed discussion on whether China has met these prerequisites. In another word, this part would examine whether it is feasible for China to start sub-national bond market now.

##### *A China Has Sound Macroeconomic Environment for Sub-national Bond Financing in General*

In this section, the author would look into the prerequisites for establishing sub-national bond market from macro-economic perspective. In specific, it will discuss the development of China's capital market, the general character of China's economy, the situation of inflation and consolidated debt, and the recent interest rate liberalization process.

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<sup>92</sup> Daher, *supra* note 78, at 3.

<sup>93</sup> Noel, *supra* note 70, at 17–18.

a) *Maturity and Trend of China's Bond Market*

A country's economy will affect its capital market development, and will partially determine the need to develop a certain aspect of the capital market that fits an individual country's financial and economic situation.<sup>94</sup> Economists find that when a country is at an early stage of economic development, it might focus more on "developing its banking system and equity market rather than deep and liquid bond markets."<sup>95</sup> This is exactly the situation in China. Bank lending has been the main financing channel for enterprises for decades as a legacy of planned economy, under which credit allocation was centrally controlled. China's equity market has also expanded very quickly in the past decades. The market value of the stock market grew from zero (when capital market starts to develop around 1990) to the third largest in the world by the end of 2011.<sup>96</sup> In contrast, the development of bond market lags far behind. Although the market value of the bond market is similar to that of the equity market,<sup>97</sup> most bonds are low interest rate bonds issued by the state, central bank, or big financial institutions, and are generally categorized as risk-free bond.<sup>98</sup> For private borrowers, bond issuance is not a commonly used way to get finance.

Now comes to a stage where the government devotes more efforts on the development of China's bond market. In the recent years, given the increasing financing demand, and the urgent need for the transition of the Chinese banking sector, China has seen a rapid growth of the bond market. This is largely due to the central government's attitude and policy guidance on this matter. In the twelfth five-year plan (2011-2015), "to

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<sup>94</sup> Kee-Hong Bae, *Determinants of Local Currency Bonds and Foreign Holdings: Implications for Bond Market Development in the People's Republic of China 2* (ADB Working Paper Series on Regional Economic Integration No. 97, 2012), <http://www.adb.org/sites/default/files/pub/2012/wp97-bae-determinants-local-currency-bonds.pdf>.

<sup>95</sup> *Id.*

<sup>96</sup> 中国证券监督管理委员会 [CHINA SEC. REG. COMM'N.], 2011 年报 [2011 ANNUAL REPORT], at 2, (2012), [http://www.csrc.gov.cn/pub/newsite/zjhjs/zjhn/201205/t20120516\\_210088.htm](http://www.csrc.gov.cn/pub/newsite/zjhjs/zjhn/201205/t20120516_210088.htm) (the market value of the stock market is 21.5 trillion yuan, the 3<sup>rd</sup> largest in the world).

<sup>97</sup> Wind 咨询金融终端 [WIND FINANCIAL TERMINAL], 市场规模统计 [*Statistics on Market Size*] (by the end of Dec. 2012, the value of equity market is 27.6trillion); Wind 咨询金融终端 [WIND FINANCIAL TERMINAL], 存量债券统计 [*Statistics on Outstanding Bond*] (the value of bond market is 26.24 trillion).

<sup>98</sup> Wind 咨询金融终端 [WIND FINANCIAL TERMINAL], 存量债券统计 [*Statistics on Outstanding Bond*] (according to the author's calculation, treasury bond, central bank bond, and financial bond take around 70% of the whole bond market).

actively promote the development of the bond market"<sup>99</sup> and "to explore the bond issuance mechanism for sub-national government"<sup>100</sup> are considered as significant policy objectives in the coming few years. In addition, the state has recently promulgated many important policies to promote the development of the bond market, such as to start treasury futures, high-yield bonds, and small and medium enterprise (SME) bonds. These policies would create an environment for and facilitate the development of sub-national bond market if the ban were repealed.

Although China's bond market is not sufficiently developed, it has a fairly long history and well developed service infrastructures, such as trading platform, settlement system and custodial system. The practice of Treasury bond and financial institution bonds makes benchmark yield curves available for pricing long-term bonds including sub-national bonds. Also, financial intermediaries have gained a lot of experience in matters regarding bond issuance and trading. Therefore, the government issuers and financial intermediaries have sufficient experience of bond issuance and trade matters. Moreover, in China, there is no history of material default of any bond so far, which means investors may have enough confidence in investing a new type of bond.<sup>101</sup> In all, China may not have much trouble regarding investor's familiarity and confidence, which is a big problem for some emerging economies.

### b) *Stable Macroeconomic Environment*

As Lili Liu argues, "Economic growth is a key determinant of debt sustainability."<sup>102</sup> Also, evidentiary research shows that the most important variable in bond market development is the degree of economic development measured by GDP per capita.<sup>103</sup> China has kept fast GDP

<sup>99</sup> 国民经济和社会发展第十二个五年规划纲要 [The Twelfth Five-year Plan] (promulgated by the Nat'l People's Cong., Mar. 14, 2011, effective Mar. 14, 2011) ch.48 §2, CLI.1.146717 CHINALAWINFO.

<sup>100</sup> *Id.* ch.47 §1.

<sup>101</sup> So far, YunChengTou (云城投, a bond issued by UDIV Corp. held by YunNan province) is the only bond that gets close to default. But the potential default is relieved by YunNan government's promise to increase capital, loan and subsidies to the UDIV. Admittedly, allowing sub-national governments to default could have many adverse impacts. However, no-default history also has negative consequences. It may increase moral hazard and bail-out expectation of sub-national governments, and distort pricing due to the increased difficulty in credit ratings. Also, the fact that investors have not learnt the hard way about the consequences of defaults may become stressful political pressure on central government to bail out.

<sup>102</sup> Lili Liu, *Strengthening Sub-National Debt Financing and Managing Risks* 36, THE WORLD BANK (2010), [http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt\\_English.pdf](http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt_English.pdf)

<sup>103</sup> Bae, *supra* note 94, at 25.

growth rates and GDP per capita growth rates continuously and steadily since the 1978 Reform and Open policy.<sup>104</sup> The GDP per capita in China still ranks very low due to the large population. But the situation is much better in China's wealthier provinces. The growth of GDP and GDP per capita could enhance governments' revenues, and consequently increase the upper limit of borrowings since the governments have stronger ability of repayment. However, when we evaluate local level governments' bond issuance ability, we could only use local GDP of each individual locality. Because the level of economic development in China is very imbalanced among different regions, it may not be feasible to allow every sub-national entity to issue bonds. A more practical way for China is to set certain explicit standards to let local governments with sufficient debt repayment ability enter bond market.

In Daher's formula, controllable inflation is another important macroeconomic prerequisite for the establishment of sub-national bond market. Because it always takes very long time to get recovery of investments on infrastructure projects, sub-national bonds are typically long-term bonds. As a fixed income product with long duration, sub-national bonds could be more sensitive to inflation expectation than short or medium term bonds.<sup>105</sup> The Chinese government has been very cautious toward inflation and the following data shows that China has successfully maintained inflation rate in a reasonable scope in the past.

Table 3: Inflation rate in China (2002-2012)<sup>106</sup>

year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
rate	-0.8	1.2	3.9	1.8	1.5	4.8	5.9	-0.7	3.3	5.4	2.6

According to Daher's formula, consolidated debt of both the central and local governments should adhere to macro-economic fiscal policies

<sup>104</sup> *GDP Growth*, THE WORLD BANK, <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries>; *GDP Per Capita*, THE WORLD BANK, <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD/countries>.

<sup>105</sup> For a bond, the longer the duration, the more sensitive it is to inflation expectation, because based on the formula for bond pricing:

$P = c(1+r)^{-1} + c(1+r)^{-2} + \dots + c(1+r)^{-Y} + B(1+r)^{-Y}$  (where:  $c$  = annual coupon payment,  $Y$  = number of years to maturity,  $B$  = par value,  $P$  = purchase price,  $r$  = nominal interest rate = real interest rate + inflation rate), the bigger the  $y$ , the bigger the  $(1+r)^{-Y}$ , which means increasing of number of years could enlarge the impact of inflation rate which is included in the nominal interest rate.

<sup>106</sup> *Inflation, consumer prices*, THE WORLD BANK, <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG/countries>.



so as to keep the stability of the national economy. On this matter, the final account of 2011 shows that the central government has a public deficit/GDP ratio of 1.4%, that is, 0.65 trillion *yuan*<sup>107</sup>. This is lower than 3%, an internationally recognized warning rate for excessive deficit, and is also far below 8.6%, the deficit ratio of U.S.<sup>108</sup> However, the number has not taken into account the hidden debt that local government may pass to the central government, a typical moral hazard behavior regarding intergovernmental fiscal relation. In addition, some economists believe that local governments in China are borrowing excessively, especially through UDIV bond and loan from trust. By the end of 2011, it is estimated that local government debt had reached 2.4 trillion, which would bring the consolidated deficit ratio to 6%.<sup>109</sup> Whether the consolidated debt is excessive or not is still in debate. But there is no doubt that the banking sector has suffered greatly from sub-national lending because local governments get financed mainly through rolling over bank loans. Therefore, if further borrowing is necessary, it is better to allow the governments to issue bonds so as to relieve the stability risk in banking sector.

### c) *Ongoing Interest Rate Liberalization Process*

The fast pace of interest rate liberalization would promote the development of price discovery mechanism<sup>110</sup> in the bond market, and provide incentives for local governments to turn to the bond market for financing.

Administrative control of interest rates has been a long time practice in China, and has caused significant distortion in China's banking sector. Before liberalization, each commercial bank had to follow the interest rates fixed by the central bank, and there was no room for differentiating interest rates based on assessment of credits. Economists believe that so far the controlled deposit rates are lower while lending rates are higher than real market rates in China. Interest rate controls in China has caused much negative influence: it fails to compensate household

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<sup>107</sup> 财政部 [MINISTRY OF FIN.], 关于 2011 年中央决算的报告 [REPORT ON THE RESULT OF 2011 BUDGET], [http://www.mof.gov.cn/zhengwuxinxi/caizhengshuju/201207/t20120711\\_665583.html](http://www.mof.gov.cn/zhengwuxinxi/caizhengshuju/201207/t20120711_665583.html).

<sup>108</sup> 杨国英 (Yang Guoying), 我国整体财政赤字率极可能比欧元区还高 [China's Consolidated Deficit Ratio is Probably Higher than that of Euro Zone], 21CN 财经 [21CN.COM], June 28, 2012, <http://finance.21cn.com/news/comments/2012/06/28/12239263.shtml>.

<sup>109</sup> *Id.*

<sup>110</sup> Price discovery mechanism in bond market is a process in which market price of a bond is determined through interaction between buyers and sellers. The real market interest rate would help parties find the real market value of a bond.

savings appropriately, decreases incentives of banks to improve its capacity of risk pricing, and prevents the government from getting real macro-economic and liquidity information.<sup>111</sup> A more relevant distortion is that because banks could not price interest of loans based on borrowers' credits, they tend to lend capital to less risky borrowers, usually large and well-connected enterprises (many of them have government background, including UDIVs) rather than small and medium-sized enterprises and households.<sup>112</sup> This could explain why local governments have obtained much fund from banks through UDIVs in the past.

Right now, interest rate is still controlled in China, but the process of liberalization of interest rate has speeded up. Very recently, Zhou Xiaochuan, the Chief of the Central Bank, admitted that conditions are "basically ripe" for liberalizing China's interest-rate policies.<sup>113</sup> On June 7, 2012, the Central Bank allowed banks to offer deposit rate up to 110% of the benchmark deposit rate set by the central bank and loan rate as low as 80% of the benchmark lending rate.<sup>114</sup> This is widely considered as a big move of liberalization of interest rate process.

The liberalization would promote better pricing of capital and risk, and increase the competition between direct financing (financing from capital market) and indirect financing (mainly through banking sector). Because the current bond market in China is relatively too thin to get efficient pricing, the liberalization of interest rate in the banking sector would provide important reference for pricing in the bond market because the costs of these two ways of financing are comparable.

In conclusion, except for the concern of excessive borrowing, the macroeconomic conditions for the start of sub-national bond issuance are probably satisfied in general.

### *B Legal and Regulatory Framework is not Sophisticated Enough for Sub-national Bond Financing*

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<sup>111</sup> Tarhan Feyzioglu, Nathan Porter & Előd Takáts, *Interest Rate Liberalization in China 3* (IMF Working Paper No. WP/09/171, 2009), <http://www.imf.org/external/pubs/ft/wp/2009/wp09171.pdf>.

<sup>112</sup> *Id.*

<sup>113</sup> Aaron Back & Tom Orlik, *China Hints at Interest-Rate Liberalization*, THE WALL STREET JOURNAL (Mar. 20, 2012, 7:03 AM), <http://online.wsj.com/article/SB10001424052702304724404577292461092542818.html>

<sup>114</sup> 中国人民银行决定下调金融机构人民币存贷款基准利率并调整利率浮动区间的通知 [Notice of the People's Bank of China on Lowering the RMB Benchmark Interest Rates for Deposits and Loans of Financial Institutions and Adjusting the Floating Range of Deposit and Loan Interest Rates] (promulgated by the People's Bank of China, June. 7, 2012, effective June. 8, 2012) CIL.4.189370-CHINALAWINFO.

A sound legal and regulatory framework could cure the moral hazard problem, provide effective monitoring and supervising mechanism, define clear procedural and substantive requirement for issuance, and provide a predictable ex post solution in case of a default. To examine China's performance regarding these requirements, the discussion below will cover the following five subsections: 1. intergovernmental fiscal relation, 2. monitoring and supervising institutions, 3. ex ante requirement on issuance, 4. disclosure requirement/ transparency, and 5. ex post insolvency mechanism. Based on the analysis below, the current regulatory framework in China has not developed maturely enough to support an efficient sub-national bond market. Among all these legal and regulatory obstacles, some are technical problems while others are more fundamental obstacles that are hard to overcome.

*a) Unclear Intergovernmental Fiscal Relation and Limited Fiscal Autonomy of Local Governments*

The expectation of a bail-out or intervention by the central government could generate moral hazard by the borrowing local governments when they are facing serious fiscal stress. In Noel's research, the lack of fiscal autonomy combined with excessive mandatory expenditure, the past practice of bail-out or intervention by the central government, problematic intergovernmental fiscal transfer system, and the concern of "too big to fail" could all create moral hazard and soften local governments' budget constraints.

In China, the current fiscal system derived from the 1994 tax assignment scheme also creates moral hazard because it causes substantial mismatch between revenues and expenditures of local governments. While there is heavy expenditure pressure on local governments, their fiscal autonomy is limited. The main sources of revenue for a local government are from the general budget revenue (mainly tax revenues) and fund budget revenue (mainly from land transfer fee). As discussed in Part I of the paper, tax revenues are far from enough for local governments and each of the existing channels is problematic. There is even a big ongoing debate on whether local governments should be granted independent tax power.

The current fiscal scheme fixes local tax rates, prescribes local tax bases and local fee schedules. As a result, there are very few budgetary options left to the local governmental borrowers. Therefore, some schol-

ars advocate for independent tax power of local governments.<sup>115</sup> Prof. Zhu Qiuxiang believes “[g]ranting sub-national government the regulatory power on tax and fee collections is the trend and orientation for improving China’s public fiscal system.”<sup>116</sup> However, some others believe that in the modern society, tax reform is not only about collecting tax revenues; it is more about a tool for macroeconomic adjustment and control.<sup>117</sup> For example, tax reduction policy could be used for achieving economic recovery or developing certain industries, thus tax legislation power should be centralized. Due to the prudent and restrictive attitude of the central government, the latter opinion will probably continue to prevail in China.

No matter which policy is taken, all scholars agree that the current tax-sharing scheme provides inadequate tax revenue to local governments. In practice, local governments have developed many extra-budgetary financing channels, as we have seen in the first part of the paper. On the surface, these financing channels have expanded the fiscal autonomy of local governments, but the validity of these channels is still largely dependent on the central government’s attitude. If the state tightens the control of these financing channels (such as issuance policy to regulate UDIV borrowings), different kinds of transfer and grants from the central to local level, and persistent negotiation between the central government and local governments would become inevitable to make up the fiscal gap. All these blur the boundaries of the fiscal responsibility of local governments and may induce irresponsible expenditure at the local level.

While the situation is problematic, it is also unrealistic for a country to completely solve the moral hazard problem. For instance, a central government could hardly withstand the political pressure when there is a “too big to fail” situation with one of its provinces. Some scholars believe China’s decentralized fiscal system has already provided local govern-

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<sup>115</sup> See 邓子基 (DENG ZHII), 地方税系研究 [RES. ON LOC. TAXES], at 252–58, 经济学出版社 [Economic Science Press] (5th ed. 2007); see also 冉富强 (Ran Fuqiang), 美国州宪法公债控制的方式、实效及启示 [Methods, Effect and Policy Suggestion, on Control of Public Debt by U.S. State Constitutions], 政治与法律 [POL. & LAW], no. 9, at 37 (2011).

<sup>116</sup> 朱丘祥 (ZHU QIUXIANG), 分税与宪政 [TAX SHARING & CONSTITUTIONALISM], at 225, (2008).

<sup>117</sup> 夏启明 (Xia Qiming), 地方政府发债的法律问题研究 [Research on Legal Issues of Local Government Bond Issuance], 云南大学学报法学版 [J. OF YUNNAN UNIV. LAW EDITION], vol. 22, no. 1, at 85 (2009).

ments with fiscal autonomy that are much stronger than many other developing countries.<sup>118</sup>

b) *Predictable Monitoring and Supervising Institutions*

Experienced monitoring and supervising institutions are critical to the efficiency of supervising scheme as a whole. Since sub-national bonds are a type of financial products issued by the governments rather than ordinary private entities, two kinds of supervising institutions are involved. In the pre-issuance stage, the legislative branch may have the power to determine the limit of issuance amount pursuant to the country's fiscal policy goal. In the issuance and trading stage, capital market regulators, such as the China's Securities Regulatory Commission (CSRC), may play the dominant supervisory role.

i. *Supervising Institutions in Pre-issuance Stage*

The question in the pre-issuance stage is which level of government has the power to determine the amount of sub-national bonds to be issued. International practice of central-local government relationship regarding sub-national bond issuance varies from country to country. For example, in Japan, the central government has strict control of the amount and condition of sub-national debt to be issued. The amount is determined through consultation between the central and local governments.<sup>119</sup> In contrast, in the U.S., the federal government has no power to determine the amount of bonds a local government could issue. The decision power depends on the laws of each state, and there are typically four models on issuance of general obligation bond: by referendum; by majority approval in state legislature; by setting limitation on the debt/revenue ratio; and complete prohibition on general obligation bonds.<sup>120</sup>

In China, the question of how to divide power between the central fiscal authority and local legislatures in deciding the issuance amount depends on what approval method the central authority takes. In the current bond market in China, there are two approval methods being used. The issuances of financial bonds (bonds issued by certain financial insti-

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<sup>118</sup> Lili Liu, *Strengthening Sub-National Debt Financing and Managing Risks* 36, THE WORLD BANK (2010), [http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt\\_English.pdf](http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt_English.pdf).

<sup>119</sup> 王一中 (Wang Yizhong), 地方债券的各国财政制度比较 [International Fiscal Policy Comparison on Sub-national Bond], 财会研究 [RES. OF FIN. & ACCOUNTING], issue 11 (2009), <http://cks.mof.gov.cn/crifs/html/default/waiguocaizheng/history/3326.html>.

<sup>120</sup> Ran, *supra* note 114, at 33.

tutions, such as commercial banks), listed corporate bonds, and enterprise bonds are subject to “verification and approval system” (*Hezhunzhi*)<sup>121</sup>, which means that the central regulatory agencies will conduct substantive review concerning the issuance amount, issuance method, guarantee, repayment resources and ability. The government is performing part of the market function, as compared with a disclosure-centered system, in which the authority only regulates the truthfulness and completeness of the materials disclosed, and leaves the market to judge on the quality of the issued security. The issuances of (super) short term commercial papers and medium-term notes are subject to “registration system” (*Zhucezhi*),<sup>122</sup> which means that the issuers need only register the issuance and then issue the bonds without further substantive review.

The registration system has a higher requirement of self-regulation for the issuers and intermediate players, and thus it is more commonly used in mature markets. Considering the current practice of China’s securities market, the significant disparity among local governments’ financial capabilities and their probability of excessive borrowing, it is reasonable to expect that the central authority will strictly control the overall amount of sub-national bonds and coordinate the amounts for different regions in the development of a sub-national bond market in the future. They may also conduct substantive review of the issuance of sub-national bonds.

At the same time, local congresses have the power, according to the PRC Constitution, to “examine and approve the plans for economic and social development, the budgets of their respective administrative regions, and the reports on their implementation.”<sup>123</sup> Before congress meetings, governments at the same level must submit their budgets to the congress for approval. Taking all these into consideration, the approval framework will probably be like this: when the central government determines the upper limit of bonds to be issued, local legislatures retain the power to determine the exact amount based on the locality’s need and fiscal capability, and supervise the use, balance and repayment of bonds through regular reports from local governments.

This is consistent with the practice in 2009 when the central government issued sub-national bonds on behalf of local governments. The

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<sup>121</sup> Asia Development Bank, *People’s Republic of China Bond Market Guide* 8 (2011), [https://wpqr1.adb.org/LotusQuickr/asean3abmf/Main.nsf/h\\_Index/4CC53EFBD63D7BA3482579D4001B5CED/\\$file/ABMF%20Vol%201%20Sec1%20PRC.pdf](https://wpqr1.adb.org/LotusQuickr/asean3abmf/Main.nsf/h_Index/4CC53EFBD63D7BA3482579D4001B5CED/$file/ABMF%20Vol%201%20Sec1%20PRC.pdf).

<sup>122</sup> *Id.*

<sup>123</sup> 宪法(1982) [Constitution (1982)] art. 99, CLI.1.1457 CHINALAWINFO.

approval procedure was: local governments filed issuance plans to the Ministry of Finance (MOF); the State Council examined the application plan and determined the upper limit of issuance amount; local governments submitted the issuance plans (the amount should be subject to the State Council's decision) to the congress at the same level for approval; subject to State Council's and local congress' approvals, local governments filed the adjusted issuance plan to the MOF again and consulted with the MOF regarding the details, such as timing and exact amount.<sup>124</sup>

## ii. Market Regulators in Issuance and Trading Stage

Effective monitoring and supervision requires experienced regulators of the market. For the development of China's sub-national bond market, this would not be a big challenge. In China, several very experienced regulatory authorities are involved in the bond market:

The highest authority is the State Council, under which several agencies play different roles. Divided by the trading market, the People's Bank of China (PBC) regulates the interbank bond market, while the CSRC regulates the exchange market where listed-bond trading takes place. Notably, China's interbank bond market is the market where financial institutions trade bonds, and is the market where most bond trading takes place in China. In addition, the National Association of Financial Market Institutional Investor (NAFMI), a self-regulatory organization, also plays an important role in the interbank market.

Divided by instruments, the PBC regulates Treasury bonds and UDIV bonds together with the Ministry of Finance (MOF) and CSRC (if the bonds are listed), with the MOF determining the authorization and quota of them. The PBC also regulates central bank bills, policy bonds, other financial bonds, subordinated bonds, short term financing bills, international development institute bonds, asset-backed securities, and mid-term notes, etc. The CSRC regulates Treasury bonds, enterprise bonds, convertible bonds, and corporate bonds.<sup>125</sup> The National Development and Reform Commission (NDRC) regulates enterprise bonds (*Qiyè zhài*) by controlling issuance quota and authorizing new issue applications.

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<sup>124</sup> Ran, *supra* note 114, at 39.

<sup>125</sup> People's Bank of China Financial Market Department, *The Reform and Development of China's Bond Market* 5 (2011), [http://www.globalcoe-waseda-law-commerce.org/activity/20110430/3\\_2\\_1\\_PBoC.pdf](http://www.globalcoe-waseda-law-commerce.org/activity/20110430/3_2_1_PBoC.pdf).

Although the fragmented assignment of roles results in uneconomic costs for issuers,<sup>126</sup> it at least showed us a clear division of supervisory responsibilities over China's bond market, and provides a predictable picture of the regulating framework once China formally starts sub-national bond issuance. Because the nature of sub-national bond issuance is most similar to that of Treasury bond (both are issued by government) and UDIV bond (both are issued mainly for the purpose of local infrastructure development), we can expect that the PBC and the CSRC (if the bonds are listed) will regulate the issuance and trading market while the MOF will regulate the fiscal amount of sub-national bond issuance. In particular, the existing local government debt management division under the MOF Budgetary Department will probably take the responsibility.

*c) Lack of Clarity about Ex Ante Requirement for Issuance*

Although it is not difficult to predict the regulating and supervisory agencies, many further questions are left uncertain, such as which local governments' instrumentalities could issue bonds, what type of bonds they could issue, and under what conditions they could issue.

*i. Level of Local Governments as Issuers*

It is unclear which level of governments could be the potential issuers of sub-national bond in China. The scale of the governments makes big differences. For example, for small issuers, additional assistance mechanism, such as "pooled borrowing" (a mechanism to pool borrowers together to issue bonds, otherwise these borrowers may be economically inefficient to issue bonds due to their small size) may be necessary to reduce the borrowing cost. In some countries, "issuer" covers a wide range of entities. For example, in the U.S., potential municipal bond issuers include "states, counties, cities, or their agencies to finance public-purpose projects—schools, roads and bridges, utilities, affordable housing, airports, hospitals, and other public facilities and programs."<sup>127</sup>

We do not expect that China would allow a similar range of issuing entities in the near future. One reason is that China is at the very nascent stage of sub-national bond development, thus would be very cautious in

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<sup>126</sup> Kee-Hong Bae, *Determinants of Local Currency Bonds and Foreign Holdings: Implications for Bond Market Development in the People's Republic of China* 15 (ADB Working Paper Series on Regional Economic Integration No. 97, 2012), <http://www.adb.org/sites/default/files/pub/2012/wp97-bae-determinants-local-currency-bonds.pdf>.

<sup>127</sup> *Education Center*, MSRB, <http://emma.msrb.org/EducationCenter/EducationCenter.aspx>.



decentralizing the power. Another reason lies in the fundamental difference of political systems. In a federalist system, such as the U.S., sovereignty is constitutionally divided between the federal authority and the constituent units such as states or provinces. Thus a state level government has inherent power to decide its own financing method. In contrast, in a unitary country such as China, any level of government below the central government is considered as a local government, and is subject to the control by the central government. To allow the provincial governments to issue bond is already an important step of decentralization.

If we refer to the track record of sub-national bond financing in China, both provincial and certain municipal level governments may be potential issuers. Since 2009 when China allowed sub-national bond for the first time, the MOF has issued such bonds on behalf of most of the provinces and several municipalities. Until now, except for province level municipalities<sup>128</sup>, Xiamen, Qingdao, Ningbo, Dalian, and Shenzhen are the only municipalities on behalf of which the MOF have issued bonds.<sup>129</sup> In the current trial, only Shenzhen is allowed to issue bonds, aside from other three province-level governments.

It is noteworthy that these non-provincial municipalities are among “municipalities specifically designated under the State plan” (*Jihua Danlie Shi*), a category of cities that enjoys the same fiscal power as that of provinces, and is treated as deputy-provincial municipalities in the administrative hierarchy. China set this category of cities in the 1980s to grant these cities more power and autonomy for their development. Municipalities under this category do not need to turn over revenue to the provincial government they belong to, but only need to share revenue directly with the central government under the 1994 Tax Assignment Scheme.<sup>130</sup>

The practice shows that the central government is very cautious to grant issuing rights to governments that are below province level. Thus ordinary municipalities probably cannot take advantage of the sub-national bond market.

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<sup>128</sup> There are four provincial level municipalities (Zhixiashi) in China, including Beijing, Shanghai, Tianjin and Chongqing.

<sup>129</sup> The author collected the information based on all the past bonds that the MOF issued on behalf of sub-national governments that are revealed at [www.chinabond.com.cn](http://www.chinabond.com.cn).

<sup>130</sup> 国务院关于实行分税制财政管理体制的决定 [The State Council’s Decision on Implementing Tax Assignment Management System] (promulgated by the St. Council, Dec. 15, 1993, effective Jan. 1, 1994) para. 1, CLI.2.8852 CHINALAWINFO.

## ii. Type of Bonds to be Issued

Divided by sources of repayment, sub-national bond generally has two types: General Obligation Bonds (“GO bond”) and Revenue bonds. GO bonds are issued against “full faith and credit” of the issuing governments, which means the issuers back these bonds with all their revenue-raising power. Revenue bonds are typically backed by revenue streams that are directly related to the services provided, such as user fees for certain utilities.

It is unclear what type of bonds local governments could issue in the future. Looking back to the sub-national bond issuance practice since 2009, only GO bonds have been issued. Meanwhile, most UDIV bonds are revenue bonds or hybrid bonds (which means repayments are secured by project revenues, but at the same time de facto guaranteed by local government’s assets and revenue. It is necessary for the regulator to specify the type of sub-national bond in the regulating scheme because there will be big differences for disclosure requirements and credit rating results for these two types of bonds. For GO bonds, market players will look to the overall assets, revenue and spending of the government, while for revenue bond, the focus is more about the profit generation ability of the project alone.

Divided by purpose of issuance, general obligations bonds usually include long-term investment bond and bond for offsetting deficits. As a golden rule for debt financing, “many countries specify that borrowing is allowed only for long-term public capital investments.”<sup>131</sup> This is the lesson from the 1990s default crisis in many developing countries where governments borrowed heavily to roll over existing debt,<sup>132</sup> Therefore, explicit rules on the purpose of the bond is crucially important for the sustainability of the sub-national bond market. Short term borrowing through bond financing should be strictly limited.

## iii. Fiscal Conditions an Issuer Should Satisfy

A common element in the ex-ante regulation framework in countries that have a sub-national debt market is the explicit limitations on key fiscal indicators. The rules on these limitations are important for standardizing the examination and approval practice. Otherwise, the central authority probably has to review issuance applications on a case-by-case basis, and has to be involved in continuous negotiations

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<sup>131</sup> Liu, *supra* note 117, at 5.

<sup>132</sup> *Id.*

with sub-national issuers. In addition, strict limitations on fiscal situations of sub-national issuers could also improve the fiscal sustainability of local governments. However, China has not established such a fiscal monitoring framework yet.

Lili Liu suggested that such monitoring framework covers two questions: First, how to pick fiscal indicators; second, how to determine the threshold of these fiscal indicators.<sup>133</sup> She suggested some usual candidates for these indicators: debt stock -to- sub-national GDP ratio, debt stock -to- total revenue ratio, debt service -to- total revenue ratio, and budget deficit-to-sub-national GDP ratio, etc.<sup>134</sup> The indicators could be liquidity indicators, solvency indicators, or debt service ability indicators. She also suggested that how to determine the thresholds is an empirical question and is “country period specific.”<sup>135</sup> Nonetheless, it is important to set a framework of these limitations beforehand in order to bind local government’s borrowing in a sustainable way. In this field, Brazil, Colombia, India, Poland all set good examples in regulating fiscal indicators,<sup>136</sup> and their practice could be borrowed to design the framework in China.

#### d) *Insufficient Disclosure and Inadequate Transparency*

Except from the above regulating inadequacies, a more problematic situation in developing ex ante supervising and monitoring framework is the insufficient disclosure requirements and the low level of transparency of the issuing governments.

##### i. Inadequate Transparency

Fiscal transparency of the government is inadequate in China. The 1994 Budget Law has no language on any disclosure requirement for government budgets. For more than a decade, there has been no legislation on the disclosure requirements concerning the fiscal condition of local governments except the PRC Supervision Law in 2006, which broadly stipulated that governments should report their implementation of budgets to the congresses at the corresponding level.<sup>137</sup> It is only after

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<sup>133</sup> *Id.* at 7.

<sup>134</sup> *Id.* at 37.

<sup>135</sup> *Id.* at 38.

<sup>136</sup> *See id.* at 7, 38–39 (these countries have established a set of fiscal targets and corresponding thresholds; Lili Liu listed specific practice for each country in her paper).

<sup>137</sup> 各级人民代表大会常务委员会监督法 [Supervision of Standing Committees of People’s Congresses at Various Levels] (promulgated by the Standing Comm. Nat’l People’s Cong., Aug. 27, 2006, effective Jan. 1, 2007), CLI.1.78894 CHINALAWINFO.

2008, when the Government Information Disclosure Regulation came into effect, specifying that governments at all levels are required to take initiative to disclose fiscal information to the public.<sup>138</sup> The information to be disclosed includes, among others, “statistical information on national economy and social development,” “fiscal budget report and implementation report,” “situation on the approval of great construction projects and implementation” and so on.<sup>139</sup> Before the Regulation, government officials usually use the PRC State Secrets Law (*Guojia Baomi Fa*) to turn down requests of disclosure from the public.<sup>140</sup> After the regulation, the country has made some improvement.

The central government and its departments moved first in 2010 by releasing their budgets of “three public consumptions” (*Sangong Xiaofei*) for more transparency and anti-corruption purpose. The “three public consumptions” include government spending on (1) vehicle purchases and maintenance, (2) overseas trips, and (3) official receptions. After that, the State Council required provincial level governments to disclose the budgets for “three public consumptions”<sup>141</sup> as well and promulgated “Administrative Regulations on Governmental Affairs” as a legal basis in 2012.<sup>142</sup> But “the three public consumptions” is only part of governments’ budget and the revealed statistics are not detailed enough.

Meanwhile, in 2008, MOF issued “Guiding Opinions of the Ministry of Finance on Speeding up the Information Disclosure of Financial Budget” to implement the Government Information Disclosure Regulation.<sup>143</sup> While the opinion is fairly detailed, the soft wording of “Guiding Opinion” probably results in unsatisfactory compliance by government agencies. According to a survey conducted by Tsinghua University re-

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<sup>138</sup> 政府信息公开条例 [Regulation on the Disclosure of Government Information] (promulgated by the St. Council, Apr. 5, 2007, effective May. 1, 2008) art. 10 & 12, CLI.2.90387 CHINALAWINFO.

<sup>139</sup> *Id.*

<sup>140</sup> 李炜光 (Li Weiguang), 保密法成预算公开挡箭牌 [State Secrets Law is Used as Shield from Budget Disclosure], 搜狐财经 [SOHU FIN.], July 29, 2010, <http://business.sohu.com/20100429/n271841527.shtml>.

<sup>141</sup> 谢雪琳 (Xie Xuelin), 国务院一年两次要求地方公布“三公经费” [The State Council has Required Sub-national Government to Publicize “Three Types of Public Expenses” Statistics for Twice within a Year], 一财网 [YICAI.COM], Aug. 16, 2012, <http://www.yicai.com/news/2012/04/1642134.html>.

<sup>142</sup> 机关事务管理条例 [Regulation on the Administration of the Institutional Affairs of Government] (promulgated by the St. Council, June 28, 2012, effective Oct. 1, 2012) CLI.2.178578 CHINALAWINFO.

<sup>143</sup> 财政部关于进一步推进财政预算信息公开的指导意见 [Guiding Opinions of the Ministry of Finance on Speeding up the Information Disclosure of Financial Budget] (promulgated by the Ministry of Fin., Sept. 10, 2008, effective Sept. 10, 2008) CLI.4.108652 CHINALAWINFO.

search team, in 2010, only 7 out of 88 cities met disclosure requirements.<sup>144</sup> The criteria of the survey include some very basic requirements shown in an ordinary U.S. municipal GO bond disclosure statement<sup>145</sup>, such as the government structure and function, the budget for the next year and final accounts. The survey also finds that GDP per capita, foreign trade dependence and top officials' education background are the most important factors positively correlate with fiscal transparency of the city.<sup>146</sup> It may implicate that a locality with transparent governance could attract more investment, which further facilitates the economic development of the locality.

Also, PBC, as the main regulator of inter-bank market, where current sub-national bond trading takes place, has no rule on information disclosure concerning sub-national bonds. Neither does NAFMII, the self-regulatory entity of OTC market (including the interbank market), have such rules or guidance. But both PBC and NAFMII have detailed disclosure rules for other types of securities, such as corporate bonds or financial bonds. In addition, the China Securities Supervisory Commission has fairly mature practice in formulating disclosure rules for different type of securities, and the experience could certainly be borrowed for sub-national bond issuance.

An efficient bond market relies heavily on public disclosure of the issuers' information. Before China can allow sub-national bond issuance completely, it is necessary to set clear disclosure requirement for the issuing governments. Considering that the quality of the information disclosed on each government's website or annual report varies from city to city, a detailed disclosure guidance including standard format, timeliness, and access should be in place.<sup>147</sup>

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<sup>144</sup> 清华大学公共管理学院 [SCH. OF PUB. POL'Y AND MGMT OF TSINGHUA UNIV.], 中国市级政府财政透明度研究报告 [REPORT ON FISCAL TRANSPARENCY OF MUNICIPAL GOVERNMENT IN CHINA], at 45–46 (May, 2012), <http://www.sppm.tsinghua.edu.cn/eWebEditor/UploadFile//20120827103224378.pdf> [hereinafter Tsinghua Report].

<sup>145</sup> For example, the official statement of a 2012 NYC GO bond runs about two hundred pages, covering detailed disclosure about government info., financial controls, sources of revenues, city service and expenditure, financial plans, etc.

<sup>146</sup> *Most Chinese cities lack fiscal transparency*, CHINA DAILY (June 12, 2012), [http://usa.chinadaily.com.cn/china/2012-06/12/content\\_15496513.htm](http://usa.chinadaily.com.cn/china/2012-06/12/content_15496513.htm)

<sup>147</sup> Tsinghua Report, *supra* note 143. The survey conducted by Tsinghua research team provides good reference as to what may be included in the disclosure guidance: 1. Government structure and function; 2. Chart of relationship between government and other public institutions (any institutions controlled by government, such as pension funds or UDIVS); 3. Budget; 4. Government funds, land transfer fee, debt and three

## ii. U.S. Experience on Disclosure Requirement of Municipal Bonds

United States has the most developed and advanced sub-national bond market in the world. Over the past two hundred years, its municipal bond market has developed into a main component of credit market and a primary source of local infrastructure finance. Among others, a strict disclosure requirement is an indispensable factor that significantly supports the development.<sup>148</sup> Traditionally, due to the federal-state comity, the lack of perceived abuse by sub-national issuers and the fact that purchasers were typically institutional investors with sufficient market expertise, municipal bonds were exempted from disclosure requirements and sold well even when disclosure “is limited to a notice of sale.”<sup>149</sup> However, as more and more individual investors entered the market and partly triggered by several bond defaults, the disclosure standards got heightened continuously.<sup>150</sup>

Nowadays the U.S. government has set very high disclosure standards for municipal bond. Below we may take a look at what information is disclosed for a typical U.S. municipal bond, and compare that with the practice in China. For purpose of comparison, the author reproduces a list of items disclosed in an official statement of New York City GO bond since the bonds in trial are GO bonds and there are no ongoing disclosure documents on these bonds yet.

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public consumptions; 5. Implementation of budget; 6. Final accounts; 7. Standards/methods for accounting and budgeting

<sup>148</sup> Other characters include: efficient credit rating, widely adopted bond insurance and tax-exemption treatment. Samir El Daher, *Municipal Bond Markets: Experience of the USA* 4, (World Bank Infrastructure Notes, Urban NO. Fm-8a, 1997), [http://www-wds.worldbank.org/external/default/WDSContentSerer/WDSP/IB/2000/11/23/000094946\\_00102705411651/Rendered/PDF/multi\\_page.pdf](http://www-wds.worldbank.org/external/default/WDSContentSerer/WDSP/IB/2000/11/23/000094946_00102705411651/Rendered/PDF/multi_page.pdf).

<sup>149</sup> *Municipal Bond Disclosure - History, Requirements and Services Provided by WMFS*, WM FIN. STRATEGIES, <http://www.munibondadvisor.com/Disclosure.htm>.

<sup>150</sup> *Id.*

Table 4: Official Statement of the NYC (GO Bond) (Fiscal 2012 Series D)  
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<i>Official Statement of The City of New York</i>	
Table of Contents	
Section I: Recent Financial Developments	Section V: City Services and Expenditures
-2011-2015 Financial Plan	-Expenditures for City Services
-The State	-Employees and Labor Relations
-Job Growth	-Capital Expenditures
Section II: The Bonds	Section VI: Financial operations
-Payment Mechanism	2006-2010 Summary of Operations
-Enforceability of City Obligations	Forecast of 2011 Results
-Use of proceeds	
Section III: Government and Financial Controls	Section VII: Financial Plan
-Structure of City Government	-Financing Program
-City Financial Management	-Assumptions
-Budgeting and Controls	-Long-Term Capital Program
Section IV: Sources of City Revenues	Section VIII: Indebtedness
-Real Estate Tax	-Indebtedness of the City and Certain
-Miscellaneous Revenues	Other Entities
-Unrestricted Intergovernmental Aid	-Public Benefit Corporation Indebtedness

In addition to technical issues and the information on revenue and expenditure, the 204-pages’ NYC’s document includes very detailed financial statement, past five years financial operation, and the financial plans and estimations in the future several years. Also, it includes the measure of fiscal control like budgeting and auditing, and other material events that could have an impact on the city’s fiscal situation. The extent of the disclosure provides a good practice for other countries that plan to develop a mature sub-national bond market.

In contrast, the information disclosed in Chinese sub-national bond issuance material is very limited. We note that there are no rules on disclosure in China now. The internet access on sub-national bonds’ issuance and trade matters is the “information disclosure” column on Chinabond.com.cn. The information under this column includes both the bonds issued by MOF on behalf of local governments since 2009 and the bonds issued by the four governments in this trial. For the bonds in trial,

<sup>151</sup> *Official Statement of City of New York*, MSRB (Sept. 28, 2011), <http://emma.msrb.org/EP579461-EP453790-EP853775.pdf>.

there are three relating sub-column: “issuing document,” “issuing result,” and “fiscal report.”<sup>152</sup> No prospectus could be found. Thus we combine the documents in the three columns as comparing target and take Shenzhen as an example. For each issuance, the Shenzhen government has provided four relating documents: 1. Notice of sale,<sup>153</sup> 2. Result of sale,<sup>154</sup> 3. Implementation of budget of the recent year,<sup>155</sup> 4. Main economic operation indicators of the recent year.<sup>156</sup> The Table below summarizes all the information provided in the four documents:

Table 5: Information disclosed by Shenzhen municipal government

<p>Issuance Notice (2 pages)</p> <p>    Type, maturity and planned amount of the bond</p> <p>    Timing (incl. timing for bidding, issuance, day of interest, distribution)</p> <p>    Timing and matter of payment of interest and principal;</p> <p>    Issuance fee arrangement;</p> <p>    Bidding arrangement;</p> <p>    Qualified underwriters;</p> <p>    Subscription and payment procedure;</p> <p>    Tax treatment;</p> <p>Notice of Result (2 pages):</p> <p>    Amount sold;</p> <p>    Final interest rate</p> <p>Implementation of Budget (2 pages):</p> <p>    Revenue of the past year, and its increasing ratio</p> <p>    Expenditure of the past year and its increasing ratio</p> <p>Performance of Main Economic Indicators (1 page):</p> <p>    Number and increasing ratio of GDP, value added by the industrial enterprises, total fixed asset investment, total sales amount of consuming goods, total export and import, FDI, budget revenue</p>
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<sup>152</sup> For bonds issued by MOF on behalf of sub-national governments, “issuing doc” “issuing result” “issuing plan” and “issuing estimate” are relevant, while there is no information under “fiscal report.”

<sup>153</sup> 关于发行深圳市 2012 年政府债券（一期）有关事宜的通知 [Notice of Issuing Matters on 2012 Shenzhen Bond (First Issue)], <http://www.chinabond.com.cn/Info/14737380>.

<sup>154</sup> 深圳市 2012 年政府债券（一期）发行结果公告 [Notice of Issuing Result of 2012 Shenzhen Bond (First issue)], <http://www.chinabond.com.cn/Info/14777253>.

<sup>155</sup> 深圳市 2011 年及 2012 年 1-6 月份公共财政预算收支情况表 [Implementation of Budget of Shenzhen in 2011 and First Half of 2012], <http://www.chinabond.com.cn/Info/14753535>.

<sup>156</sup> 深圳市 2011 年及 2012 年 1-6 月份经济运行主要指标 [Main Economic Operation Indicators of Shenzhen in 2011 and First Half of 2012], <http://www.chinabond.com.cn/Info/14753510>.



The information mainly covers technical issues of the issuance, very brief information of the fiscal condition and economic operation in the past year. In conclusion, there is big room for improvement to establish a healthy and transparent sub-national bond market in China.

e) *Lack of Ex Post Mechanism*

Government bankruptcy is not rare outside China. There are at least 884 local governments that have filed bankruptcy in Japan in its history.<sup>157</sup> In America, Orange County's bankruptcy in 1994 is the most widely cited municipal default.<sup>158</sup> The New York City also experienced a hard time of near bankruptcy in 1975.

Bankruptcy regulation provides an ex-post monitoring mechanism for local governments' fiscal situations. Without such regulation, a local government would simply default or transfer the debt to the upper level government if it were unable to repay the debt. In contrast, government bankruptcy regulation could harden local governments' budget constraint by providing reorganization mechanisms. In addition, a clear and informed solution for potential government bankruptcy provides investors with foreseeable credit right protection. Such mechanism in return helps pricing and credit rating of the bonds issued. Although insolvency is often caused by local governments' own fiscal mismanagement, it can also be caused by external influence, such as international financial crisis. As a result, whether the issuing government has a sound fiscal record or not, an ex post arrangement of default is necessary.

The problem is, in the bankruptcy law field, China only has a PRC Enterprise Bankruptcy Law (2006), which is only applicable to enterprises, as the name suggests. The notion of government bankruptcy is unknown or at least very unfamiliar to ordinary Chinese. In addition, most people in China have negative perception about the notion of bankruptcy, equating bankruptcy with liquidation while neglecting its reorganization function. However, from worldwide experience, the insolven-

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<sup>157</sup> 夏启明 (Xia Qiming), 地方政府发债的法律问题研究 [Research on Legal Issues of Local Government Bond Issuance], 云南大学学报法学版 [J. OF YUNNAN UNIV.: LAW EDITION], vol. 22, issue 1, at 87 (2009).

<sup>158</sup> To increase government revenue, the treasury of Orange County invested government funds (including funds borrowed from other public institutions of the county, such as county schools) in derivatives, which ended up in a loss of \$1.6 billion. After the proposal to raise taxes to balance the budget was voted down, the county filed for chapter 9 bankruptcy.

cy mechanism for sub-national insolvency is generally a reorganization type, not liquidation of all assets.<sup>159</sup>

Because of the many public functions a government has to perform, and for the sake of stability of a society, insolvency of a local government is fundamentally different from the bankruptcy of a private entity. Therefore, various countries set special treatment regarding government bankruptcy. For example, in US, Chapter 9 of the Bankruptcy Code is specifically designed for municipality bankruptcy. According to Chapter 9 of the US bankruptcy code, the power of court to regulate the activities of a municipal debtor is limited. For instance, the bankruptcy court may not unilaterally interfere with the political or government power, property, or the revenue of the municipality.<sup>160</sup> In addition, a government bankruptcy law usually covers uniquely designed triggering procedure, fiscal adjustment method, debt restructuring and debt relief mechanism<sup>161</sup>. These rules in all provide a complete framework for government reorganization.

However, these are all new to China, and a government bankruptcy law is not on the recent legislative agenda. Even if China were to pass government bankruptcy law; the effectiveness of such mechanism heavily depends on the degree of independence of the judicial body, which is also problematic in China. In a word, in the absence of a clear framework for local government bankruptcy, a bail-out by the higher level government is probably the only solution in case of a default. Such bail-out expectation will reinforce moral hazard of the issuing local government in its fiscal spending.

In conclusion, to develop a successful municipal bond market, the current regulatory framework is inadequate. In specific, the current fiscal relation between the central and local governments could not eliminate moral hazard of local governments; the approval criteria of bond issuance is unclear; transparency situation is improving but is still far from satisfactory; and an ex post insolvency mechanism is lacking.

### *C Fiscal Management Capacity for Sub-national Bond Market is also Problematic*

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<sup>159</sup> Lili Liu, *Managing Sub-national Fiscal Risks* 5, THE WORLD BANK (2007), <http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207588597197/APECLiu.pdf>.

<sup>160</sup> 11 U.S.C. § 904 (1) (1982).

<sup>161</sup> 财政部预算司课题组 (Dept. of Budget of the Ministry of Finance), 地方政府举债的破产机制 [*Bankruptcy Mechanism for Local Government*], 经济研究参考 [REFERENCE OF ECON. RES.], no. 43, at 8–9 (2009).

a) *Unsatisfying Budgeting, Accounting and Auditing*

To build a well-founded sub-national bond market, it is necessary for the issuing governments to gain effective fiscal management capacity on budgeting, accounting and auditing. Although China has established basic budgeting, accounting and auditing frameworks, there is pressing need for improvement in these three areas.

i. *Lack of Medium-Term Budgeting*

Medium-term budgeting is a fiscal management mechanism by which the government would extend fiscal plans beyond the current fiscal year. The mechanism could offer several benefits: first, medium-term budgeting could enhance discipline over government expenditures.<sup>162</sup> Without such budgeting scheme, a government may formulate its budget by adding incrementally on the past year’s spending and the budget will grow bigger and bigger. By setting an overall ceiling on spending for several years, governments have to manage and allocate the budget for each year carefully, and could not add new expenditures as they wish. Second, through multi-year budget scheme, the government could make a more informed fiscal plan.<sup>163</sup> Many spending decisions have impacts that go beyond the budget year. If not revealed beforehand, budget in later years may be insufficient when these impacts turn apparent. Third, medium-term budgeting could promote a more stable fiscal path. In practice, multi-term budgeting framework usually runs three to five years based on a rolling basis.<sup>164</sup> When economic shock or early signal shows any anticipated budgetary imbalances, the governments that adopt multi-term budget would have more room to respond.

The OECD has identified six policy objectives based on the features of many OECD countries’ budget formulation processes, one of which is “conduct of the annual budget process in the context of multi-year expenditures frameworks.”<sup>165</sup> Because medium-term budgeting has so many benefits, it has become universal practice among the OECD countries.<sup>166</sup> Countries that experienced the 1990s sub-national fiscal crisis, such as Brazil, Columbia, Peru, also require local governments to

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<sup>162</sup> Mick Shadwick, *Medium-Term Budget at Local Government Level 5* (Asia Development Bank, Sept. 5, 2005), [http://www.adbi.org/files/2005\\_09.05.cpp.medium.term.paper.pdf](http://www.adbi.org/files/2005_09.05.cpp.medium.term.paper.pdf).

<sup>163</sup> *Id.*

<sup>164</sup> *Id.* at 4.

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

establish medium-term fiscal framework.<sup>167</sup> In addition, as part of the post-fiscal crisis reforms in the New York City in the mid-1970s, New York City was also required to do multi-year budgeting.

However, China has not implemented such budgeting scheme yet. We note that introduction of such framework is a complicated task that requires many preconditions, including: more clear and fixed intergovernmental fiscal relation, stronger autonomy in budgeting for local governments, moving off-budget funds onto budget, stronger technical skills in budgeting and so on.<sup>168</sup> Since China has not met these conditions, the adoption of medium-term budgeting seems some way off.

## ii. Defective Accounting Method

Effective accounting standards are critical to interpret the issuing governments' fiscal performance. Since the 1980s, the world has seen a rapid improvement of government fiscal management. Following this trend, most developed countries and some developing countries replaced the cash-based accounting with accrual accounting as their government accounting method.<sup>169</sup>

It is widely recognized that the cash-based accounting for governments has many shortcomings that significantly impede government fiscal management: first, it fails to reveal the long-term liability (liabilities that go beyond the accounting year) of a government in the accounting year, and thus includes many hidden liabilities.<sup>170</sup> Similarly, the accounting method fails to provide information on the long-term capital income (which shows the long term revenue generation ability of projects), the cost of debt service (which shows whether government borrowing is efficient), and the total value of assets and stocks, etc.<sup>171</sup> Second, due to the above shortcomings, the accounting results could not reveal the real economic impact of the governments' fiscal decisions, and therefore, results in the lack of measurements for the governments' per-

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<sup>167</sup> Lili Liu, *Strengthening Sub-National Debt Financing and Managing Risks* 8, THE WORLD BANK (2010), [http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt\\_English.pdf](http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt_English.pdf).

<sup>168</sup> Shadwick, *supra* note 161, at 9.

<sup>169</sup> Hassan A. G. Ouda, *Public Sector Accounting and Budgeting Reform: The Main Issues Involved* 1, (United Nations Economic and Social Council, 2003), <http://unpan1.un.org/intradoc/groups/public/documents/unescwa/unpan010849.pdf>.

<sup>170</sup> *Id.* at 8.

<sup>171</sup> *Id.* at 8–11.

formance.<sup>172</sup> In addition, a government could easily manipulate its fiscal performance through this accounting method.

Unfortunately, although accrual accounting is universally used in the private sectors, governments in China are still using cash-based accounting. The relating rules and regulations include: Accounting Rules on General Fiscal Budgets, Accounting Rules of Governmental Units, and Accounting Rules for Non-Profit Organizations, all of which are issued by the MOF around 1997 and 1998, and have not been changed ever since.<sup>173</sup> These rules lag behind the time, and negatively influence the level of disclosure and transparency of local governments' fiscal condition.

### iii. Lack of Independence of Auditing

Independent auditing is critical to the monitoring and supervision of local governments' fiscal performances. Unfortunately, the situation of independency of government auditing is very problematic.

There are typically four models of government auditing: (1) auditing authorities that are completely independent from any state organ, such as Japan and Germany; (2) auditing authorities subordinate to the legislative branch, such as America and Canada; (3) auditing authorities subordinate to the judicial branch, a practice adopted in some Latin American countries; and (4) auditing authorities subject to the administrative branch, adopted in China.<sup>174</sup> Notably, the fourth model is inherently problematic compared with the other models.

Based on the PRC Auditing Law, the State Council establishes the National Audit Office and the local governments establish auditing authorities at the same level.<sup>175</sup> According to the Auditing Law, the auditing authorities are accountable and should report to the governments at the same level and the auditing authorities at the next higher level,<sup>176</sup> and the governments at the same level provide the fund to the auditing au-

<sup>172</sup> *Id.* at 11.

<sup>173</sup> 张敏 (Zhang Min), 中外政府会计模式的比较及启示 [Comparison and Revelation of Chinese and Foreign Government Accounting Model], 广西财经学院学报 [J. OF GUANGXI UNIV. OF FIN. AND ECON.], vol. 19, issue3, at 63 (2006).

<sup>174</sup> 杨海林、张集琼 (Yang Hailin & Zhang Jiqiong), 论我国政府审计的独立性 [On Independence of Government Auditing in China], 全国商情 [CHINA BUS.], Issue 15, at 53 (2010).

<sup>175</sup> 审计法(2006) [Audit Law(2006)] (promulgated by the Standing Comm. Nat'l People's Cong, Aug. 31, 1994, amended by the Standing Comm. Nat'l People's Cong, Feb. 28, 2006) art. 7, CLI.1.75164 CHINALAWINFO.

<sup>176</sup> *Id.* art. 9.

thorities for their work.<sup>177</sup> Since auditing authorities do not have independent fund and are led by the government that they are going to audit, the independence of auditing is very limited.

*b) Adequate Credit Rating and Credit Enhancement Mechanism*

*i. Credit Rating Agencies*

Credit rating agencies are agencies that assign letter grades of risks of the issuers by evaluating the issuers' creditworthiness, typically their willingness and ability to pay interest and principal. Because these agencies usually conduct on-site investigations and focus on investigating the risks, very often their reports could disclose more information than prospectuses regarding risk of a security. Credit agencies could also link the issuers and the investors by conveying the investors' concern and attitude to the issuers. More importantly, credit rating agencies usually follow the issuers' creditworthiness, and thus could continuously supervise the credit situation of the issuer. Investors usually make investment decisions based on these credit ratings, combining their willingness to take risks of their own. Thus credit rating directly influences the pricing of bonds and the cost of borrowing.

With the fast development of the securities market, credit rating agencies in China are also growing with increasing sophistication. So far there are eight major credit rating agencies in China's bond market, including agencies jointly held by the Big three international credit rating agencies.<sup>178</sup> For example, the first credit rating agency, China Chengxin International Credit Rating Co., Ltd (CCXI) was established in 1992 and has been jointly held by the Moody's since 2006. Credit rating standards in China are also getting closer to the international practice. In the past two decades, China's credit rating agencies have gradually built up rating capacities for various fixed income securities. In particular, they have already rated hundreds of UDIV bonds (quasi government securities) and some foreign governments.<sup>179</sup> The foreign partners of the Chinese credit rating agencies also have adequate experience in evaluating the governments' credit. Notably they have developed standards on evaluating gov-

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<sup>177</sup> *Id.* art. 11.

<sup>178</sup> Asia Development Bank, *People's Republic of China Bond Market Guide 2* (2011), [https://wpqr1.adb.org/LotusQuickr/asean3abmf/Main.nsf/h\\_Index/4CC53EFB D63D7BA3482579D4001B5CED/\\$file/ABMF%20Vol%201%20Sec1%20PRC.pdf](https://wpqr1.adb.org/LotusQuickr/asean3abmf/Main.nsf/h_Index/4CC53EFB D63D7BA3482579D4001B5CED/$file/ABMF%20Vol%201%20Sec1%20PRC.pdf).

<sup>179</sup> For example, CCXI has released credit rating report on foreign sovereignties, see 中诚信国际发布 30 个国家信用评级结果 [CCXI Release Credit Rating Result of 30 Countries], 中诚信国际信用评级有限责任公司 [CCXI.COM.CN], July 31, 2012, <http://www.ccxi.com.cn/272/418/News Info.html>.

ernments' liabilities that are off-balance sheet.<sup>180</sup> Therefore, China's credit rating agencies have the basic ability to rate sub-national bonds once they are allowed to do so.

However, there are obstacles for these agencies to assign ratings for sub-national bonds. First, the level of transparency of the governments' fiscal situation is low and the fiscal disclosed information of local governments may be insufficient for credit ratings. Second, the State Council has issued a circular in 1995, forbidding credit ratings from rating sub-national bond, and the circular is still effective.<sup>181</sup> Probably because of this circular, none of the sub-national bonds issued by the MOF on behalf of local governments since 2009 and the bonds issued in the current trial have been rated. However, the rationale in the 1995 Circular is that because local government is prohibited from borrowing, there is no need to rate local governments' credit. Therefore, if sub-national bond issuance is allowed, this circular probably would be repealed.

## ii. Credit Enhancement Mechanism

Credit enhancement mechanism is a method usually adopted by a borrower to obtain better terms for an outstanding debt. Typical credit enhancement mechanisms include posting collateral, securitization, posing insurance, obtaining letter of credit, and so forth. Credit enhancement mechanism could enhance the liquidity of secondary market because borrower with low rating could get market access by adopting credit enhancement measures. Credit enhancement practice varies from country to country. In the U.S. municipal bond market, bond insurance plays a very important role. Many investors actually look to the insurer of municipal bond to make investment decisions.<sup>182</sup> "Municipal bond insurance is

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<sup>180</sup> Lili Liu, *Strengthening Sub-National Debt Financing and Managing Risks* 17, THE WORLD BANK (2010), [http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt\\_English.pdf](http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt_English.pdf).

<sup>181</sup> 国务院办公厅关于地方政府不得对外举债和进行信用评级的通知 [Circular of the General Office of the State Council Concerning Local Governments not Being Allowed to Undertake Foreign Debt or Conduct Credit Ratings] (promulgated by The General Office of the St. Council, Jan. 11, 1995, effective Jan. 11, 1995) CLI.2.12352 CHINALAWINFO.

<sup>182</sup> Bond insurance is very important in US municipal bond market. Before subprime crisis, there were more than ten bond-insurance companies, such as AMBAC, MBIA, FGIC, etc. however, many of them involved in subprime bond insurance business, and even used their management assets to buy high risky products such as CDO, CDS. This practice led to bankruptcy of some of the bond insurance companies. It serves as a good lesson for other countries that is going to start a new credit enhancement mechanism.

relatively unknown outside the U.S.,<sup>183</sup> and is unfamiliar to China. But the general concept is well understood and there are a series of credit enhancement practice in China, such as guarantee, letter of credit, securitization. Therefore, it would not be a big problem for China in case there is necessity of credit enhancement mechanism for sub-national bonds.

### iii. Equal Treatment in the Debt Market

In Noel's framework, establishing a level playing field means removing the protective framework for certain institutions that enjoy privileges in funding local governments.<sup>184</sup> The forms of protection include that certain institutions could provide fund at subsidized rates, or enjoy special authority to require local governments to maintain accounts with their fund.<sup>185</sup> Equal treatment in the sub-national bond market could facilitate price discovery and increase private sector finance for local governments. The problem of privilege lending would not cause much trouble for China. As explained above, the sources of sub-national borrowing is mainly from state banks, and the interest rate of loans fixed by the Central Bank for sub-national units is deemed higher than the market value. Therefore, once bond financing channel is open, banks as original lenders do not enjoy much privilege in funding.

From the market access side: currently sub-national bonds are traded in the interbank bond market and all the members of the market (all the interbank market members are institutional investors) could trade the bonds freely. Since the bonds are not traded in the exchanges, individual investors do not have direct access to investing in these bonds. But this does not completely preclude private participation in the secondary sub-national bond market because individuals could still enter into the market through buying insurance or mutual funds.

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<sup>183</sup> James Leigland, *Accelerating Municipal Bond Market Development in Emerging Economies: An Assessment of Strategies and Progress* 14, (Research Triangle Institute, 1997), <http://www.developmentfunds.org/pubs/Accelerating%20Municipal%20Bond%20Mkt%20Dvpt.pdf>.

<sup>184</sup> Michel Noel, *Building Sub-National Debt Markets in Developing and Transition Economies, A Framework for Analysis, Policy Reform and Assistance Strategy* 17 (World Bank Policy Research Working Paper No. 2339, 2000), [http://www-wds.worldbank.org/external/default/WDSContent Serve r/IW3P/IB/2000/06/09/000094946\\_00052705305247/additional/104504322\\_20041117154007.pdf](http://www-wds.worldbank.org/external/default/WDSContentServe r/IW3P/IB/2000/06/09/000094946_00052705305247/additional/104504322_20041117154007.pdf).

<sup>185</sup> *Id.*



#### iv. Sufficient Market Infrastructure

Unlike many developing countries in the World Bank studies, although the sub-national bond market is at its very nascent stage, China's bond market in general has witnessed considerable improvement in the last decade. The volume of outstanding bond has reached the fourth largest in the world by the end of 2011,<sup>186</sup> the types of bonds have evolved to a wide range of categories and the trading instruments have also developed significantly.<sup>187</sup> With these fast developments, China has built experienced market infrastructure, such as trading platforms, settlement and custodial systems, and payment systems, which are sufficient to support the introduction of sub-national bonds.

In the inter-bank bond market where 99% bond trading volume is taking place, the Central Bank has established a set of mechanism which "specifies obligation and responsibility of various intermediate actors in China's bond market," including underwriters, accounting firms, law firms, rating agencies, etc.<sup>188</sup> The two types of trading platforms, the inter-bank market and the two Exchanges, were established in the 1990s, and have built sufficient infrastructure and experience for secondary market trading. The settlement system, consisting of three central depository facilities, also has a long time practice. The current market infrastructure is probably strong enough for the introduction of a new type of bond.

In conclusion, the current budgeting, accounting and auditing schemes are far from satisfactory. In contrast, credit rating, credit enhancement, market access and market infrastructure has developed mature enough for the introduction of sub-national bond market.

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<sup>186</sup> 杨海霞 (Yang Haixia), 债市面临机遇期 [Bond Market is Facing Great Opportunities], 中国投资 [CHINA INV.] (2012), <http://finance.sina.com.cn/money/bond/20120906/113013063817.shtml>.

<sup>187</sup> China's bond market started from Treasury bonds and corporate bonds, and has evolved into a wide range of categories, including policy bank bonds, central bank bills, financial bonds, subordinated bonds of commercial banks, hybrid capital bonds, super and short-term commercial papers, medium-term notes, hybrid capital bonds, credit asset securitization products, listed corporation bonds, convertible bonds, UDIV bonds and local government bonds in the trial (usually collectively named as local government bonds), international development institution bonds, small and medium size enterprise collective notes and private placement notes. The trading instruments has also evolved significantly from spot trading and repo to bond forwards, forward rate agreement, RMB interest rate swap, bond lending, credit risk mitigation warrant, etc.

<sup>188</sup> Asia Development Bank, *People's Republic of China Bond Market Guide 3* (2011), [https://wpqr1.adb.org/LotusQuickr/asean3abmf/Main.nsf/h\\_Index/4CC53 EFB D63D7BA3482579D4001B5CED/\\$file/ABMF%20Vol%201%20Sec1%20PRC.pdf](https://wpqr1.adb.org/LotusQuickr/asean3abmf/Main.nsf/h_Index/4CC53 EFB D63D7BA3482579D4001B5CED/$file/ABMF%20Vol%201%20Sec1%20PRC.pdf).

## V Conclusion

China's sub-national bond market is at its trial period, and there is pressing need to develop the market. The necessity comes from the mismatch of revenues and responsibilities of local governments, combined with the weakness in the existing financing channels for local governments. The fiscal framework created significant fiscal gap for local governments and pushed them to develop many extra-budgetary financing methods, many of which are unsustainable. Allowing local governments to issue bond could reduce moral hazard of local governments, relieve NPL risk in the banking sector, and promote more transparent and efficient governance for local governments.

Based on the experience in helping developing countries to establish local bond markets, some international organizations provided valuable guidance on this field. Taking their studies and China's context in mind, the author believes China has not been fully prepared to establish a well-founded sub-national bond market. Although the macroeconomic condition and market infrastructure is sufficient, considerable obstacles lie in regulatory issues and fiscal management capacity. The fiscal system causes serious financial difficulties for local governments. Also, China has not established mature ex ante and ex post monitoring mechanism, and has much room to improve its public debt management ability, such as budgeting, accounting and auditing abilities.

The author believes that in order to measure up on the prerequisites for a successful municipal bond market, China has much work to do in the following fields in the future. This paper lists the following policy suggestions and invites further discussion in this regard:

1. Establish a more predictable and sound intergovernmental fiscal relation, including enlarging revenue and borrowing autonomy of local governments.
2. Clarify the scope of permitted sub-national issuers, types and purpose of issuance, and issuance and approval procedure.<sup>189</sup>
3. Develop key monitoring fiscal indicators and thresholds for these indicators.<sup>190</sup>

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<sup>189</sup> Lili Liu, *Strengthening Sub-National Debt Financing and Managing Risks* 31–32, THE WORLD BANK (2010), [http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt\\_English.pdf](http://siteresources.worldbank.org/INTDEBTDEPT/Resources/468980-1207588563500/4864698-1207775351512/SSDebt_English.pdf).

4. Promote higher level of disclosure of government fiscal condition.
5. Develop ex post insolvency scheme for local governments.
6. Improve budgeting, accounting and auditing ability and open credit ratings on local governments.

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<sup>190</sup> *Id.*