

The Evolution of China as a WTO Disputant

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The attitude of China towards the World Trade Organisation's (WTO) Dispute Settlement Mechanism (DSM) has evolved considerably over the last nine years. For some time, China saw the institution of trade disputes in the WTO as a failure of dialogue and negotiation. Vice Premier Wu Yi maintained that the United States' (US) filing of a complaint against China in the WTO regarding IPR standards "(flew) in the face of the agreement between the two countries' leaders to propose dialogue as a way of settling disputes."¹

On the other hand, the US Trade Representative at the time, Susan C. Schwab, insisted: "This should not be regarded as a failure in our trade relationship with China. Quite the contrary. Resorting to dispute settlement is itself a form of engagement. It is evidence of two countries working to resolve disputes about obligations through neutral, legal mechanisms."²

This is a clear illustration of the uniqueness of China's initial perceptions and approach to dispute resolution before the WTO. China has since departed from this policy of minimal involvement in WTO litigation and instituted and defended complaints in order to protect its trade interests. This brief aims to study the causes, stages and implications of this change in policy, the lessons China has learnt over the years and those it is yet to incorporate. It also draws lessons from Brazil, a successful developing country disputant, which could be implemented in the Chinese context.

Chinese Legal Culture and International Organisations

The WTO was initially meant to pursue the objectives of raising standards of living, ensuring full employment, realising its aims in consonance with sustainable development and environmental protection and ensuring that developing countries were not excluded from the benefits of expanding international trade. However, it has since become a body primarily concerned with liberalising world trade, helping 'world trade flow as easily as possible'.³ The WTO provides for a rule-based multilateral trading system and as a result, globalises economic regulation.

A defining feature of the WTO is its DSM. Through it, members of the WTO can bring actions against other members who violate obligations under WTO agreements. If no solution is reached after the initial consultation stage, a panel is set up to hear the matter. Parties may appeal the panel decision before the Appellate Body. Panel and Appellate Body reports, once adopted by the Dispute Settlement Body (DSB), are binding on the disputing members and the country affected by the violation can take action against the violator if the recommendations are not implemented. As such, the WTO endorses a particular framework for the resolution of trade disputes which member countries are expected

to abide by. Hence, along with economic regulation, it globalises a particular legal culture.

The rules-based, legalistic nature of the WTO has a cultural background – that of western democracies. Peng (2000) postulates that the true basis of western civilisation and legal thought is the Magna Carta,⁴ the legal charter granting certain inalienable rights and ensuring that the King would be bound by law. However, this concept of the 'rule of law', the idea that the law is supreme and laid out in clear and strict terms, is still developing in East Asian countries.

Confucian thinking dominated many aspects of the traditional Chinese state, society and culture, and has a palpable influence on Chinese values today. Confucianism holds the values of forbearance and selflessness in high regard. This, coupled with its emphasis on a harmonious society, has shaped the Chinese legal tradition. Confucianism teaches that it is not desirable for one to assert one's rights, but rather to settle the matter and arrive at a compromise. Until recently the courts were seen as the last resort, and all litigation was tied to criminal procedure and punishment. Hence, to be involved in litigation of any nature was considered shameful.

This ethic is common to most East Asian countries and influences the approach and functioning of international bodies in which they hold a dominant position, such as Asia-Pacific Economic Cooperation (APEC). Here, decisions are reached on a more flexible and consensual basis and there is little of the strict legalism that characterises western legal systems and the WTO regime. This clearly evidences the fact that East Asia has a distinct legal culture that it is inclined to adopt even as it participates in international organisations.

Sequence of Events

China acceded to the WTO on December 11, 2001. In March the following year, it requested to join consultations initiated by the European Communities (EC) at the WTO challenging the US on its steel safeguard measures. Up until 2006, there was only one dispute brought against China before the WTO, and that was by the US. The complaint was against the partial refund of value-added tax allowed to enterprises in China on integrated circuit chips manufactured or designed in China. Following negotiations, China conceded to remove the impugned measures by way of a mutually agreed solution.

Apart from this, there were three incidents in which countries threatened to bring disputes against China before the WTO. In these situations China preferred to negotiate with the other country rather than be taken to court. For instance, on January 06, 2006, the US threatened to bring a dispute regarding anti-dumping duties imposed by China on US kraft linerboard in September 2005. China withdrew the measures three days later following an administrative review.

However, since 2006, and as of June 2010, there have been nine disputes (18 cases) brought against China. Of these, the US has been either sole complainant or co-complainant in all but the latest dispute, in which the European Union (EU) made a request for consultations just this May. Up until 2006, the George Bush administration had consistently opposed attempts in Congress to bring strong actions against China's economic policies, including, for the first time, bills calling for WTO litigation as a means of sanction. It saw China as an important source of cheap consumer goods and as a ready market for US exports. However, with the Democrat majority in both Houses following the 2006 midterm elections, the Bush administration was forced to change its policy. The sudden increase in US WTO litigation against China is reflective of this shift of power and also coincides with failed international negotiations between the two countries.

In March 2006, the EC, the US and Canada brought a dispute against China regarding measures it imposed on imports of automobile parts. The *Auto Parts Case* marks a change in the Chinese government's attitude towards the DSM. Far from compromising its interests in order

to save face, China saw the dispute through right to the Appellate Body stage. The US brought another three cases against China in 2007. The second dealt with the protection and enforcement of intellectual property rights (IPRs) and the third, instituted the same day, with trading rights and distribution services available for particular publications and audiovisual entertainment products and services. The US, the sole complainant in these two cases, received no backing from other countries on these issues.

It was at this point, when it found itself the subject of numerous complaints that China began to institute its own at the WTO. On May 29, 2007 and April 02, 2007, the US Department of Commerce made preliminary determinations, on anti-dumping and countervailing duties respectively, for imports of coated free sheet paper from China. The decision to impose countervailing duties on exports from a non-market economy has been described as 'an abrupt change of policy by the US, which broke a 23-year precedent'⁵. On September 14, 2007, China requested consultations with the US regarding these preliminary determinations. The dispute is still in the consultation stage. A number of complaints followed the *Coated Free Sheet Paper Dispute*, most of them regarding anti-dumping duties imposed on products imported from China. China has brought a total of seven disputes to the WTO since its accession, of which five are against the US and two against the EU.

Trade between China and the EU has grown vastly in the last couple of years. China is the EU's biggest trading partner after the US, but the EU runs a trade deficit with China and is its largest market.⁶ As a result, the number of trade disputes between the two is growing as well. On May 07, 2010, the EU instituted the most recent case against China, regarding anti-dumping duties imposed by China on EU iron or steel fastener imports.

In addition to this, China has participated in as many as 67 cases as a third party and is the fifth most frequent third party participant after Japan (99), the EU (94), the US (78) and Canada (71). Third parties to a dispute receive all documents in relation to the dispute and are allowed to make written and oral submissions. Generally, countries participate in this role if they have market access interests at stake, want to know how a particular agreement will be interpreted or require experience with the WTO litigation process. China has been involved as a third party in cases covering a wide variety of trade issues and products and gained a great deal from the experience.

Individual Cases: Lessons Learned

A closer look at some of the disputes illustrates the lessons China has learned regarding the DSM and the change in its attitude and approach over the years.

The US Steel Safeguards Case

China was one of the eight countries that challenged the US Steel safeguards in March 2002. This seemingly aggressive move by China soon after its accession is, perhaps, better described as an anomaly. It was the result of a combination of unique circumstances. The measures in question were an increase in import duties and a tariff rate quota on imports of certain steel products. On November 10, 2003, the Appellate Body upheld the Panel's ultimate conclusion that all the safeguard measures were inconsistent with US obligations under WTO laws.

Though some analysts hailed this as a significant victory for China, and saw in this episode, an emerging policy of 'aggressive legalism'⁷, a closer look of the surrounding circumstances suggests otherwise. First, amongst China's co-complainants there were major economic powers – the EC, Brazil, Japan and Korea – all experienced WTO disputants. Further, safeguard measures challenged before the WTO are very likely to be struck down⁸ and the measures in this particular dispute were subject to heavy criticism from the international community from the start. US officials themselves expected a negative ruling on the safeguards. Charlene Barshefsky, US Trade Representative during President Bill Clinton's second term, stated:

"We had concluded – and I had my office look at this closely – that the case was, at that time, a losing case. The notion that the US should initiate a losing case flew in the face of free-trade principles."⁹

Statements made by US officials during President Bush's term suggest that the government *wanted* the safeguard measures to be challenged before the WTO. The Bush Administration expected to lose the case, but made use of the year and a half long process to employ the safeguards for as long as possible. Besides, it feared that the EC would take stronger action allowed against safeguards, in the form of demand for compensation or suspension of concessions.

The 'victory' itself did little for Chinese industry. According to officials from the China Association for Iron and Steel Industries, the Chinese steel industry, which relied more on domestic markets at the time, was not greatly affected by the safeguards measure in the first place. The officials said the exercise was more significant in that it allowed China to get a sense of how to use the WTO DSM.¹⁰

The VAT Rebate Case

The *VAT Rebate case* was the first complaint brought against China in the WTO since its accession, and the Chinese government was embarrassed at having been 'dragged to court' before the international community. It preferred to settle the matter quietly rather than go through the shameful process of litigation.

On March 18, 2004, the US lodged a complaint against China over rebates on value-added tax allowed to enterprises in China on integrated circuit (IC) chips manufactured or designed in China. The US argued that this violated China's obligations under Article I (Most-Favoured Nation Treatment Obligation) and Article III (National Treatment Obligation) of the General Agreement on Tariffs and Trade (GATT) 1994, the Accession Protocol and Article XVII (National Treatment Obligation in service sectors) of the General Agreement on Trade in Services (GATS).

On July 14, 2004, following four rounds of consultations, China signed a memorandum of understanding with the US in which it agreed to revoke the rebate applicable to firms producing the ICs in China by April 01, 2005. Until then it would only be available to those manufacturers eligible to avail of it as of July 14, 2004. China undertook to revoke the rebate applicable to ICs designed in China but manufactured abroad, with effect from October 01, 2004.

The Coke Export Quotas Case

As far as the *VAT Rebate Case* is concerned, one might argue that China's conciliatory approach could be explained by the fact that it didn't have a strong legal position or vital economic interests to defend. In response, Gao (2005) explains that China's initial reluctance to engage in WTO litigation is unequivocally demonstrated by the manner in which it handled its dispute with the EC regarding export quotas on coke.¹¹ Coke is produced from coal and is used in the manufacture of steel. China is the largest producer of coke in the world¹² and supplied more than one third of the EU's total consumption of coke in 2003. The process of converting coal into coke causes a great deal of environmental pollution. Many coke production units in the EU were forced to shut down due to environmentalist movements. At the same time, the EU is home to some of the largest steel manufacturing companies in the world. These factors increased the bloc's demand for coke from China. Meanwhile, the Chinese government, also concerned with the pollution issue, called a meeting regarding coke exports in July 2003.

Many experts suggested that China reduce its coke exports to curb pollution. On January 01, 2004, China announced its decision to reduce its export quota on coke by 26 percent from 12 million tonnes (in 2003) to 9 million tonnes, in order to meet domestic demand. On March 31, 2004, an agitated EU threatened to bring China before the DSM unless it removed the measure and on May 09, 2004, announced a five-day deadline, which was eventually extended to May 28, 2004. The EU and China reached an agreement whereby China would not only continue to supply the same amount of coke in 2004 to the EU as it had in 2003, but also remove the export permit fee, reducing the price from US\$450 to US\$250 per MT.

China certainly could have made a case defending the restrictions on the basis of exceptions provided under WTO laws – exceptions regarding the protection of life and health, conservation of exhaustible natural resources, securing of essential quantities of domestic materials for a domestic processing industry in certain situations, and so on. Instead of allowing litigation to ensue, it chose to settle the matter and concede strong economic interests. Litigation aside, China could have protected the measures by modifying the form they took or the purpose they averred to fulfill through careful legal drafting.

The Auto Parts Case

The *Auto Parts case* illustrated the Chinese government's realisation that, in order to survive in the WTO regime, it would have to shed its inhibitions regarding the dispute settlement system and learn to use it to its fullest advantage. There are certain loopholes inherent in the system and China was able to utilise them in this case.

On March 30, 2006, the EC, the US and Canada requested consultations with China regarding measures imposed on their imports into China of automobile parts used to manufacture vehicles to be sold in China. They claimed the measures effectively discouraged Chinese manufacturers from using imported automobile parts. China's response was noticeably calmer in this case. Chong Quan, a Ministry of Commerce spokesman, merely said:

"The Chinese side expresses *regret* over this and is earnestly studying the request for consultations by the EU and the US."¹³ (Emphasis supplied.)

China determinedly saw the case through the full course of the dispute settlement process, even filing an appeal against the Panel decision. However, the Appellate Body for the most part upheld the Panel decision and China notified the DSB that it would implement the necessary reforms on September 01, 2009.

China did not limit itself to legal argumentation in order to protect its economic interests, but took advantage of certain loopholes in the system. The first such loophole is the fact that no retrospective compensation can be claimed from the respondent even if it is found that the impugned measures caused unjust damage to the complainant or undue benefit to the respondent. Consequently, it is in the respondent's interest to postpone an unfavourable judgement and benefit from the measures imposed until it is delivered. The measures were instituted as part of a long-term plan aimed at ensuring that by 2010, half of all automobile sales come from internationally competitive Chinese companies and exports of auto parts surpass 40 percent of all parts sales. This gained priority over the government's reluctance to engage in WTO litigation.

The second loophole to be noted is the fact that even when it is found that a measure is inconsistent with WTO agreements, the DSB only calls for compliance

and does not specify what qualifies as compliance. Within a month of the release of the Panel Report, the government announced a 'green tax' system on cars, with higher taxes imposed on cars with larger engine capacities. It is foreign automobile manufacturers that manufacture cars and parts for cars with larger engine capacities. This indirectly achieved what the impugned measures could not.

The EU Footwear Case

The *EU Footwear case* illustrates the growing involvement of Chinese industry in trade disputes. The EU Council adopted a resolution on October 05, 2006 imposing a definitive anti-dumping duty on imports of footwear with leather uppers from China and Vietnam into the EU. The duties of 16.5 and 10 percent on Chinese and Vietnamese imports respectively, were 'aimed at protecting the EU footwear market'.¹⁴ The move drew strong criticism not only from the Chinese government, but also from consumer groups and EU shoe manufacturers, like Nike, Adidas and Puma, with operations in China. Shoe manufacturers brought a series of cases against the Council resolution before the General Court, a branch of the European Court of Justice.

However, on March 04, 2010, the Court held that the duties were correctly calculated and legally imposed. It was only when the EU Council extended the measures for another 15 months in December 2009 however, that China resorted to the WTO DSM. Yao Jian, a spokesman for the Ministry of Commerce, said that China was 'strongly dissatisfied' with the Council's decision.¹⁵ A Panel was established on May 18, 2010 but has not yet been composed.

The EU-China Steel Fasteners Cases

The majority of the complaints brought by China to the WTO have challenged anti-dumping measures imposed on Chinese imports. All of these are pending, while the impugned measures continue to be in force. One such complaint was raised against the EU on July 31, 2009 in relation to antidumping duties imposed on imports of iron or steel fasteners from China. The Panel expects to complete its work by September 2010. In the meantime, the Chinese government seems to have taken matters into its own hands by imposing 'corresponding measures' in the form of anti-dumping duties on imports of iron or steel fasteners from the EU.

Consequently, the EU instituted a case against China on May 07, 2010 challenging these duties. The EU took issue with, *inter alia*, Article 56 of the Chinese Anti-Dumping Regulations, which states:

"...where a country (region) discriminatorily imposes anti-dumping measures on the exports from the People's Republic of China, China may, on the basis of actual situations, take corresponding measures against that country (region)..."¹⁶

A Panel is yet to be established to hear the EU's complaint. China has effectively bypassed the system

by imposing corresponding measures without waiting for the Panel's decision on the legality of the EU's anti-dumping duties. It has succeeded in turning the tables on the EU, which until now enjoyed the benefit of a drawn-out WTO dispute.

Lessons for China from Brazil

Those who argue that the WTO DSM *can* be made to work for developing countries quote Brazil as an example. It is considered one of the most successful WTO disputants in terms of the way in which it has used the system to its advantage. A study of how it has achieved this capability could provide valuable lessons for developing countries like China.

Brazil's participation in the dispute settlement system under the GATT prepared it for the still more legalised WTO system. However, the country did face certain challenges. Brazil dealt with these challenges first by evolving a 'three pillar' institutional structure to deal with WTO disputes. This consists of a specialised body that deals with WTO dispute settlement at Brasilia, Brazil's WTO mission in Geneva, and the Brazilian private sector along with the legal resources it supplies. Secondly, there has been considerable investment by both the public and private sector in developing expertise in trade law and policy. Finally, Brazil's Ministry of Foreign Affairs has competent trade law and dispute settlement professionals and the country has allocated sufficient resources on dispute settlement. These three factors of an institutional setup, public-private investment and involvement, and the focus on training trade law and dispute settlement experts have enabled Brazil to become a successful WTO disputant.

China, like Brazil, adheres to the civil law system and has faced many of the same challenges that Brazil did in its engagement with the WTO DSM, such as the emphasis on fact-finding in Panel hearings. Nevertheless, while private interest groups and industry play an important role in the DSM in Brazil, the US and the EU, it is the Chinese government that dominates China's participation. Enterprises in China with a direct stake in the outcome of dispute settlement process have had little influence over what happens at the global level.

Over the last couple of decades, China has been in the process of enacting various civil laws in order to fill the traditional void in its legal system. The most recent is a tort law code, which came into effect on July 01, 2010. China has recognised the need for civil laws, and civil compensation over administrative penalties to enforce civil laws, in order to engage with the WTO system but further action is required.

In the years leading up to and following China's accession to the WTO, Chinese lawyers and researchers were urged

to learn about WTO laws and its dispute settlement process. "We are newcomers to the WTO. We still need some time to build up full capacity," states Xiao Jin,¹⁷ a WTO lawyer for King & Wood, a PRC Law firm that has worked with foreign lawyers and the government on some WTO cases. China has largely used foreign lawyers for DSM hearings. Nevertheless, Chinese lawyers have a better understanding of Chinese laws and are better placed to explain their background and rationale before an international panel, and so developing domestic expertise should be a priority. China has managed to increase its institutional involvement in the WTO recently. In November 2007, Zhang Yuejiao was appointed as a judge in the Appellate Body, becoming its first Chinese member.

Conclusion: China as a Successful WTO Disputant

The DSM forms an integral part of the WTO system, and dispute settlement a vital component of foreign trade policy. The study of China's WTO disputes and trade dispute settlement setup shows that though it has understood this, it is yet to become what is considered a successful WTO disputant. In order to effectively handle disputes, the government will have to utilise the resources available with the private sector. Major institutional and legal reforms will be required to facilitate private involvement in the process.

Up until 2006 China participated in just two WTO disputes as a respondent or complainant. As a respondent in the *VAT Rebate case* it settled the matter early on and as a co-complainant in the *Steel Safeguards case* it gained exposure to the DSM alongside experienced disputants. Aside from this, where it perceived a matter would be taken to the DSM, China preferred to compromise economic interests rather than be dragged to court. China's change in attitude followed an onslaught of WTO litigation targeting sensitive sectors such as its domestic automobile industry. The new approach, aside from being more aggressive, made use of loopholes in the WTO DSM. More than half the claims brought by China have involved anti-dumping measures on Chinese goods. Even as they remain pending at various stages of the DSM, China has countered these actions with corresponding measures (in the *EU-China Steel Fasteners cases*).

In the midst of the global crisis and rising protectionist tendencies, as well as trade surpluses with some of its major trading partners, China must expect to be heavily litigated against in the coming years. A study of the disputes and China's increasing willingness to engage in WTO litigation has demonstrated that it has slowly but surely accepted the legal culture of the WTO regime. It must now embrace major structural and foreign policy changes in order to become a successful disputant and protect its trade interests.

Annexure I : Tables – China as a WTO Disputant

China as a Respondent

Date of Request for Consultations	Complainant	Dispute	Stage	Outcome
March 18, 2004	US	Value-Added Tax on Integrated Circuits	Mutually agreed solution (Pre-Panel)	Against China
March 30, 2006 (EC, US, Canada)	European Communities/ US/Canada	Measures Affecting Imports of Automobile Parts	Appellate Body Report	Against China
February 02, 2007 (US) February 26, 2007 (Mexico)	US/Mexico	Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments	August 31, 2007: Panel established; December 19, 2007: MoU between China and US; February 07, 2008: MoU between China and Mexico	Compromise
April 10, 2007	US	Measures Affecting the Protection and Enforcement of Intellectual Property Rights	Panel Report Implementation: US & China – agreed procedures under Art. 21, 22, DSU	Against China
April 10, 2007	US	Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products	Appellate Body Report	Against China
March 03, 2008 (EC, US) June 20, 2008 (Canada)	European Communities/ US/Canada	Measures Affecting Financial Information Services and Foreign Financial Information Suppliers in China	December 04, 2008: Informed of MoUs with EC, US and Canada	Compromise
December 19, 2008 (US, Mexico) January 19, 2009 (Guatemala)	US/Mexico/ Guatemala	Grants, Loans and Other Incentives	In consultations	NA
June 23, 2009 (US, EU) August 21, 2009 (Mexico)	US/EU/Mexico	Measures Related to the Exportation of Various Raw Materials	March 29, 2010: Panel composed	NA
May 07, 2010	European Union	Provisional Anti-Dumping Duties on Certain Iron and Steel Fasteners from the European Union	May 07, 2010: EU requested consultations with China	NA

China as a Complainant

Date of Request for Consultations	Respondent	Dispute	Stage	Outcome
March 26, 2002	US	Definitive Safeguard Measures on Imports of Certain Steel Products	Appellate Body Report	Against US
September 14, 2007	US	Preliminary Anti-Dumping and Countervailing Duty Determinations on Coated Free Sheet Paper from China	In consultations	NA
September 19, 2008	US	Definitive Anti-Dumping and Countervailing Duties on Certain Products from China	March 04, 2009: Panel composed	NA
April 17, 2009	US	Certain Measures Affecting Imports of Poultry from China	September 23, 2009: Panel composed	NA
July 31, 2009	European Communities	Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China	December 09, 2009: Panel composed	NA
September 14, 2009	US	Measures Affecting Imports of Certain Passenger Vehicle and Light Truck Tyres from China	March 12, 2010: Panel composed	NA
February 04, 2010	European Union	Anti-Dumping Measures on Certain Footwear from China	May 18, 2010: Panel established, not composed	NA

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