

Section 4

TOWARD THE ESTABLISHMENT OF TRADE RULES TO CALM THE ESCALATING FRICTION BETWEEN THE U.S. AND CHINA

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1. Hegemonic U.S. and Emerging China

Friction between the United States and China has escalated beyond trade disputes to encompass economic and security tensions. In the postwar period, particularly since 2000, economic globalization has deepened the interdependence between global economic growth and the distribution of its benefits. Nevertheless, the struggle for supremacy in the international order has intensified in the realm of international politics. Over the past 70 years since the end of World War II, by confining power struggles to security and political domains, economic globalization has achieved relative stability, contributing to global economic welfare, even for smaller nations. It would be unacceptable for a bilateral dispute to dismantle this entire framework. Although the parties involved prioritize their own interests, they may seek to de-escalate tensions when their interests begin to deteriorate.

This section will examine the structural factors underlying current economic frictions and, based on these insights, explore updates to the framework that has supported globalization, as well as measures necessary to ease tensions.

2. The Economic and National Power Balance between the U.S. and China

China's vast population has long established it as the world's second-largest economy in terms of total GDP. Almost every country trades with China, and many count it as their largest trading partner. This sheer scale endows China with significant bargaining power, which can occasionally be wielded for coercion. Consequently, debates often center around which nation has the largest total GDP and whether China will surpass the U.S. in economic size.

From an economic perspective, however, GDP per capita provides a more nuanced indicator of national power and qualitative development. As shown in [Figure 1-4-1](#), the disparity in GDP per capita between the U.S. and China remains substantial, demonstrating that China is not yet positioned to assume global leadership. Nevertheless, China harbors aspirations for dominance,

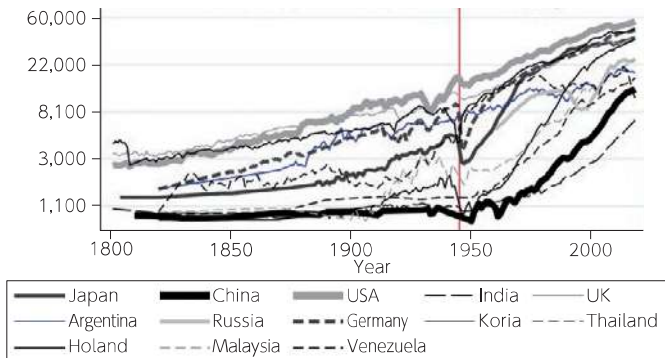


Figure 1-4-1 GDP per capita since 1800 (\$, log)

Note 1: Red line indicate 1945.

Note 2: Standardized using 1990 PPP.

Source: Maddison Project Database, version 2020

exacerbating tensions with the U.S.

China's recent economic growth has been facilitated by its adherence to globalization trends. When China joined the WTO in 2001, it committed to challenging entry conditions, including reductions in tariffs, elimination of non-tariff barriers, and market access for services. Over the past two decades, China has worked steadily to address these issues while maintaining that its subsidies and industrial policies are consistent with existing WTO agreements. However, persistent and intensifying U.S. criticisms in recent years may have left China feeling disoriented.

Despite China's rapid development since its WTO accession, it remains far from being a developed nation. For instance, it imports more integrated circuits than resources such as oil or natural gas, underscoring its dependency on foreign semiconductor supplies. While recognizing the strategic importance of semiconductors, China lacks the capacity for self-sufficiency in this critical sector, reinforcing its status as an emerging economy.

3. Mutual Distrust between the U.S. and China

(1) The "No. 1 vs. Others" Framework

A significant source of mutual distrust lies in the lack of a robust enforcement mechanism within the international order. Unlike domestic legal systems, international rules lack a centralized authority akin to a court, making enforcement fundamentally difficult. As the world's leading power, the U.S. benefits from the

absence of binding rules, enabling it to sidestep international norms. Historically, the U.S. has demonstrated a tendency to disregard rules when convenient.

Conversely, China, as the No. 2 power, relies heavily on international rules to counterbalance the influence of the No. 1 power. China's skepticism regarding the U.S.'s commitment to rules-based governance has grown over time, particularly since 2015, when China began prioritizing its own national security.

Upon its WTO accession, China accepted stringent commitments beyond standard WTO obligations, including provisions on state-owned enterprises, intellectual property rights, and technology transfers. It also agreed to forgo non-market economy treatment by 2016. However, the U.S. withheld recognition, arguing that conditions were not met, exacerbating bilateral tensions.

The U.S.'s approach to disciplining China has evolved over time. During the Obama administration, the U.S. adhered to a "rules-based" principle, filing WTO complaints about China's alleged hidden subsidies and trade distortions. These cases often failed due to legal deficiencies. Under the Trump administration, the U.S. shifted to unilateral actions, including Section 301 investigations, tariffs citing national security concerns, and export restrictions targeting Chinese technology firms such as Huawei. The Biden administration has maintained a similarly tough stance, implementing industrial policies designed to exclude China, such as the Inflation Reduction Act, which restricts imports of electric vehicles using Chinese batteries.

(2) Economic-Security Intersections

The intersection of economic and security issues has become increasingly pronounced. Historical examples, such as the League of Nations' use of economic sanctions, illustrate the risks of weaponizing the economy. Despite their initial intent to deter aggression, such measures often failed, leading to the breakdown of international stability.

The WTO, founded in the aftermath of World War II, sought to avoid such outcomes by establishing principles such as the prohibition of unilateral measures and the elimination of economic blocs. However, modern trade dynamics, particularly the rise of technologies like semiconductors, necessitate the redefinition of rules governing security exceptions.

4. Disciplining Authoritarian Regimes Effectively

(1) The Stabilizing Role of Trade Rules

Ultimately, the discipline provided by trade rules helps prevent a great depression, even in the face of an intensified international political environment.

Nevertheless, economic friction between China, the U.S., and Europe shows no signs of subsiding, and further measures will be required.

In fact, the use of trade rules has expanded as a response to growing economic frictions. [Table 1-4-1](#) below outlines how the Japanese government has utilized trade rules. The Trade Organization Division of the Trade Policy Bureau within the Ministry of Economy, Trade and Industry (METI) established a subcommittee to investigate unfair trade policies and practices. This subcommittee compiles the Report on Compliance by Major Trading Partners with Trade Agreements, which addresses actions taken by foreign countries that appear inconsistent with existing rules. Following the annual publication of this report, METI formulates its annual action policy in the METI Priorities Based on the Report on Compliance by Major Trading Partners with Trade Agreements. [Table 1-4-1](#) summarizes the issues METI has prioritized in response to economic and trade frictions.

When concerns arise regarding a trade policy or measure, bilateral and multilateral consultations are initially conducted, with the possibility of initiating WTO dispute settlement procedures. Depending on the outcomes of these consultations, the WTO dispute settlement process may be formally invoked. Once a dispute is resolved, WTO recommendations are monitored to ensure compliance. In recent years, the WTO has increasingly addressed issues requiring close attention even before formal consultations are initiated.

From these developments, several observations can be made. First, the number of economic and trade disputes highlighted in the Japanese government's "priorities" has risen sharply since 2015, when China began prioritizing national security, and 2017, when the Trump administration took office in the U.S. Second, these disputes primarily involve China and the U.S. While most issues concern China, there are also longstanding disputes with the U.S. Between 2015 and 2024, a total of 44 trade policies and measures were identified as potentially violating trade rules.

Of these, 16 disputes involve China. Some of these cases have been resolved through WTO dispute settlement procedures. However, many are categorized as "Aiming to resolve the issue through bilateral and multilateral consultations with a view to initiating WTO dispute settlement procedures," and some have not advanced to formal WTO dispute resolution. These include issues such as the "Improper operation of anti-dumping," "Industrial subsidies," and "Cybersecurity laws." Numerous problems related to China remain inadequately addressed under the existing rules.

Meanwhile, six disputes involve the United States. Unfair antidumping practices by the U.S. have consistently been a bilateral issue. Although complaints

have been filed with the WTO and recommendations have been issued, these recommendations have not been implemented.

(2) Industrial Policy Competition and the Risks of Authoritarianism

The first issue is that competition through industrial policy has a significant potential to result in “international market failure.” A mechanism is needed to prevent this.

Currently, existing rules allow for measures such as (1) anti-dumping and safeguards, (2) consultations in international forums, and (3) the use of WTO dispute settlement procedures regarding subsidy agreements. However, there is no discipline addressing (4) the fair and effective distribution of economies of scale.

Historically, during periods of economic friction between Japan and the United States, Japan sought to mitigate tensions through political negotiations. These efforts led to measures such as voluntary export restrictions, the expansion of voluntary imports, and the distribution of economies of scale through “horizontal division of labor” via overseas direct investment. However, these measures were temporary and ad hoc. Currently, there is no room for such “temporary measures” in the context of U.S.-China relations.

As a result, “power play” policies that interfere with supply chains, such as decoupling, friend-shoring, and collaboration among like-minded countries, have been proposed. However, decoupling China does not address the fundamental problem. Political pressure might prompt China to alter its behavior, but it has also spurred China to seriously focus on developing domestic industries to reduce its vulnerability to such pressures. If this trend continues, conflicts are likely to intensify, increasing the risk of economic frictions spilling over into security issues.

Second, if the characteristics of the Chinese system, often described as authoritarian, create unfairness in international transactions, effective regulatory rules must be established. The issues to be addressed include the following:

Lack of Rule of Law: In China, the state is not ultimately subject to the constraints of its own laws. The Chinese Communist Party, a private group, holds the exclusive authority to enact the constitution, while the people lack this right. Consequently, the legal system is inherently unstable, and the enforcement of laws lacks consistency. This instability is a fundamental issue within the Chinese system.

Discriminatory Treatment of Enterprises: The Chinese government treats enterprises differently based on ownership type—state-owned, foreign-owned, or privately-owned—resulting in discrimination. Such practices distort market

competition and create unfair outcomes.

Security Exemptions: The Xi administration has prioritized national security above all else, broadly applying security exemptions to justify its policies.

At present, China does not possess the strength to become a hegemonic power. However, its impatience to secure its position drives a strong sense of urgency, potentially pushing China toward attempts to alter the international order to meet its objectives. In doing so, China risks disregarding the interests of other nations while prioritizing its own national security.

While China is free to adopt its own system, if that system unilaterally affects other countries, new regulations are required. It is important to clarify these issues, organize specific challenges, and engage in discussions with China to find mutually acceptable compromises.

In 2023, there were rumors about a crisis surrounding the potential collapse of the WTO, partly due to arbitrary lawsuits from the United States and other factors. However, we cannot afford to remain idle; proactive measures are needed to prevent such a collapse. Reforming WTO rules is essential. Following issues are important. **Regulating Arbitrary State Actions:** Discussions should focus on mechanisms to regulate arbitrary actions by states. **Improving Trade Rules:** Efforts should aim to enhance rules to separate economic transactions from political agendas. **Balancing Security and Economic Growth:** Effective methods must be identified to balance security concerns with economic development.

Additionally, in cases involving military aggression, such as Russia's invasion of Ukraine, mechanisms to impose appropriate penalties in the context of globalization are essential.

Maintaining the WTO's dispute settlement procedures is also crucial. These mechanisms can help prevent China from weaponizing its economy and increase the costs associated with such deviations.

Regarding security exceptions, it is important to note a significant difference between the CPTPP and the RCEP. The RCEP, which includes China, allows each member country to define its own security exceptions. In contrast, the CPTPP imposes an obligation on member countries to explain why a given issue qualifies as a security exception and to implement it accordingly. If China seeks CPTPP membership, addressing this requirement will be a fundamental issue in accession negotiations. Furthermore, if the EU adopts regulations similar to those of the CPTPP, these principles could potentially be integrated into the WTO framework.

Many countries, including China and Vietnam, participate in the current free trade framework while maintaining authoritarian market regimes. Rather than resorting to measures like just isolating or pressuring China, it is crucial to

establish regulations that address government actions distorting competition. This approach is essential to ensure the coexistence of these two systems within the global trade order.

References

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Table 1-4-1

Changes in the “Ministry of Economy, Trade and Industry Policy on Initiatives in Response to the Unfair Trade Report”

2015	2016	2017	2018	2019
1. While the details are unclear, a significant impact on trade and investment is expected, so the implementation requires particular attention.				
<div>(Legend)<div><div>China</div><div>U.S.</div><div>Other</div></div></div>			<div>⑧ China: Export Control Law</div> <div>⑨ China: Foreign Investment Law (New)</div>	
2. Aiming to resolve the issue through bilateral and multilateral consultations with a view to initiating WTO dispute settlement procedures.				
<div>① China: Correcting the inappropriate system and operation of Anti-Dumping (AD) measures.</div> <div>② China: Correcting the regulations on IT equipment security in banking (New)</div> <div>③ Russia: Correcting of the tariff concession violations due to mixed taxation (a combination of ad valorem and specific taxes)</div> <div>④ U.S.: Improvement of the Sunset Review (the final review for the continuation of AD measures) and the early repeal of AD measures against Japan that have been in place for an unjustifiably long time.</div> <div>⑤ Brazil: Correction of discriminatory systems and practices in the application of industrial law and other tax systems</div> <div>⑥ Indonesia: Ensuring the WTO-consistent implementation of the New Industry Law, the New Trade Law, and related regulations (including franchise regulations and retail industry regulations that stipulate local content requirements)</div> <div>⑦ Indonesia: Corrective action on export restrictions on mineral resources (nickel, etc.)</div> <div>⑧ China: Corrective action for safeguard measures (hot-rolled steel sheets) (New)</div> <div>⑨ Korea: Sunset Review of Stainless Steel Bars (Terminal Review Concerning Continuation of Anti-Dumping (AD) Measures)</div> <div>⑩ India: Corrective action for safeguard measures (hot-rolled steel sheets) (New)</div> <div>⑪ Korea: Sunset Review of Stainless Steel Bars (Terminal Review Concerning Continuation of Anti-Dumping (AD) Measures)</div> <div>⑫ U.S.: Restrictions on imports of steel and aluminum products based on Section 232 of the Trade Expansion Act of 1962 (New)</div> <div>⑬ Vietnam: Imported Vehicle Certification System (New)</div> <div>⑭ India: Increase in customs duties on IT products (New)</div>				
3. Those that have already started WTO dispute settlement procedures				
<div>⑮ China: Correction of AD duties on high-performance seamless stainless steel pipes from Japan</div> <div>⑯ Korea: Correction of AD measures on pneumatic valves (New)</div> <div>⑰ Brazil: Correcting discriminatory tax benefits for automobiles and other products</div> <div>⑱ India: Safeguard (SG) measures for hot-rolled coils</div> <div>⑲ Korea: Sunset Review on Stainless Steel Bars (Terminal Review on the Continuation of Anti-Dumping (AD) Measures) (Consultation)</div> <div>⑳ India: Tariff measures on ICT products - (Consultation)</div> <div>㉑ Korea: Support measures for the domestic shipbuilding industry (Consultation)(New) Initiatives by the Ministry of Land, Infrastructure, Transport and Tourism</div> <div>㉒ Ukraine: Correcting the safeguard measures on passenger cars</div>				
4. We will seek early implementation of the WTO recommendations				
<div>㉓ China: Corrective action for export restrictions on raw materials (rare earths, etc.)</div> <div>㉔ U.S.: Complete abolition of zeroing (an inappropriate method of calculating AD tax)</div> <div>㉕ U.S.: Suspension of the distribution of AD tax and countervailing duty revenue from goods that have cleared customs based on the Byrd Amendment to US companies</div> <div>㉖ Argentina: Correcting import restrictions on a wide range of items</div> <div>㉗ Brazil: Discriminatory tax benefits for automobiles and other products</div>				
2015	2016	2017	2018	2019

Source: Prepared by the author from the Ministry of Economy, Trade and Industry's "Policy for Addressing the Issues Raised in the Unfair Trade Report" for each year.

