Briefing Paper

Asia-Pacific Programme
December 2021

China’s approach to global economic governance

From the WTO to the AIIB

Summary

— Over the past 20 years, China’s trade and development finance objectives and Western concerns about these have remained relatively consistent. China has adopted a multifaceted approach to global economic governance that combines both bilateral and multilateral tools as well as a mix of cooperative and confrontational tactics.

— Domestic needs, strategic concerns and the country’s development experience all drive this approach. For the foreseeable future, China will continue to combine cooperative multilateral engagement with ‘outside options’ – in the form of bilateral or regional cooperation – to stimulate internal reforms in existing global institutions, such as the World Bank.

— When multilateral institutions have impeded China’s pursuit of its trade objectives, the country has instead taken an alternative approach, such as through regional trade agreements. However, this route has only been successful with buy-in from major partners.

— In development finance, China pursues both bilateral and multilateral approaches. Bilateral lending allows Beijing to mitigate overcapacity in industries, facilitate Chinese enterprises’ global expansion, stimulate trade with recipient countries, and increase influence in the developing world. Meanwhile, engagement with the World Bank and the Asian Development Bank (ADB), as well as new co-established financial institutions, like the Asian Infrastructure Investment Bank (AIIB), helps China to gain influence in setting rules and norms.

Jue Wang and
Michael Sampson

CHATHAM HOUSE

LEIDEN ASIA CENTRE

Introduction

China's entry into the World Trade Organization (WTO) on 11 December 2001 marked the culmination of the country's long-standing effort to integrate into the global economy, following its repeated economic reforms since the late 1970s. In the last two decades, the world economy and China's place within it have changed dramatically. The country's gross domestic product (GDP) has grown more than tenfold from just over $1.3 trillion in 2001 to $14.7 trillion in 2020.[1] It was the world's fifth-largest exporter of goods in 2001, with a 4.7 per cent share of global exports; that figure stands at almost 15 per cent in 2021, making it by far the largest exporter.[2] Even against the backdrop of the COVID-19 pandemic, China's share of global exports has continued to increase.[3]

In addition, China is also the largest sovereign creditor in overseas development finance and is now ranked third in terms of voting share and voting power in the International Monetary Fund (IMF) and the World Bank, respectively. The country is increasingly assertive in pushing for WTO reforms and is a driving force behind many regional trade agreements. More recently, China has also co-created new institutions that provide development finance, such as the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB). After 20 years as a WTO member, what do these developments say about China's global economic governance objectives and strategies?

This paper argues that the discontinuities between the approaches of China and the West to trade and development finance should not be overstated, despite recent rising tensions. China has consistently adopted a multifaceted approach to global economic governance since joining the WTO – and this is likely to continue. In this paper, 'multifaceted' refers to Beijing's pursuit of a mix of cooperative and confrontational approaches to economic governance, and often a combination of both, particularly where 'outside options' exist.[4] Outside options are the alternative mechanisms that China uses to achieve goals that are difficult to secure within multilateral institutions. For example, the use of regional trade agreements to secure recognition of China's market economy status, which the WTO does not acknowledge. While China has generally pursued consistent goals, its growing assertiveness, improved economic position and outward economic expansion – rather than any fundamental change in policies and objectives – have led to increasingly tense confrontations with the West.

The concerns of Western states *vis-à-vis* China have remained relatively consistent in the past two decades. These persist over the role of indirect state subsidies via China's state-owned enterprises (SOEs), China's status as a developing country in the WTO, forced technology transfers from Western multinationals, poor environmental and social governance in Chinese-funded development projects,

1 World Bank (undated), 'GDP (current US$) – China', https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=CN (accessed 1 Nov. 2021).
2 UNCTAD (2021), 'Evolution of the world's 25 top trading nations', https://unctad.org/topic/trade-analysis/chart-10-may-2021.
3 Reuters (2021), 'China's export share grew in pandemic but may be near peak, UNCTAD says', 27 April 2021, https://www.reuters.com/world/china/chinas-export-share-grew-pandemic-may-be-near-peak-unctad-says-2021-04-27.
4 Lipscy, P. Y. (2017), *Renegotiating the World Order*, Cambridge: Cambridge University Press, https://doi.org/10.1017/9781316570463.

and a lack of policy conditionality on its development finance initiatives. Clearly the role of SOEs, the advantages China derives from its developing-country status at the WTO, and its development finance initiatives have an increasing impact on global economic governance as the country's share of world GDP grows. It is unsurprising then that the Western response to the country has intensified in line with China's economic development.

Many countries are now querying whether China's approach to global economic governance strengthens or undermines the liberal international order. However, asking this question has little value.[5] China is already a crucial component of the economic liberal international order and has benefited substantially from being integrated into it. The international trade regime has ensured that China has faced relatively low tariffs for its exports, allowing it to maximize its advantage of low labour costs. China's WTO membership and international trade rules have also allowed it to commit credibly to economic liberalization in ways that would have otherwise been difficult.[6] Similarly, China's participation in the global investment regime, in the form of 145 bilateral investment treaties and membership of the International Centre for Settlement of Investment Disputes (ICSID), has allowed Beijing to attract foreign investment.[7]

Many countries are now querying whether China's approach to global economic governance strengthens or undermines the liberal international order.

While the liberal international order has been crucial in facilitating the economic development of China, countries around the world are now more reliant than ever on China-based manufacturing and supply chains.[8] The country's deeper integration into the global economy has already changed the liberal international order, due to the unique relationship that exists between state and market in China and the country's centrality in the global trading system. China's overseas development finance is offered mostly in the form of non-concessional loans from national development banks, state-owned commercial banks, other investment corporations and non-financial SOEs. As is the case for its domestic development projects, the central government does not subsidize loans for foreign investment; instead, creditors raise funds in the domestic and global capital markets. This model is described as 'market-based, state-supported', rather than fully state-backed. This could be interpreted as China exporting its domestic development finance model, which reflects its unique state–market relationship.[9]

5 Kastner, S. L., Pearson, M. M. and Rector, C. (2020), 'China and Global Governance: Opportunistic Multilateralism', *Global Policy*, 11(1): p. 165, https://doi.org/10.1111/1758-5899.12772.
6 Hale, T. (2016), 'International Sources of Political Order in the People's Republic of China: A Lacuna in the Fukuyama Framework', *Journal of Chinese Governance*, 1(3): p. 432, https://doi.org/10.1080/23812346.2016.1216760.
7 Ibid.
8 Javorcik, B. (2020), 'Global Supply Chains Will Not Be the Same in the Post-COVID-19 World', in Baldwin, R. E. and Evenett, S. J. (eds) (2020), *COVID-19 and Trade Policy: Why Turning Inward Won't Work*, London: Centre for Economic Policy Research Press, p. 111, https://voxeu.org/content/covid-19-and-trade-policy-why-turning-inward-won-t-work.
9 Chen, M. (2020), 'Beyond Donation: China's Policy Banks and the Reshaping of Development Finance', *Studies in Comparative International Development*, 55(4): pp. 436–59, https://doi.org/10.1007/s12116-020-09310-9.

Furthermore, China's rapidly expanding role in development finance and its growing share of global trade have led to broader geopolitical concerns as well as questions over environmental contamination, labour treatment, land acquisition and gender equality. To address these issues, the international community must pay more policy attention to developing countries, where Chinese-funded projects have real impacts on local communities, instead of overemphasizing debates around China vs the West. In line with its previous approach, it is likely that China will continue to adopt a cooperative stance on the multilateral level while keeping its outside options open through bilateral and regional cooperation. Understanding why China chooses to pursue this strategy demands a more nuanced assessment of the factors driving its preferences and strategies.

Understanding China's multifaceted approach

Three key elements are driving China's approach to global economic governance: the domestic economy, strategic concerns and development experience. Firstly, especially since its investment- and export-driven economic growth started to slow in 2008, the Chinese government has implemented a series of measures to reform and 'upgrade' the domestic economy. It has striven to reduce overcapacity in traditional heavy industries; boost exports of China's so-called 'advantage industries' including telecommunications, high-speed railways and renewable energy;[10] push for technological upgrades in manufacturing; support central SOEs in strategic industries; and tighten financial regulation to maintain stability. Unsurprisingly, China mobilizes resources in international economic institutions to help achieve these domestic objectives.

Secondly, China's increasing engagement in the global economy, through trade and overseas investment and lending, has also led to confrontation with its geopolitical and economic competitors and partners (including recipients of Chinese funds). To improve the outcomes of these clashes, China has sought to lobby the political elites in recipient countries and promise financial rewards to boost its strategic position in bilateral relationships. It has made efforts to increase its power in multilateral governance institutions to give China more say in establishing rules and norms in various economic areas.

Finally, China's own development experience shapes the country's approach to global economic governance. This includes prioritizing physical over social infrastructure, limiting foreign political intervention attached to economic assistance, maintaining the dominance of SOEs in key industries, and adopting a hybrid market-based economic model with state support mechanisms.[11]

It is unsurprising that China has sought to change aspects of the global economic governance system that was largely constructed prior to its own dramatic economic development.[12] However, its efforts have often been constrained by the resistance

10 Li, Z. and Guo, J. (2019), '中国五大优势产业链报告 [Report on China's Five Largest Advantage Industries]', *Securities Daily*, December 2019, http://www.zqrb.cn/2019-12-27/zip_13236499765e0596c71ae41.pdf.
11 Chen (2020), 'Beyond Donation'.
12 Young, O. R. (1982), 'Regime Dynamics: The Rise and Fall of International Regimes', *International Organization*, 36(2): pp. 277–97; Hirschman, A. O. (1970), *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Cambridge, MA: Harvard University Press.

of other dominant states, a lack of leverage and institutional inertia. The responses of international institutions themselves have also varied. Sometimes these have adapted to China's economic growth and demands for reform, as seen in the increase of China's voting power in the World Bank.[13] On other occasions institutions have been slow to respond, for example, in relation to China's various reform proposals at the WTO. Research in this area suggests that the response of institutions often depends on the ability of dissatisfied states to exercise effective outside options by using or creating alternative institutions. China has more leverage to secure concessions when it has outside options and when its contributions to the institution are perceived as crucial.[14] The availability of outside options depends, in turn, on the policy area in which an institution operates, with some areas exhibiting more institutional overlap than others.[15] Countries such as China, dissatisfied with elements of existing institutions, must therefore select strategies that are tailored to specific policy areas.

Trade: 20 years of WTO membership

In line with its broader engagement in global economic governance, Beijing's approach to the WTO has evolved as China's economy has grown over the past two decades. Having initially adopted a low profile following accession, China then engaged in a long process of institutional learning and legal capacity-building.[16] In later years it has become more proactive, participating in the reform of committees and calling for improvements in transparency and information-sharing. Informed by its own accession experience, China has also established initiatives to assist new and prospective WTO members, such as the Least-Developed Countries (LDCs) and Accessions Programme.[17] In addition, it continues to push for greater recognition of the problems that trade liberalization presents for developing countries.

Despite progress in WTO reforms, fundamental disputes remain. Most prominently, China's status as a self-identified developing country remains contentious among members, as does the country's desire to be recognized as a market economy. These disagreements can be traced back to China's accession process. On joining the WTO, China agreed to reduce tariffs on industrial goods further than other major developing countries, such as India and Brazil.[18] It also agreed to make subsidies to SOEs subject to countervailing duties, and not to apply the Subsidies and Countervailing Measures (SCM) Agreement that allows flexibility in providing domestic subsidies.[19] At the same time, China accepted being designated as a non-market economy for a stipulated period of 15 years. This has made it easier

13 Kruck, A. and Zangl, B. (2019), 'Trading Privileges for Support: The Strategic Co-Optation of Emerging Powers into International Institutions', *International Theory,* 11(3): pp. 318–43, https://doi.org/10.1017/S1752971919000101.
14 Lipscy (2017), *Renegotiating the World Order*; Kastner, S. L., Pearson, M. M. and Rector, C. (2018), *China's Strategic Multilateralism: Investing in Global Governance,* Cambridge: Cambridge University Press.
15 Lipscy (2017), *Renegotiating the World Order.*
16 Shaffer, G. and Gao, H. (2018), 'China's Rise: How It Took on the U.S. at the WTO', *University of Illinois Law Review,* 2018(1): p. 125.
17 World Trade Organization (undated), 'China's LDCs and Accessions Programme', https://www.wto.org/english/thewto_e/acc_e/china_programme_e.htm.
18 Halverson, K. (2004), 'China's WTO Accession: Economic, Legal, and Political Implications', *Boston College International and Comparative Law Review*, 27(2): p. 327.
19 Ibid., p. 328.

for other WTO members to successfully impose countervailing measures on Chinese exports.[20] The accession protocol also required China to allow prices for traded goods and services to be determined by market forces, with only limited exceptions.[21] As a result, the method for other WTO members to determine dumping margins on products from China is calculated using the non-market economy methodology, where Chinese exporters' prices are compared using values from an 'economically comparable country'.[22] These values are used because prices in China are not viewed as being based on market principles.[23] Consequently, if China were considered a market economy, dumping margins would be based on Chinese prices rather than surrogate values.[24] The Chinese interpretation of the accession agreement was that its non-market economy status would lapse in 2016 but this did not occur. It has filed WTO disputes against the US and the EU over this issue, but without success.[25]

To date, China has been party to 69 cases, 22 as complainant and 47 as respondent, with only the US and EU more active in this respect.

China's approach to trade disputes more broadly has evolved. Chinese representatives initially took part in a large number of cases as a third party in order to gain a better understanding of the process. Only after 2006 did the country more actively participate in disputes.[26] To date, China has been party to 69 cases, 22 as complainant and 47 as respondent, with only the US and EU more active in this respect.[27] It has also seen important later successes in this process, notably in 2011, when the appellate body was asked to decide whether SOEs should be considered as 'public bodies' that grant subsidies and thus subject to countervailing measures by other states. The appellate body decided that SOEs do not *automatically* count as subsidy providers. This was an important qualification to an earlier ruling that SOEs were indeed public bodies that could provide subsidies to other Chinese firms and therefore be subject to countervailing measures.[28] For China's competitors, concerns persist that Chinese SOEs gain an unfair advantage through soft financing, guarantees and special access to energy and land. This may also mean that these companies indirectly subsidize downstream firms, while they are protected in the domestic market from foreign competitors due to China's rules on joint venture requirements and public procurement.[29]

---

20 Ibid.
21 Ya Qin, J. (2003), '"WTO-Plus" Obligations and Their Implications for the World Trade Organization Legal System: An Appraisal of the China Accession Protocol', *Journal of World Trade*, 37(3): p. 505.
22 Telep, J. M. and Lutz, R. C. (2018), 'China's Long Road To Market Economy Status', *Georgetown Journal of International Law*, 49(2): pp. 693–708.
23 US Department of Commerce (2015), 'Enforcement and Compliance Anti-Dumping Manual' in Telep and Lutz (2018), 'China's Long Road To Market Economy Status', p. 695.
24 World Trade Organization (2001), 'China's Accession Protocol', Geneva: World Trade Organization.
25 Bown, C. P. and Keynes, S. (2020), 'Why Trump Shot the Sheriffs: The End of WTO Dispute Settlement 1.0', *PIIE Working Paper*, 20(4): pp. 1–26.
26 Gao, H. (2011), 'China's Ascent in Global Trade Governance', in Deere Birkbeck, C. (ed.) (2011), *Making Global Trade Governance Work for Development: Perspectives and Priorities from Developing Countries*, Cambridge: Cambridge University Press, pp. 168–70, https://doi.org/DOI: 10.1017/CBO9780511996221.007.
27 World Trade Organization (2021), 'Disputes by member', https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm.
28 Bown and Keynes (2020), 'Why Trump Shot the Sheriffs'.
29 Hoekman, B. and Sapir, A. (2021), 'State-Owned Enterprises and International Competition: Towards Plurilateral Agreement', in Hoekman, B., Tu, X. and Wang, D. (eds) (2021), *Rebooting Multilateral Trade Cooperation: Perspectives from China and Europe*, London: Centre for Economic Policy Research Press.

One consequence of WTO disputes, such as the 2011 ruling on SOEs, has been the ongoing US dissatisfaction with the appellate body. This has culminated in the US blocking new appointments since 2016, eventually rendering the appellate body unable to perform its core function.[30] China notably supported the largely EU-driven proposals on the multi-party interim appeal arrangement (MPIA), designed to replicate the functions of the appellate body. There are currently 23 signatories to the MPIA but the US is not one of them. As it stands, the effectiveness of the MPIA remains to be seen as decisions will be notified to the WTO's Dispute Settlement Body but not formally adopted. Decisions are nevertheless intended to be binding.[31]

Tensions over SOEs are unlikely to be resolved soon given the emphasis that Chinese officials place on China's continued status as a developing economy, and the importance of SOEs in developing the country's higher value-added advanced industries. For China, SOEs remain important in supporting domestic growth and employment policies. There are currently more than 15,000 SOEs operating, and the total assets managed by them increased by more than 11 times between 1997 and 2016.[32] These SOEs perform an important function in domestic employment policies and have the capacity to hire excess labour during periods of high social instability.[33] Consequently, while China shares common ground with the EU on the continued functioning of the appellate body, both the EU and US believe that Chinese SOEs are unfairly competing and dumping exports in foreign markets. The US, EU and Japan have in recent years coordinated to argue that China's approach threatens fair trade and undermines core WTO objectives of preventing export subsidies and the dumping of products at below cost in international markets.[34]

Meanwhile, as part of its 2019 reform proposals, China advocated for SOEs to be recognized as 'equal players' alongside private enterprises.[35] The proposals, while emphasizing the continuing importance of multilateral cooperation, criticized a lack of progress in agricultural sector liberalization and the special and differential treatment of developing countries. In recent years, Beijing has increasingly pushed for WTO reforms that address the difficulties of developing countries 'by providing developing members with flexibility and policy space needed for their economic development'.[36] At the same time, the US has argued for reform of 'special and differential treatment' provisions at the WTO, which give developing countries more favourable treatment. US reform proposals in 2019 were particularly critical of China's self-declaration of its developing-country status, arguing that the current

30 *American Journal of International Law* (2019), 'United States Continues to Block New Appellate Body Members for the World Trade Organization, Risking the Collapse of the Appellate Process', 113(4): pp. 822–31, https://doi.org/10.1017/AJIL.2019.59.
31 Lester, S. (2020), 'Can Interim Appeal Arbitration Preserve the WTO Dispute System?', Cato Institute Free Trade Bulletin, https://www.cato.org/free-trade-bulletin/can-interim-appeal-arbitration-preserve-wto-dispute-system?queryID=9f4d8ae439d052d49e824c5837f6dc04#mpia-temporary-replacement-appellate.
32 Lin, K. J., Lu. X., Zhang, J. and Zheng, Y. (2020), 'State-owned enterprises in China: A review of 40 years of research and practice', *China Journal of Accounting Research*, 13(1): pp. 31–55, https://doi.org/10.1016/j.cjar.2019.12.001.
33 Shleifer, A. and Vishny, R. W. (1994), 'Politicians and Firms', *The Quarterly Journal of Economics* 109(4): pp. 995–1025, https://doi.org/10.2307/2118354; Lin, Lu, Zhang and Zheng (2020), 'State-owned enterprises in China'.
34 Trade Ministries of Japan, US and European Union (2020), 'Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union', 14 January 2020, Washington, DC, https://trade.ec.europa.eu/doclib/docs/2020/january/tradoc_158567.pdf.
35 Delegation of China (2019), 'China's Proposal on WTO Reform: Communication from China', https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?CatalogueIdList=254127&CurrentCatalogueIdIndex=0.
36 Ministry of Commerce (2018), 'China's Position Paper on WTO Reform', https://www.mfa.gov.cn/ce/celt//eng/xwdt/t1616985.htm; MOFCOM (2019), 'China's Proposal on WTO Reform', vol. 8. Beijing, https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?CatalogueIdList=254127&CurrentCatalogueIdIndex=0.

definition does not distinguish between different kinds of developing country.[37] Chinese officials have also criticized the growing use of national security exceptions to protect domestic industries, primarily by the US.[38]

While pushing for reforms at the multilateral level, China is also active in concluding regional trade agreements that may be seen as a 'hedge' against slow progress on its objectives at the WTO.[39] These regional agreements are often quite different from those concluded by the US, EU or Japan, and tend to adopt a more gradual and limited approach to the liberalization schedules of developing economies, particularly in agriculture. They also incorporate separate, more limited dispute resolution procedures, and include recognition of China as a market economy. The dispute resolution clauses in agreements, such as that with the Association of Southeast Asian Nations (ASEAN), also provide China with the potential to avoid the protectionist 'special safeguards' it often faces in export markets.[40] These bilateral safeguard measures differ from those of the WTO as their application is more limited. If a dispute is pursued under the agreement with ASEAN, it implies that compensation is voluntary. However, these mechanisms are yet to be utilized and have had limited impact on the broader global trade regime.[41] Beijing has also made recognition of its market economy status a condition of concluding bilateral agreements.[42] Despite the potential challenge to multilateral rules on its market economy status, China's bilateral moves on this front have thus far had little impact at the multilateral level due to the continuing opposition of other major economies.

A development with greater potential to affect global trade rules is the conclusion of the Regional Comprehensive Economic Partnership (RCEP). The agreement covers one-third of the global population and accounts for a similar share of global GDP.[43] It includes US allies Japan, South Korea and Australia but not the US itself; this, combined with the failure of the Trans-Pacific Partnership (TPP), suggests that the RCEP may threaten the continued US role in 'setting the rules of the road' in trade.[44] Notably, the RCEP incorporates relatively limited rules of origin standards, with only 40 per cent of a given product's value needing to be added within RCEP countries. This is potentially important given the significant production networks across multiple countries in the region. It has been suggested that this may make it easier for China to avoid anti-dumping measures that have been contentious at the WTO.[45]

---

37 Delegation of US (2019), 'Procedures to Strengthen the Negotiating Function of the WTO', https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?CatalogueIdList=251580.
38 MOFCOM (2019), 'China's Proposal on WTO Reform'.
39 Chin, G. and Stubbs, R. (2011), 'China, Regional Institution-Building and the China-ASEAN Free Trade Area', *Review of International Political Economy*, 18(3): p. 283, https://doi.org/10.1080/09692291003762548.
40 Lawrence, R. Z. (2008), 'China and the Multilateral Trading System', in Eichengreen, B., Wyplosz, C. and Park, Y. C. (eds) (2008), *China, Asia, and the New World Economy*, Oxford: Oxford University Press, p. 158; Chin and Stubbs (2011), 'China, Regional Institution-Building and the China-ASEAN Free Trade Area', p. 290.
41 Sookhakich, P. (2019), 'Limits and Challenging Factors of the Dispute Settlement Mechanism in the Light of China-ASEAN Free Trade Agreement Perspective', *Asian Political Science Review*, 3(1): pp. 37–39, https://doi.org/10.2139/ssrn.3459317.
42 Australian Government (2006), 'Chapter 11 – The Proposed Australia–China Free Trade Agreement – Parliament of Australia', https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Foreign_Affairs_Defence_and_Trade/Completed_inquiries/2004-07/china/report01/c11.
43 Sytsma, T. (2020), 'RCEP Forms the World's Largest Trading Bloc. What Does This Mean for Global Trade?', *The RAND* blog, 9 December 2020, https://www.rand.org/blog/2020/12/rcep-forms-the-worlds-largest-trading-bloc-what-does.html.
44 BBC News (2020), 'Biden vows to set "rules of the road" on trade', 17 November 2020, https://www.bbc.com/news/business-54958299.
45 Sytsma (2020), 'RCEP Forms the World's Largest Trading Bloc'.

Similarly, the EU–China Comprehensive Agreement on Investment (CAI), which is currently only agreed in principle, may well have an impact on the development of global trade rules. Given the EU's significant high-tech sector, building up the investment relationship further is an important component of China's strategy to develop its own high-tech industry.[46] Currently, WTO rules entail limited coverage of investment issues and are largely focused on 'mode III' delivery: services supplied by one WTO member, through its presence in the territory of another member.[47] The CAI is more wide-ranging, and the EU believes the deal will improve transparency in terms of China's subsidies to SOEs, and reduce requirements for EU investors to share intellectual property with their Chinese joint venture partners.[48]

Forced technology transfers to Chinese firms have been a concern for the US and EU for many years and were an important factor in the recent US–China trade war.[49] China has implemented more international technology transfer measures related to foreign direct investment (FDI) than any country in the world.[50] These measures include joint venture requirements that limit foreign equity and prohibit foreign investors from operating in China unless they partner with a local company, or in some cases, unless the Chinese partner is a controlling shareholder.[51] Counting against the CAI is the lack of an investment protection chapter and the failure to secure an investment court system, instead relying on state-to-state dispute settlement.[52] The likelihood of the agreement eventually coming into force will depend more on internal EU politics than on those of China; the European Parliament voted to suspend ratification in May 2021 due to human rights concerns in China.[53]

The past two decades of China's WTO membership illustrate the strategies pursued by Beijing at the multilateral and bilateral levels. Where China has not secured its objectives at the multilateral level, it has sought to exercise outside options at the bilateral and regional levels. The impact of the latter on the former has so far been limited, although this may change with recent developments such as the RCEP. China's more successful efforts at securing its objectives (the MPIA and the RCEP) have usually taken place when cooperating with major partners; its less successful efforts (such as gaining market economy status) have tended to come when pursuing

---

46 Wang, L. and Li, Y. (2020), 'The negotiation of EU–China comprehensive agreement on investment and its potential impact in the post-pandemic era', *Journal of Chinese Economic and Business Studies*, 18(4): pp. 365–72, https://doi.org/10.1080/14765284.2020.1855846.
47 Kurtz, J. and Gong, B. (2021), 'The EU–China Comprehensive Agreement on Investment: A Model for Investment Coverage in the World Trade Organization?', in Hoekman, B., Tu, X. and Wang, D. (eds) (2021), *Rebooting Multilateral Trade Cooperation: Perspectives from China and Europe*, London: Centre for Economic Policy Research Press.
48 European Commission (2021), 'Key Elements of the EU-China Comprehensive Agreement on Investment', https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2542.
49 Office of the United States Trade Representative (2018), 'Findings of the Investigation into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation under Section 301 of the Trade Act of 1974', https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF.
50 Javorcik (2020), 'Global Supply Chains Will Not Be the Same in the Post-COVID-19 World', p. 136.
51 Office of the United States Trade Representative (2018), 'Findings of the Investigation into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation under Section 301 of the Trade Act of 1974', p. 19.
52 Godement, F., Dębski, S., D'Hooghe, I., Huotari, M., Oertel, J., Tonchev, P., Holslag, J., Karaskova, I., Duchatel, M., Casarini, N., Okano-Heijmans, M., Šimalčík, M., Zenglein, M. J., Poggetti, L. and Bondaz, A. (2020), 'EU Should Not Rush Investment Deal with China', *Clingendael Magazine*, 18 December 2020, Netherlands Institute of International Relations, https://www.clingendael.org/publication/eu-should-not-rush-investment-deal-china.
53 Emmott, R. (2021), 'EU Parliament Freezes China Deal Ratification until Beijing Lifts Sanctions', Reuters, 20 May 2021, https://www.reuters.com/world/china/eu-parliament-freezes-china-deal-ratification-until-beijing-lifts-sanctions-2021-05-20.

ineffective outside options that lack the support of these same major economic partners. This trend is likely to continue, with China only achieving its core objectives in trade when it has buy-in from major economies.

Development finance: A new model?

China is the world's largest sovereign creditor in overseas development finance. According to AidData's latest estimates, the country's annual financial commitment to international development projects amounts to around $85 billion.[54] In 2000–12, China's average annual development finance commitment to the rest of the world was below that of the US. However, since 2013, this amount has soared and reached more than double that of the US in 2013–17.[55] China's lending has tapered off in recent years, partially due to its own economic slowdown and the COVID-19 pandemic.[56] China provides development finance via both bilateral and multilateral channels. The bilateral channel – that is, overseas development projects funded by Chinese financial institutions and implemented by Chinese SOEs as the main contractor(s) – processes considerably more funds than the multilateral channel does. The multilateral channel refers to Chinese participation in numerous multilateral development finance institutions (MDFIs) as a creditor and its efforts in co-establishing new MDFIs, such as the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB).

China provides development finance via both bilateral and multilateral channels. The bilateral channel – that is, projects funded by Chinese financial institutions and implemented by Chinese SOEs as the main contractor(s) – processes considerably more funds than the multilateral channel does.

China is pursuing several aims through bilateral development lending: to mitigate overcapacity in industries such as construction, energy and transport; to facilitate the expansion of Chinese enterprises in the global market; to stimulate trade with recipient countries; and to increase Chinese influence in the developing world. A number of domestic financial institutions are central to these objectives, especially the China Development Bank (CDB) and Export-Import Bank of China (CHEXIM), the four biggest state commercial banks, and several state-owned investment

---

54 Malik, A., Parks, B., Russell, B., Lin, J., Walsh, K., Solomon, K., Zhang, S., Elston, T. and Goodman, S. (2021), *Banking on the Belt and Road: Insights from a new global dataset of 13,427 Chinese development projects*, Williamsburg, VA: AidData at William & Mary, https://www.aiddata.org/publications/banking-on-the-belt-and-road.
55 Ibid.
56 Since most of the Chinese development lending is used for financing infrastructure and energy projects, the progress of which has been hindered by the COVID-19 pandemic, the total amount of its overseas development lending has tapered.

funds and corporations.[57] The two policy banks – CDB and CHEXIM – are by far the largest players in their field; they have provided more financing to the developing regions than all of the Western-based MDFIs combined in recent years.[58] CDB is the most active creditor of energy and infrastructure projects under the Belt and Road Initiative (BRI); CHEXIM also provides concessional loans and credit for export buyers in addition to normal loans.[59]

Chinese national development finance institutions differ from their Western counterparts and MDFIs in several aspects: they mostly fund infrastructure and energy projects; they lend large amounts to bundles of projects that involve multiple Chinese actors; they have less strict control on the social and environmental impacts of their operations; their loans often do not impose policy conditions; and they lend to different regions compared to Western development finance institutions.[60] Although the Chinese institutions complement Western efforts in development finance by providing extra funds and supporting different regions, they also pose several challenges. For example, Chinese loans without policy conditions attached have become more attractive to many developing countries than Western loans. The fact that China's SOEs have a significant advantage in securing contracts in Chinese-funded projects, which often do not include open tendering, is considered by many to be a violation of international market rules.

Moreover, Chinese creditors endorse building multiple large-scale infrastructure projects simultaneously, sometimes based on anticipated demand – a development approach described as 'Big Push industrialization' – in preference to 'micro interventions in human capital, the environment and institutional reform'.[61] In addition, frustration at not being able to hold Beijing accountable for its debt sustainability has been voiced by members of the Paris Club – a multilateral framework that coordinates the resolution of general sovereign illiquidity or unsustainable external debt of developing countries; China is not a member of the Paris Club.[62] These differences and challenges have generated much scepticism and criticism of China's rising role in the global governance of development finance.

However, China's overseas development finance may be less 'statist' than many in the West suppose. The majority of its finance is not subsidized.[63] The policy banks raise much of the funds from capital markets through bond auctions. Since their fundraising processes are driven by profit-oriented market incentives, they need to fulfil their commercial interests, rather than the government's political

---

57 Carrai, M. A. (2018), 'It Is Not the End of History: The Financing Institutions of the Belt and Road Initiative and the Bretton Woods System', in Chaisse, J. and Górski, J. (eds) (2018), *The Belt and Road Initiative: Law, Economics and Politics*, Boston MA: BRILL, pp. 107–45; Sampson, M., Wang, J. and Mosquera Valderrama, I. (2021), 'Trade, Tax, and Development Finance: Understanding China's Choice of BRI Agreements and Institutions', in Schneider, F. (ed.) (2021), *Global Perspectives on China's Belt and Road Initiative: Asserting Agency through Regional Connectivity*, Amsterdam: Amsterdam University Press, https://doi.org/10.2307/j.ctv1dc9k7j.
58 Chin, G. T. and Gallagher, K. P. (2019), 'Coordinated Credit Spaces: The Globalization of Chinese Development Finance', *Development and Change,* 50(1): pp. 245–74, https://doi.org/10.1111/dech.12470.
59 Sanderson, H. and Forsythe, M. (2012), *China's Superbank: Debt, Oil and Influence*, 1. Aufl., Hoboken, NJ: Bloomberg Press.
60 Chin and Gallagher (2019), 'Coordinated Credit Spaces'; Sampson, Wang, and Mosquera Valderrama (2021), 'Trade, Tax, and Development Finance'.
61 Chin and Gallagher (2019), 'Coordinated Credit Spaces'.
62 Chorzempa, M. and Mazarei, A. (2021), 'Improving China's Participation in Resolving Developing-Country Debt Problems', Peterson Institute for International Economics, https://www.piie.com/sites/default/files/documents/pb21-10.pdf.
63 Bräutigam, D. and Gallagher, K. P. (2014), 'Bartering Globalization: China's Commodity-Backed Finance in Africa and Latin America', *Global Policy*, 5(3): pp. 346–52, https://doi.org/10.1111/1758-5899.12138.

interests, to survive. Thus, it is easy to understand why Chinese policy banks tend to offer loans at normal market interest rates. However, the state does play an important role here, not so much as the regulator but as the guarantor. It provides credit guarantees for the bonds issued by policy banks, to ensure that the banks can afford to make 'expensive loans' to fund long-term, large-scale public development projects.[64] Although the state does not lend directly, it does bear significant risk if the loans cannot be repaid, which has happened in several BRI projects. In these instances, the Chinese government has the dilemma of either wiping the debt, which hurts the commercial interests of Chinese banks; extending the loan terms; or requiring repayment in other asset forms, which may be criticized as a form of debt-trap diplomacy.

Indeed, China's bilateral overseas development finance faces increasing challenges. The returns on capital have been eroded by the volatile political, economic and security conditions in some borrower countries in combination with Chinese creditors' 'non-interference' mode of lending. Moreover, Chinese-funded projects are often criticized for their negative environmental and social governance impacts, which create tension between project operators and project-affected communities in developing countries.[65] Furthermore, China's massive bilateral development lending, especially under the ambitious BRI, often causes uneasiness among its geopolitical competitors and systemic rivals, including the US, Japan, India and EU countries. The resistant and sometimes hostile reactions from these countries have created significant hurdles for China's overseas development lending.

MDFIs can handle such issues more deftly. They have some advantages in allocating and coordinating resources for development projects compared to bilateral lending: they provide economic and technical expertise and better monitoring of project spending; their business models allow multiple creditors to share financial risks; they manage the relationship with civil groups, media and project-affected communities more skilfully; and they alleviate the geopolitical tensions that are often seen in bilateral interactions between states.[66] In addition, engaging in multilateral institutions helps China to gain influence in setting rules and norms. This allows the country to shape the global governance of development finance based on its own preferences and experience, which are more state-coordinated and infrastructure-focused.

This explains why Beijing has continued to contribute to various MDFIs and established new multilateral institutions like the NDB and the AIIB, despite the boost that bilateral lending gives to Chinese national economic interests. Beijing adopts a 'multi-front' approach to engaging with MDFIs. It collaborates with numerous existing MDFIs, from dominating players such as the World Bank and the Asian Development Bank (ADB) to smaller institutions that are marginally linked to China such as the International Fund for Agricultural Development. China has also established new MDFIs, particularly the AIIB, which better reflect Beijing's interests in development finance. In turn, the AIIB's institutional and

64 Chen, M. (2020), 'State Actors, Market Games: Credit Guarantees and the Funding of China Development Bank', *New Political Economy*, 25(3): pp. 453–68, https://doi.org/10.1080/13563467.2019.1613353.
65 Russel, D. R. and Berger, B. (2019), 'Navigating the Belt and Road Initiative', New York: Asia Society Policy Institute, https://asiasociety.org/sites/default/files/2019-06/Navigating%20the%20Belt%20and%20Road%20Initiative_2.pdf.
66 Sampson, Wang and Mosquera Valderrama (2021), 'Trade, Tax, and Development Finance'.

operational innovations, along with China's ambitious bilateral lending, have resulted in institutional and policy changes in traditional MDFIs like the World Bank and the ADB.

China is currently the third-largest shareholder in the World Bank and the ADB, and is pursuing further influence in both institutions. Although Beijing is dissatisfied with some aspects of these two banks, established under the Bretton Woods system and Western leadership, China acknowledges the strategic and knowledge gains from collaborating with them. In recent years, China has increased knowledge cooperation with both banks, through which it can share its development experience with the banks' other members.[67] It has intensified innovative financial collaboration with the International Finance Corporation (IFC), especially on green bonds and blue bonds.[68] Moreover, China has managed to gain support from the World Bank and the ADB for its ambitious overseas investment projects, including energy cooperation in Africa and the BRI.[69] China is also active in smaller MDFIs, such as the African Development Bank and the Inter-American Development Bank, in order to engage with the MDFIs of the regions in which it has invested heavily.

China has managed to gain support from the World Bank and the ADB for its ambitious overseas investment projects, including energy cooperation in Africa and the BRI.

Meanwhile, Beijing realizes that the World Bank will remain US-led, and that Japan and the US will continue to jointly lead the ADB. Therefore, in order to have a dominant voice in multilateral governance, China needed to establish a new MDFI outside the Bretton Woods system. The AIIB was accordingly founded in 2015. Although the US and Japan did not join the bank, Beijing did receive endorsement and support from several of its geopolitical competitors and systemic rivals, including India, Australia and EU countries, which made the bank more global. Although the AIIB's general governance framework and project practices are in line with the World Bank and the ADB, several of its institutional features particularly reflect Chinese interests and objectives. Under China's leadership, the architects of the AIIB sought to address Beijing's dissatisfaction with traditional MDFIs. They also had more specific aims: to mobilize resources for infrastructure projects; to focus on the economic performance of projects rather than the social impact; to adopt the latest methods of development finance; to be more efficient

67 World Bank (2012), 'China and World Bank Group Launch New Knowledge Hub to Provide Solutions for Reducing Poverty', 27 November 2012, Washington, DC: World Bank, https://www.worldbank.org/en/news/press-release/2012/11/27/china-world-bank-group-launch-new-knowledge-hub-to-provide-solutions-reducing-poverty.
68 International Finance Corporation (2014), 'IFC Issued First Renminbi-Denominated Green Bonds on the London Stock Exchange to Support Climate-Friendly Investments', Washington, DC: International Financial Corporation, https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/ifc+issued+first+renminbi-denominated+green+bonds+on+the+london+stock+exchange+to+support+climate-friendly+investments; International Finance Corporation (2016), 'Helping China Advance Green Finance', Washington, DC: International Finance Corporation, https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/helping-china-advance-green-finance.
69 World Bank (2016), 'World Bank and China Scale Up Support for Africa', 8 September 2016, Washington, DC: World Bank, https://www.worldbank.org/en/news/press-release/2016/09/08/world-bank-and-china-scale-up-support-for-africa.

in both project operation and institutional set-up than traditional multilateral development banks (MDBs); to respond better to the needs of regional members, developing countries and borrowers; and to make the governance procedures and project operation more flexible, and strategic and institutional adjustments easier, than in traditional MDFIs.[70]

Some of these objectives were achieved. For instance, the AIIB offers more decision-making powers to regional members and the bank's policies and strategies take into account Asian countries' specific needs and development trajectories. Moreover, the AIIB has adopted the latest implementation methods, made project operations more flexible and simplified the process of making strategic and institutional adjustments.[71] Nevertheless, it has attracted some controversy. For example, the AIIB's focus on economic performance rather than social implications of projects could be understood as a 'non-intervention' approach, which makes it popular among some borrowers. The bank has also been criticized for lacking social accountability and precluding opportunities of collaborating with other MDFIs on social issues.[72] Moreover, critics disapprove of the bank's investments in fossil fuel-based energy. Finally, the AIIB also streamlined its project operation and institutional set-ups, although doing so has cast doubt over the effectiveness of the bank's safeguarding mechanisms.[73]

The innovations in the AIIB alongside China's strong bilateral actions have had a wider impact on MDFIs. For example, having claimed to shift away from infrastructure projects towards social policy and governance reform programmes in the past 10 years, the World Bank and the ADB have recently made efforts to increase infrastructure funding – this could easily be read as a response to China's strong advocacy of infrastructure financing. Moreover, the World Bank's new regulatory framework offers large borrowers (including China) more freedom to use their respective country systems, as an alternative to its Environmental and Social Standards, for monitoring and controlling the environmental and social impacts of World Bank-funded projects.[74] In addition, the ADB has reduced its project approval cycle from three years to 18 months as a response to the AIIB's leaner institutional set-up and faster project procedures.[75]

In summary, China adopts both bilateral and multilateral approaches to increase the chances of achieving its domestic objectives and to push forward reforms in the global governance of development finance. China's use of outside options as an alternative to the traditional MDFIs – such as lending bilaterally and establishing the AIIB – has been largely successful without the support of major economic powers like the US and Japan, though endorsement from India and European

70 Sampson, M. and Wang, J. (2021), 'Strategies of Institutional Change in International Development Finance: China's Multi-Front Approach', Conference paper, presented at SASE 2020.
71 Lichtenstein, N. (2019), 'AIIB at Three: A Comparative and Institutional Perspective', *Global Policy*, 10(4): pp. 582–86, https://doi.org/10.1111/1758-5899.12703.
72 Heldt, E. C. and Schmidtke, H. (2019), 'Global Democracy in Decline?: How Rising Authoritarianism Limits Democratic Control over International Institutions', *Global Governance*, 25(2): pp. 231–54, https://doi.org/10.1163/19426720-02502005.
73 Gransow, B. and Price, S. (2019), 'Social Risk Management at AIIB – Chinese or International Characteristics?', *Chinese Journal of Political Science*, 24(2): pp. 289–311, https://doi.org/10.1007/s11366-018-9553-8.
74 Dann, P. and Riegner, M. (2019), 'The World Bank's Environmental and Social Safeguards and the Evolution of Global Order', *Leiden Journal of International Law*, 32(3): pp. 537–59, https://doi.org/10.1017/S0922156519000293.
75 Kumar, N. and Arora, O. (2019), 'Financing Sustainable Infrastructure Development in South Asia: The Case of AIIB', *Global Policy*, 10(4): pp. 619–24, https://doi.org/10.1111/1758-5899.12732.

states contributed to the success of the AIIB. Furthermore, these powerful outside options have successfully prompted changes inside the World Bank and the ADB. Beijing's multifaceted approach is underpinned by the country's abundant financial resources, rich experience in infrastructure development, rising strategic role in the international economy, and its pragmatic attitude to global governance.

Conclusion: Balancing competing preferences

The Chinese government will need to deepen international cooperation in trade, development finance and broader global economic governance, to pursue domestic objectives of reducing over-investment and overcapacity in heavy industry and re-focusing on 'advantage industries', such as telecommunications and renewable energy. Recognition of the importance of further cooperation is evidenced in China's recent efforts to secure an investment agreement with the EU and the conclusion of the RCEP trade agreement at the end of 2020.

Over the past two decades China has learned that global integration is an important component in the high growth rates and employment levels necessary to maintain domestic social stability.[76] Awareness of the advantages of deeper integration co-exists with a desire to secure a more prominent voice in key institutions to resist policies that do not align with China's own normative preferences.

The issue of SOEs is a clear illustration of this dilemma. SOEs are central to China's growth model but at the same time they increase tensions with trade partners. As the Chinese economy continues to grow, the existence of domestic SOEs will place increasing strains on the multilateral system. The country's multifaceted approach to global economic governance reflects its awareness of these tensions, combining elements of both constructive engagement and direct challenges of certain rules and norms. The balance between these two facets will continue to depend not only on domestic developments in China but also on the reactions of key international institutions and other major economies. China's experience in development finance could be instructive in this respect. The establishment of the AIIB with the eventual buy-in from European partners and India, combined with China's bilateral actions, is likely to have prompted recent changes at the multilateral level that were more in line with Chinese preferences. This 'success' suggests that China's approach to global economic governance will continue to be multifaceted – maintaining broad engagement while utilizing outside options where available to stimulate reforms in existing institutions.

76 Hale (2016), 'International Sources of Political Order in the People's Republic of China'.

About the authors

Jue Wang is assistant professor at the Leiden University Institute for Area Studies. She is a scholar of international political economy, with a focus on China, its external economic relationships and its role in regional and global economic governance. Her academic work has been published in, among others, *International Affairs* and *Chinese Political Science Review*. Her latest publications have focused on China's relationship with international economic organizations and the Belt and Road Initiative. Dr Wang is also an associate fellow in the Asia-Pacific Programme at Chatham House. She regularly comments on Chinese and international affairs for media outlets including the BBC, CGTN, Al Jazeera, the *New York Times*, *The Times* and *Newsweek*.

Michael Sampson is assistant professor of international relations at the Institute of Political Science, Leiden University. His research focuses primarily on the strategic and distributional consequences of international institutions, international trade, and the impact of rising powers on global economic governance. His academic work has been published in *The Pacific Review* and *International Politics*. His most recent research has focused on the implications of the EU–China investment agreement and the Belt and Road Initiative. He has also written for *The Diplomat* on China's trade agreements and Oxford University Press on interstate cooperation theory.

Acknowledgments

This paper is a result of a research collaboration between the LeidenAsiaCentre and Chatham House. We benefited greatly from the productive discussions with scholars and practitioners of international organizations at a workshop that discussed China's role in global governance, organized by the LeidenAsiaCentre and Chatham House in November 2019.

Cover image: An exhibition themed on the 20th anniversary of China's accession to the World Trade Organization is seen during the 4th China International Import Expo on 8 November 2021 in Shanghai, China.
Photo credit: Copyright © VCG/VCG/Getty Images

ISBN 978 1 78413 505 8

This publication is printed on FSC-certified paper.
designbysoapbox.com

Independent thinking since 1920

Chatham House, the Royal Institute of International Affairs, is a world-leading policy institute based in London. Our mission is to help governments and societies build a sustainably secure, prosperous and just world.

CHATHAM HOUSE

The Royal Institute of International Affairs
Chatham House
10 St James's Square, London SW1Y 4LE
T +44 (0)20 7957 5700
contact@chathamhouse.org | chathamhouse.org

Charity Registration Number: 208223