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China, the United States and the Rules of Trade

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Abstract

The administration of President Donald Trump has made altering the international commercial practices of Chinese firms, state-owned enterprises and various levels of government the centrepiece of its trade policy agenda. It expects China to meet its perceived standards for the conduct of international commerce. It takes no account of China's experience with the *unequal treaties* imposed on China by the United States and other powers in the 19th and early 20th centuries – and as a result has unrealistic expectations regarding China's international trade practices. The existing rules of trade have little to say regarding the complaints of the United States pertaining to China's conduct of international commerce. The rules of trade agreed at the WTO, however, constrain the ability of the Trump administration to induce China to change its trade practices. As a result, the Trump administration is attempting to have the constraints removed or is choosing to ignore them. This puts the rules-based system of international trade at risk.

Keywords: China, rules-based trade, Trump administration, unequal treaties, WTO

Introduction

Regarding certain Commodities heretofore Contraband. The restrictions affecting trade in Opium ... are relaxed under the following conditions: 1. – Opium will henceforth pay thirty taels per picul Import Duty.

Rule 5, Treaty of Tientsin (between Great Britain and China), 1858¹

The Chinese Government, recognizing that the existing system of levying duties on goods in transit, and especially the system of taxation known as *likin*, impedes the free circulation of commodities to the general injury of trade, hereby undertakes to abandon the levy of *likin* and all other transit duties throughout the Empire and to abolish all the offices, stations and barriers maintained for their collection and not to establish other offices for levying duties on goods in transit. It is clearly understood that, after the offices, stations and barriers for taxing goods in transit have been abolished, no attempt shall be made to re-establish them in any form or on any pretext whatsoever.

Article IV, Commercial Treaty (between the United States and China) 1903²

The most potent driver of China's competitive edge is not cheap labor, as is commonly believed, but rather a potent set of illegal trade practices that Chinese officials promised to abandon as a condition of joining the WTO.

Peter Navarro, *Confront China Now*, 2012, 27³

The reason why some people are used to arrogantly adopting double standards is due to Western egotism and white supremacy.

Lu Shaye, Ambassador of China to Canada, January 9, 2019, 11⁴

The comments of Lu Shaye, China's ambassador to Canada, caused a considerable stir in the Canadian government, the press and more broadly among civil society. Viewed from the lens of modern western society they appear, at the very least, very undiplomatic and out of sync with current societal norms. On the contrary, however, it can be argued that they represent a view of the world held by many in China's senior leadership – a view that is coloured by western treatment of China in the trade agreements imposed in the 19th and early 20th centuries. These trade arrangements, long forgotten in the west that imposed them, are known in China as the *unequal treaties* and, far from being forgotten, still shape the Chinese view of its relationships with European countries, the United States and Japan. Put Ambassador Lu's comments, which were a reaction to Canada's complaints regarding China's detention of a number

of Canadian citizens,⁵ in the context of the 1858 Treaty of Tientsin (between the United States and China).⁶ Its Article XI reads:

Subjects of China guilty of any criminal act towards citizens of the United States shall be punished by the Chinese authorities according to the laws of China; and citizens of the United States, either on shore or in any merchant vessel, who may insult, trouble or wound the person or injure the property of Chinese or commit any other improper act in China, shall be punished only by the Consul⁷ or other public functionary thereto authorized, according to the laws of the United States (717-718).

That the Canadian government, press and members of civil society criticizing the judicial system in China were suggesting, at least implicitly, that Canadians (westerners) should not be subject to China's legal proceedings clearly harks back to the *extraterritoriality* clauses⁸ imposed on China through the *unequal treaties* – which were based on *Western egotism and white supremacy*.

A relevant question is why someone like China's Ambassador to Canada in 2019 would view the world from a perspective of 19th and early 20th century trade treaties. First, the impact of the *unequal treaties* is still felt in China. The last manifestation of the *unequal treaties* was the return of Hong Kong to Chinese sovereignty in 1997 (Plunkett and Kerr, 1997). At the celebratory ceremony marking Hong Kong's return to China, Chinese President Jiang Zemin described the handover as “the redemption of one hundred years of national humiliation” (Renmin Ribao, 1997). The question of Hong Kong has not, of course, been finally settled, because it retains a considerable degree of autonomy under the One Country – Two Systems governance structure agreed with the United Kingdom as a conditions of Hong Kong's return to Chinese sovereignty (Hobbs and Kerr, 2000; Hobbs and Kerr, 1998). Hong Kong, with its greater degree of individual freedoms, remains an irritation for the Chinese leadership and a reminder of the *unequal treaties*.

Second, the *unequal treaties* were used consistently throughout the whole of the 20th century by both the Guomindang⁹ (GMD) and the Chinese Communist Party (CCP) to *beat the drum* of nationalism. According to Wang (2003, 442), who made an extensive study of the use of the idea of the *unequal treaties* by both the GMD and the CCP,

... part of the content, style, rhetoric and argumentation of the discourse of the Unequal Treaties became integrated as a perpetual element in the common inheritance of Chinese-ness. Elicited from the century-long history of the Unequal Treaties and national humiliations are the contradictory images of China as a victim of Western imperialism and as a vanquisher who rises from the ashes, like a phoenix, in its efforts to terminate foreign rights.

Over time, influential Chinese leaders hammered away at the unequal treaties keeping them in the public's mind and making them a central aspect of a Chinese citizen's world view. Sun Yat-Sen, the first major leader to emerge in post-imperial China, stated at the GMD's First National Conference in 1924 that

All Unequal Treaties, including foreign concessions, consular jurisdiction, foreign management of customs service, and all foreign political rights on China's soil, are detrimental to China's sovereignty. They all ought to be abolished so as to leave the way open for new treaties based on the spirit of bilateral equality and mutual respect for sovereignty (Qin Xiaoyi, Vol. 2, 1989, 138).

Mao Tse-tung wrote about the unequal treaties extensively in his 1939 work titled *The Chinese Revolution and the Chinese Communist Party* (Mao, 1939). He thought that the ending of many aspects of the *unequal treaties* in 1943¹⁰ was a defining point in Chinese history. He declared, "Ours will no longer be a nation subject to insult and humiliation. We have stood up" (Mao, 1949). The *unequal treaties* were front and centre when Deng Xiaoping met with Margret Thatcher over the return of Hong Kong (China Org. Cn, 1984). Their influence continues to this day in the era of Xi Jinping. According to Wang (2015),

... the sense of humiliation is so deeply entrenched in the Chinese psyche, that even today while the rest of the world considers China a strong and powerful nation, many Chinese behave as the ones being bullied and mistreated, with a hostile eye for "hostile foreign forces".

The humiliation experienced by China due to the imposition of the *unequal treaties* has been used a tool to foster nationalism among the wider Chinese population. According to Callahan (2004, 204),

The PRC's¹¹ very deliberate appeal to national humiliation in state education policy can tell us much about how historical memory informs both domestic and international politics. Chinese textbooks¹² characteristically mention the century of national humiliation to define modern Chinese history and to celebrate the foundation of the PRC in 1949. The discourse recounts how at the hands of foreign invaders and corrupt Chinese regimes, sovereignty was lost, territory was dismembered, and the Chinese people were thus humiliated.

In 2001, the National People's Congress in Beijing even declared a new national holiday, National Humiliation Day (Callahan, 2004). Hence, far from being forgotten, the humiliation attributed to the *unequal treaties* directly informs, and shapes, the current thinking on international affairs by the Chinese leadership and the wider population – including those engaging in international business and foreign trade. In this light, the comments of Ambassador Lu are consistent with this view of the world.

The *unequal treaties* and how China has interpreted them colour its approach to international commerce and the rules of trade that are contained in international trade agreements such as the WTO.

Does the Trump Administration Have Realistic Expectations regarding China's Conduct of International Commerce?

Since the taking up of the reins of government by the administration of President Donald Trump, the relationship between the United States and China has been defined by unrealized expectations regarding the international commercial practices of Chinese firms, the implicit (sometimes explicit) support of those practices by various levels of Chinese governments, the practices of state-owned enterprises and the macroeconomic strategy of the Chinese government. Basically, the Trump administration expects all of these Chinese entities to conduct their international commercial dealings in ways that are acceptable – where what is acceptable is defined by the administration. When these expectations are not met, the Trump administration feels it is justified in using trade policy to induce Chinese entities to comply. The United States has imposed tariffs on a broad range of Chinese goods with the expectation that this will impose a sufficient cost on Chinese firms, and indirectly on Chinese society, to have them cease what are, in the administration's view, nefarious practices in their conduct of international business. If the tariffs do not provide sufficient inducement for change in China, then the tariffs and other trade barriers will be successively raised until they are sufficient.

Of course, the imposition of broad-based tariffs is not (likely)¹³ compliant with the obligations of the United States as a member of the World Trade Organization. China, faced with what it considers an *illegal act*, has retaliated with the strategic imposition of its own tariffs and other trade barriers against U.S. goods – and has set the stage for a major *beggar-thy-neighbour* trade war – a phenomenon not seen since the Great Depression of the 1930s and one of the major spurs to create a rules-based international trading system through the negotiation of the International Trade Organization, and failing that, the General Agreement on Tariffs and Trade in 1947 (Miner, 2007; Josling, 2007). Trade agreements are put in place to constrain the ability of governments to intervene in international trade activities – clauses typically prohibit the imposition of new tariffs and other trade barriers, limit the use of trade distorting subsidies, regulate the use of legitimate trade barriers,¹⁴ etc. The Trump administration, and the president himself, have chafed under the constraints agreed in trade agreements negotiated by previous U.S. administrations. As a result, removing the constraints imposed by trade agreements has been a major focus of the broader trade agenda of the Trump administration (Kerr, 2018b). In the eyes of the Trump administration, these constraints

prevent the United States from using its economic power to its full degree when faced with what it perceives as *unfair trade* practices of foreign firms and governments.

Clearly, one of the constraints arising from WTO commitments is that the United States is not (likely) allowed to impose broad-based trade barriers on Chinese imports. The administration knows this but is betting that China will back down long before a dispute – which China has initiated – at the WTO can work its way through to conclusion, including appeals and the delays possible pertaining to implementation of a panel's ruling. The administration does not see tariffs as a permanent state of affairs but rather a tactic to achieve an objective – such as a change in Chinese trading arrangements. Further, the United States is not cooperating at the WTO to fill positions that have become vacant on the Appellate Body of the dispute settlement mechanism. Members of the Appellate Body have fixed terms. Once a member of the Appellate Body's term has expired, a new member must be appointed. As with most aspects of the WTO, appointment of new members is by consensus. The United States has refused to consent to the appointment of new members. The Appellate Body should have seven members, three of which must hear any appeal of a panel's ruling. Hence, once the number of members falls below three, arguably then no appeals can be heard. If no appeals to a panel's ruling can be heard, then the panel process has no validity and, in essence, the WTO's dispute settlement mechanism will cease to function. Thus, it may well be that by the time the case against the U.S. tariffs works its way through the system, the process may have no validity.

One of the Trump administration's major advisors and strategists on trade with China is Professor Peter Navarro. He has published widely on China's international trade activities¹⁵ and was appointed an Assistant to the President and Director of a newly created Office of Trade and Manufacturing Policy. While his work is controversial,¹⁶ his views align closely with the Trump administration's public pronouncements on the problems it perceives pertaining to trade with China. Many of the concerns raised by Professor Navarro and the Trump administration lie outside the scope of what has been agreed at the WTO – and, hence, any expectations that the organization can deal with the perceived transgressions are unrealistic. In other cases, where WTO rules do apply, given the weight the perceived humiliation associated with the *unequal treaties* still carries in China, one should not have an expectation that China would strictly comply with its WTO obligations. While one could hope China would live up to its obligations, realistic assessments would not yield such an expectation. If that is true, is it worth risking a trade war when the probability of compliance is small?

One of the major, and oft voiced, complaints regarding the commercial practices of Chinese firms and state-owned enterprises is that in order to partner with Chinese firms

in doing business in China, firms from the United States must agree to share their advanced technology with the Chinese partner. The agreements of the WTO are silent on such practices. The WTO deals primarily with constraining governments' ability to impede trade.¹⁷ While it is seen by some as a weakness of the WTO, its members have never agreed to the inclusion of *competition policy*¹⁸ aspects of international commerce in its provisions. No other international institution deals with the subject – there is no internationally agreed commercial law (Kerr and Perdakis, 2014; Bessel et al., 2006). The WTO provides no mechanism to deal with requirements embedded in the provisions of international commercial transactions. As a result, the WTO does not sanction the use of trade measures to deter the inclusion of such provisions in international commercial transactions. It is this constraint that frustrates those in the United States charged with developing trade policy regarding China and has led to the imposition of tariffs on Chinese goods entering the United States – knowing full well these trade barriers will be challenged at the WTO.

Of course, there is no compulsion for U.S. firms to enter into such technology transfer arrangements with Chinese firms or state-owned enterprises. It is the draw of the huge and profitable Chinese market that exerts a powerful pull on U.S. firms. They simply find the allure of the Chinese market irresistible even if they find some of the terms of their commercial transactions unpalatable. Again, the mistakes of the past may simply be repeating themselves. It is not the first time the lure of the Chinese market has distorted judgement (Ceko and Kerr, 2000). In 1885 Her Britannic Majesty's Consul in Tientsin wrote,

The principal feature of the year has been the eagerness of foreign capitalists to place their services at the disposal of the Chinese Government. After the termination of hostilities with France the idea got abroad that China was about to take a great step in advance, and the Viceroy who is regarded by foreigners as the leader of the party of progress, has had submitted to him schemes and projects without number. The competition was so keen among the rival bidders that it was even said that one would be concessionaire had offered to construct 80 miles of railway for nothing.

Since Syndicate after Syndicate has been arriving, China's attitude has been that of a rich heiress, who, with self-complacent smile, sees suitor after suitor come to bend the knee. To disinterested lookers-on the performance has been equally amusing. What is passing through the mind of Chinese statesmen may be imagined from the remark made to me by an intelligent Chinese official, who said that if Chinese would only wait a little, foreign capitalists would not only offer to lend capital for nothing but to pay interest into the bargain (Foreign Office, 1886, 4).

Another major complaint of the Trump administration, and U.S. firms, is the theft of trade secrets by Chinese firms.¹⁹ Again, this is an area that concerns competition policy and international commercial practices. Domestically, such practices are dealt with using commercial law. Absent an agreed international commercial legal system, there is no institution through which recourse can be sought. For the most part, the WTO is silent on this issue. The Trump administration sees this as a failing of the WTO because it cannot authorize retaliation through the use of trade sanctions for the theft of trade secrets. It is one of the reasons used to justify the imposition of broad-based tariffs on Chinese goods in 2018.

The protection of intellectual property of foreigners is one area, however, where the WTO is not silent. The Agreement on Trade Related Aspects of Intellectual Property (TRIPS) was incorporated into the new WTO when it was created. It was one of the three international agreements, along with the General Agreement on Trade in Services (GATS) and the updated GATT-1994, that the WTO would administer. The WTO was endowed with a central dispute settlement mechanism that handled disputes for all three agreements. This structuring of the WTO was deliberate. Included in the dispute settlement mechanism was the possibility of *cross-agreement* retaliation, whereby a failure to live up to commitments to protect intellectual property of foreigners under the TRIPS could lead to retaliation through authorization of the imposition of trade measures by the aggrieved party under the GATT-1994 (Kerr, 2003). The threat of trade sanctions was supposed to provide sufficient threat to induce developing countries to protect the intellectual property of foreigners. This proved, however, not to be the case (Yampoin and Kerr, 1998; Gaisford, et al., 2002). Further, while many countries, including China, put laws in place to comply with their TRIPS obligations, the TRIPS is sufficiently ambiguous regarding enforcement that developing countries often fail to put sufficient resources into enforcing their intellectual property laws (Kerr, 2007; Loppacher and Kerr, 2004). Thus, the TRIPS has not lived up to the expectation that it would act as an international intellectual property policeman. As a result, countries, including the United States, have not aggressively pursued the use of the cross-agreement retaliation provisions. Again, the shortcomings of the TRIPS are another source of frustration with the WTO in the United States and another reason the Trump administration has eschewed the use of WTO mechanisms and, instead, has imposed broad-based tariffs on imports from China.

Josling (2007, 73) states that

[t]he informality of the trade system, however, proved advantageous in allowing for constructive ambiguity in trade rules. The major powers were able to make use of the 'space' for accommodating interest groups that might have derailed a more legally binding system.

From the outset the GATT/WTO institution was designed to allow for creative solutions based on pragmatic economic assessments rather than strict legal interpretation of its rules (Kerr, 2018b). In China's case, the idea of interest groups could be extended to those having the perception that provisions included in the *unequal treaties* are associated with national humiliation. Hence, one wonders whether one should expect the Chinese government to vigorously enforce the protection of the intellectual property of foreigners – given that cross-agreement retaliation does not provide a sufficient threat, and the history of intellectual property protection in the *unequal treaties*. The Commercial Treaty (between China and the United States) of 1903 states the following in Article IX (752-753):

... the Government of China ... now agrees to fully protect any citizen, firm or corporation of the United States in the exclusive use in the Empire of China of any lawful trade-mark to the exclusive use of which in the United States they are entitled, or which they have adopted and used, or intend to adopt and use as soon as registered, for exclusive use within the Empire of China. To this end the Chinese Government agrees to issue by its proper authorities proclamations, having the force of law, forbidding all subjects of China from infringing on, imitating, colorably imitating, or knowingly passing off an imitation of trade-marks belonging to citizens of the United States

and in Article X (753):

The Government of China now agrees that it will establish a Patent Office. After this office has been established and special laws with regard to inventions have been adopted, it will thereupon ... issue certificates of protection ... to citizens of the United States on all their patents issued by the United States²⁰

The attempt to secure protection for intellectual property in China long precedes the TRIPS and such provisions can be seen, in Chinese eyes, as a legacy of the *unequal treaties*.

The final major complaint of the Trump administration is that China manipulates its exchange rate to foster exports to the detriment of U.S. manufacturers. Of course, the angst relating to China's supposed currency manipulation among a segment of the United States trade community – including Peter Navarro – precedes the Trump administration. It is also dismissed as a fiction by other trade economists. The WTO is silent on this issue, probably because the negotiators of the GATT in the 1940s perceived that issues pertaining to exchange rates were in the purview of the International Monetary Fund (IMF) recently negotiated at Bretton Woods.²¹ The IMF cannot authorize retaliatory trade sanctions for currency manipulation, leaving the Trump administration with no international institutional mechanism with which to

counter its perceived effects. From China's perspective, even if it is manipulating its currency as its critics claim, it is playing within the rules.

Conclusions

While there have been other aspects of international trade that have been part of the Trump administration's trade policy agenda – renegotiation of NAFTA, withdrawal from the TransPacific Partnership, excess capacity in the global steel industry – trade relations with China have been at the centre. It accuses China of not playing by the rules. This is, however, largely a misnomer – in reality China's (including the activities of private firms and state-owned enterprises as well as various levels of government) conduct of international commerce does not meet the Trump administration's standard for the *fair* conduct of international commerce. *Fair trade*, however, is defined in the *eye of the beholder*. China's perception of *fair trade* is heavily influenced by its history of relations with those *foreign powers*, including the United States, that imposed the *unequal treaties* on it in the 19th and early 20th centuries. The Trump administration's standards for the conduct of international commerce take no account of the *weight of history* that shapes China's international commercial practices. The result is a major international confrontation.

The rules of trade, as opposed to standards for the conduct of international commercial practices, have been negotiated and administered at the WTO.²² China's conduct of international commerce largely stays within what is permissible within the rules of trade, if not in their *spirit*. As a result, at least from the perspective of the Trump administration, the WTO has been ineffective in disciplining China's international commercial practices. Further, its rules (which were agreed by and often formulated by previous administrations in the United States) act as a constraint on the ability of the Trump administration to punish China for what it considers *unfair* practices or to deter China from further breaches in its conduct of trade. As a result, the Trump administration is attempting to remove those constraints (Kerr, 2018a), or acts as if they do not exist (e.g., by imposing wide ranging tariffs on imports of Chinese goods). China believes it is largely playing by the existing internationally agreed rules, where a dispute settlement system exists for dealing with everything from accusations of the use of *unfair* subsidies to the failure to protect the intellectual property of U.S. firms. The current trade policy activities of the Trump administration appear as an attempt to impose a new *unfair treaty* on it. China's perception of its experience with past *unfair treaties* suggests that it is likely to resist. The Trump administration needs to factor this into its trade strategy towards China. Otherwise, its strategic attempt to induce China to

alter its international commercial practices is likely to degenerate into a true *beggar-thy-neighbour* trade war – which no one wins.

The inability of the United States to achieve what it perceives as its legitimate ends within the agreed rules of trade is worrying for the rules-based system of international trade. While the existing system centred around the WTO is far from perfect, a world without rules of trade is truly terrifying. The negative effect on investment in trade-related activities due to the steep rise in the risks associated with engaging in international commerce will quickly spill over to negatively impact GDP growth and global economic welfare. Josling (2007, 71) suggested that “[t]he multilateral system can break down if there is a critical disillusionment in the hegemonic powers with its value and performance.” The Trump administration is showing signs that level of disillusionment may be fast approaching.

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Endnotes

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- ¹ Treaty of Tientsin (1858) as reprinted in Inspector General of Customs (1917), 419.
- ² Commercial Treaty (2003) as reprinted in Inspector General of Customs (1917), 747-748.
- ³ Navarro and Roach (2012).
- ⁴ Lu Shaye (2019).
- ⁵ The detention of two Canadian citizens and the sentencing of another Canadian to death had been linked to Canada's response to a U.S. request that Huawei executive Meng Wanzhou be detained for extradition to the United States.
- ⁶ Reprinted in Inspector General of Customs (1917).
- ⁷ A consul was the official representative of the United States in various locations in China.
- ⁸ Which meant that foreigners who broke the law in China could not be subject to the Chinese legal system. The clause from the 1856 Treaty of Tientsin (between the United States and China) quoted above is one example of an *extraterritoriality* clause.
- ⁹ The political party of the Nationalist government defeated by the Communists in the civil war and which retreated to Taiwan.
- ¹⁰ The Republic of China reached agreements with both the United States and the United Kingdom to end many of the provisions of their respective *unequal treaties*, including extraterritoriality, tariff caps and consular jurisdiction (Craven, 2005).
- ¹¹ The People's Republic of China.
- ¹² I have observed this in my own teaching. I teach a third/fourth year undergraduate course in international agribusiness. I normally have three or four students who grew up in China in a class of forty-odd students. When I bring up the topic of the *unequal treaties* the Canadian students have never heard of them, but ALL the Chinese students in the class are familiar with them.
- ¹³ Of course, whether or not the imposition of tariffs by the United States on Chinese goods is compliant with its WTO obligations can only be determined through a case brought to the dispute settlement system.
- ¹⁴ Such as those imposed for sanitary and phytosanitary reasons.
- ¹⁵ See for example Navarro (2006); Navarro and Autry (2011); Gray and Navarro (2016); Navarro (2016).
- ¹⁶ See the Wikipedia entry for Peter Navarro: https://en.wikipedia.org/wiki/Peter_Navarro.
- ¹⁷ There are a few instances where WTO law deals with the activities of private firms such as dumping (Kerr, 2006; Kerr, 2001).
- ¹⁸ Sometimes called anti-trust laws.
- ¹⁹ Again, history may have something to teach about Chinese attitudes to theft of trade secrets. Commercial tea production is based on the industry – including the *landrace* plants used – that was developed and refined in Imperial China over a long period of time. Tea became one of the products sought after during early western attempts to trade with the reluctant Imperial Qing government. As tea became the staple drink in Britain and other western countries, the British East India Company became concerned with relying solely on supplies regulated by the unpredictable Qing government. At the time, China prohibited the export of live tea plants. To diversify Britain's sources of supply for tea, plants were smuggled out of China to be planted in India. This was, in modern parlance, theft of a trade secret. It was also an example of *acceptable practices* by western businesses observed by Chinese businessmen (Rose, 2010; Sanders, 2017).
- ²⁰ Commercial Treaty (2003) as reprinted in Inspector General of Customs (1917), 747-748.
- ²¹ While the GATT does not deal with exchange rates, the Havana Charter, which was to govern the stillborn International Trade Organization (ITO), does deal with exchange rates. Its Article 24, sections 1 and 2, indicate that regarding issues of exchange rates the ITO would defer to the IMF (Interim Commission for the International Trade Organization, 1948).
- ²² And, of course in preferential trade agreements.