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How China challenges the liberal trade order: Coercion, contestation and the socialist market economy.

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Executive Summary

The original China 'engagement strategy' was grounded in the assumption that WTO membership would turn China into a liberal market economy.

Today the engagement strategy is viewed as having failed, with China's largest trading partners viewing Beijing as a systemic rival.

Yet, a significant strand of international economics still views the engagement strategy as a viable approach for driving liberal reforms within China, indicating a growing gap between political thinking and international economics. This paper addresses that gap, drawing on theoretical and empirical considerations. Theoretically, a comparative capitalism framework explains why nations evolve different varieties of market economy, and why they then seek to externalize their preferences in a multilateral context. That framework is then applied to analysis of actually existing institutions that underpin China's economy. It is argued the latter is in transition to a socialist, rather than liberal, market economy, thus China contests the liberal trading system at a systemic level (i.e. over the rules of the game, rather than within them). Two types of systemic contestation are highlighted: (1) *informal contestation*: this involves practices that challenge the liberal order without official acknowledgement by Beijing, for example, economic coercion; and (2) *formal contestation*: this involves officially challenging liberal order rules and norms in favour of ones that conform to a socialist market economy, with an example of this class of action discussed in the paper.

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make history.

1. Introduction

When China joined the World Trade Organization (WTO) in 2001, there was a longstanding assumption in Western capitals that integration into the world trading system would socialize China to become an increasingly open liberal economy. This was known as the 'engagement strategy'[1] (Friedberg, 2018, p. 10) and it was grounded in the assumption 'that deepening commercial, diplomatic, and cultural ties would transform China's internal development and external behaviour' (Campbell and Ratner, 2018, p. 60). This view encouraged China's trading partners, most crucially the United States, to take a long-term view of the country's reform path, even if concerns persisted over the potentially disruptive effects of its state-dominated economy to the liberal trading system. The engagement strategy is now viewed in Washington as having failed (Campbell and Ratner, 2018). Kurt Campbell and Ely Ratner occupy senior figures within the 2021 Biden administration, and their 2018 article summed up the bipartisan shift in attitude in Washington towards China as follows: 'Neither carrots nor sticks have swayed China as predicted. Diplomatic and commercial engagement have not brought political and economic openness...China has instead pursued its own course, belying a range of American expectations in the process' (Campbell and Ratner, 2018, p. 61). Indeed, it was growing US disillusionment regarding the WTO's inability to manage China's state-led economy that resulted in the 2018 trade war (Du and Kong, 2020), alongside bipartisan calls for a major rethink of how the United States approaches China. While the dial has not yet shifted so far in the capitals of China's other major trading partners, changing attitudes towards China are also apparent. In 2019 the European Commission released a paper that described China using a mix of positive and negative descriptors; positively as a cooperation partner and a negotiating partner, but negatively as 'an economic competitor in the pursuit of technological leadership, and a *systemic rival promoting alternative models of governance*'[2] (emphasis added). Unlike the US, the EU is not in an explicit geopolitical contest with China and seeks a cooperation-based relationship with Beijing. Hence the Commission's terminology of 'systemic rival' from an institution not known for headline-seeking rhetoric is noteworthy. Amplifying that view, a series of U.S.-EU-Japan

[1] In Germany the China engagement was termed *wandel durch handel*, or "change through trade", and holding a similar hope of a steady Chinese arc towards liberalization.

joint statements during 2019-2020 have indicated a China-focused trade reform agenda to 'address non market-orientated policies and practices of third countries that lead to severe overcapacity, create unfair competitive conditions for their workers and businesses…and undermine the proper functioning of international trade' (quoted in McDonagh and Draper, 2020, p. 1).

In Australia, Canberra's relationship with China has steadily deteriorated since its highpoint in 2015 with the signing of the China-Australia Free Trade Agreement (ChAFTA), despite China being by far Australia's largest trading partner. The breakdown in relations can in large part, be traced back to Canberra's global first in banning Huawei and ZTE from supplying 5G equipment and services based on security advice (Suri, 2020). China's unique political-economic model was critical in that decision, due to the blurry legal distinctions between the public and private sectors and fears that private firms are subject to state directives. It is clear that in liberal democracies there is a growing view that the engagement strategy has failed and that China is no longer on a reform trajectory towards a rule-of-law liberal market economy.

However, a substantial strand of current international economics trade policy literature on China has a strikingly different view. Within this literature one finds significant continuity with the original engagement strategy. Broadly taken, this involves the assumption that China can be influenced to continue economic reform using existing World Trade Organization (WTO) rules and disciplines (Bacchus, Lester, & Zhu, 2018; Bown and Hillman, 2019; Chiang, 2017; Du, 2014; Wolfe, 2017; Zhou, 2018, 2021; Zhou, Gao, & Bai, 2019), or evolution of those rules in regional agreements such as the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) (Matsushita and Lim, 2020; Mavroidis and Sapir, 2021). Unpacking this literature, there is recognition that China's state capitalism 'poses increasing challenges to the world trading system' (Bacchus, et al., 2018; Zhou, 2018, p. 609) and represents a very different development model compared to liberal market economies (Du, 2014, p. 410). However, this literature seems unwilling to follow the implications of these differences. For example, Bacchus, Lester and Zhou (2018) argue that general WTO rules and dispute settlement have been underutilized by China's trade partners to discipline unfair or anti-market actions, and that more WTO cases can change Beijing's behaviour. They then offer classic engagement strategy discourse arguing that WTO disciplines can 'encourage China to see that the best way for it to rise is not by the mercantilism and protectionism of state-managed trade but, instead, by becoming a market-oriented, rule-following, fully developed nation' (Bacchus, et al., 2018, pp. 2-3).

Other studies reinforce this continuation with a 'change through trade' socialization approach. Chiang (2017) argues that WTO rules can discipline China, pointing to counter-vailing duty law as offering a strong tool for counteracting subsidies. Others claim there exists unused scope for taking legal action against China by better utilizing China's WTO-plus obligations (Nedumpara and Zhou, 2018, p. 10; Zhou, et al., 2019, p. 980). The WTO-plus obligations are contained in the Protocol on the Accession of the People's Republic of China, where one will find a unique set of provisions applying only to China, designed to manage market-distorting effects of China's state-led capitalism.[3]

Another set of analysts view the CPTPP mega-regional trade agreement as providing the most advanced trade rules for managing China's state capitalism (Matsushita and Lim, 2020; Mavroidis and Sapir, 2021). Matsushita and Lim (2020) see the CPTPP's rules as an improvement on WTO disciplines against SOEs, such as GATT Article XVII, because it adds more precise language to target SOEs and designated monopolies than does WTO text; and also distinguishes state enterprises engaged in not-for-profit functions from those engaged in commercial business. Elsewhere, initial trade policy responses to China's application to join the CPTPP agreement on September 16, 2021 essentially restate the engagement strategy case, arguing the trade agreement could constrain China's state capitalism and drive domestic reforms (Armstrong, 2021). And while Zhou (2021) offers a sceptical view of the effectiveness of CPTPP rules by arguing they are too narrow and hold too many carve-outs; this is not a rejection of the engagement strategy. Instead Zhou adds support to the view that better use of WTO-Plus rules can reinvigorate the Engagement strategy's fading promise.

In sum, a significant strand of international trade policy literature has carried on with a preconception of China founded

[2] European Commission report, 'EU-China – A strategic outlook', March 2019, p. 1.

[3] WTO, Protocol on the Accession of the People's Republic of China, WT/L/432 (10 November 2001), available at www.wto.org.

on the original engagement strategy. As outlined in a classic paper by Thorstein Veblen, a preconception is a pre-analytical assumption or theory that provides a taken-for-granted foundation on which an analytical framework is built (Veblen, 1900). They are generally 'accepted uncritically, but applied in criticism and demonstration of all else' (Veblen, 1900, p. 241). This is appropriate so long as a preconception is valid. The original engagement strategy preconception is based on a number of assumptions. First, it contains a teleological assumption that economic reform means becoming more market-orientated in a liberal democratic understanding of that term. Second, the engagement strategy assumes China will accept legal constraints on its state-led economic model that require China to acknowledge a liberal economic model is superior to its own state-led socialist model. Third, while acknowledging challenges arising from China's state capitalism, the engagement strategy wrongly assumes China is not a systemic rival.

This paper challenges each of those assumptions by developing an institutional analysis of China's economic model. In doing so it seeks to unsettle the engagement strategy preconception that continues to hold sway in much mainstream trade policy literature.

Utilizing the theory of comparative capitalism, the paper aims to add a novel dimension to trade policy thinking on China, guided by the key concepts of 'systemic rival' and 'socialist market economy'. I argue that the concept of 'systemic rival' is an appropriate way to re-conceptualize China's challenge to the liberal trading system, by highlighting that China has developed a *socialist* rather than *liberal* market economy; with the critical distinction between both being developed in this paper.

By focusing on a comparative institutional analysis this paper's approach complements, but is distinguished from, a well-developed International Relations/geo-economics literature focusing on China's rise in terms of geopolitical tensions arising from shifts in relative power (Friedberg, 2011; Ikenberry, 2008; Mearsheimer, 2001; Sampson, 2019; Tammen and Kugler, 2006). Within this literature some view China's rise as highly likely to result in conflict (e.g. Mearsheimer, 2010), while others have argued deep trade interdependencies will provide strong incentives against conflict (e.g. Ikenberry, 2008; Steinfeld, 2010). This is an important debate. But it is noted that even if we could imagine a world where the U.S. comes to an agreement with China on relative power and spheres of influence in a new geopolitical order, this would solve only geopolitical power-based tensions. It would leave unresolved those tensions arising from conflicting economic models competing within a single trading system. The latter needs everyone to play the same game by the same rules to function fairly and effectively – whereas systemic rivalry implies a conflict over the nature of the game itself. Hence tensions with China are not just about relative power, but also about systemic compatibility within a single rule-based framework for economic competition[4].

The paper proceeds as follows. Section two provides a conceptual framework that illuminates China's institutional development as a unique variety of socialist market economy; and also allows us to conceptualize how national varieties of market economy interact with the international trading system at a strategic level. Section three maps out China's key political-economic institutions that serve as the genetic rule structure for expressing a socialist market economy. Section four draws on the paper's conceptual framework for analysis of how China's economic model contests the liberal trading order in both informal and formal ways. Section five concludes.

[4] However, since economic success is a core pillar of geopolitical power, both elements are interconnected.

2. Conceptualizing the Role of Institutions in Strategic Trade Interactions

The way in which a national economy plugs into bilateral, regional and global trade agreements is a critical foreign policy question. Governments must decide key policy metrics such as whether to open the domestic market to imports, and if so how much; whether to open up more to some nations but less to others; whether some sectors should be more open and other sectors more protected; whether inbound investment flows should be restricted in some areas but not others; whether and to what level immigration is desirable (Hiscox, 2010, p. 51). These decisions impact other policy areas such as national security, and impact economic factors such as productivity, the availability of production factors such as labour, capital and natural resources, as well as reciprocal market access to other economies. A well-established IR framework for explaining foreign policy preferences lies in assessing the effects of domestic structures and internal politics on policy ideas and implementation (Gottwald and Bersick, 2015; Katzenstein, 1976). This 'second image' (Waltz, 1959) is less concerned with how shifts in relative power distribution between states can change their foreign policy behaviour; rather, it is focused on how domestic politics shape a state's policy preferences (Helleiner and Malkin, 2012; Schirm, 2013).

This approach is particularly applicable to large countries since these tend to have a greater domestic orientation (Nölke, 2015, p. 658), and typically have a greater capacity to externalize their preferences onto others, where relative power does become important. Consequently, theory suggests that typically a large country such as China will be more focused on its domestic politics when setting foreign policy, and have a greater ability to externalize those preferences onto others compared with a small country. However, as Fioretos (2001, 2011) cautions, we must be careful about assuming what those domestic preferences are for a given country in relation to a given issue. Doing so may leave begging the very question that needs assessing. The engagement strategy is grounded in an assumption that China's long-run domestic preference will continue along a reform continuum towards a more market-orientated economy. However, today that assumption is questionable. Therefore, to gain a clearer understanding of China's domestic preferences for trade relations a second image approach seeking to reassess that assumption can derive important conceptual insights from the comparative capitalism literature (Amable, 2000; Baccaro and Pontusson, 2016; Boyer, 2005; Whitley, 1999; Witt et al., 2017). This strand of research brings into view the key role of socio-economic institutions in shaping and constraining agent preferences, and are the product of the long-term evolution of a national economy. The given institutional reality of a nation in turn influences trade policy preferences.

How do institutions have this effect? Institutions are the 'humanly devised constraints that structure political, economic and social interaction' (North, 1991, p. 97), and comprise formal elements such as laws, rules and constitutions, as well as informal elements concerning standards of accepted behaviour[5]. Both formal and informal institutions have specific methods of enforcement and sanctions if breached. They provide the system of rules regulating interactions in any given social domain (Hodgson, 2015, p. 45), and provide a relatively stable incentive structure determining agent action. Importantly, while theorists typically highlight constraint, it is important to note that institutions entail both constraint and empowerment for human agency (Hodgson, 2004, p. 656). To illustrate, since their inception GATT rules have empowered firms to export more freely through reduced border tariffs and rules against discriminatory treatment, but conversely constrain them from securing special treatment or protective tariffs in their domestic market. In such ways institutions simultaneously both constrain and enable what a community of agents can do, as well as what they view as appropriate social action. While trade agreements involve the institutionalized development of common rules, comparative studies of the major market economies in Europe, North America and Japan during the second half of the twentieth century revealed that domestic economies were far from being homogenous, despite sharing in some key economic and political institutions. Rather, there were distinct characteristics evident, including different balances in the role of the public and private sectors and different national competitive advantages (Albert, 1993; Dore, 2000; Shonfield, 1965; Streeck, 1997), which has implications for trade negotiations that seek common rules.

National differences are a result of variations across a host of social institutions that impact economic development more broadly, including but not limited to industrial relations, corporate governance, education and vocational systems of learning and training, financial regulation, ease of doing business and industrial policy. Furthermore, as each unique variety of capitalism evolves, agents and firms adapt and specialize their comparative advantage relative to the given institutional topography (Hall and Soskice, 2001). Over time institutional complementarity increases between constituent parts of the national

[5] Contrast the informal norm expressed by the term "It's just business" with the informal Chinese institution of *guanxi*. "It's just business" expresses an impersonal and contractual approach to business characteristic of liberal market economies, where one is encouraged to separate interpersonal feelings from business relations. Guanxi, on the other hand, refers to informal norms of social reciprocity and hierarchy that organize Chinese business relations; so much so that in a business dispute a contract may be considered 'a mere general guideline for action, while the *guanxi*, the social network which maintains business relationships and trust, might play a much larger role in [dispute] resolution' Cunningham and Dibooglu (2020, p. 266).

economy, with complementarity referring to the fact that 'the efficiency and returns on some building blocks depend upon, and frequently increase with, the presence of others (Fioretos, 2001, p. 219). Over time powerful interest groups, from business, labour and politics emerge who have a stake in a given institutional framework and thus seek to ensure its viability through evolution rather than revolution[6]. Different national starting points on the road to modernity are thereby maintained over time.

This helps explain the fact that while globalization has resulted in some convergences – for example it has been possible to develop common trade rules between nations – economic diversity at the national level has persevered. As a result, comparative institutional theory considers diversity to be a permanent and fundamental feature of the world economy (Amable, 2000, p. 645; Hall, 2007, p. 39; Hodgson, 2015, p. 344). Evidence also suggests that while some variations may be more economically efficient than others, it is also evident that many variations produce 'dissimilar competitive advantages that nonetheless can be equal in terms of economic performance' (McNally, 2012, p. 746). This enduring national economic diversity has important consequences for domestic preference formation concerning trade policy in a multilateral setting, leading to a growing literature in second-image comparative political economy (Fioretos, 2001, 2011; Nölke, ten Brink, Claar, & May, 2015; Weinhardt and ten Brink, 2020).

The core insight in this literature is that the form of multilateralism espoused by a nation will be driven by considerations of how such a form will impact 'the ability of that country to sustain the comparative institutional advantages provided by its specific variety of capitalism' (Fioretos, 2001, p. 215). Put another way, the internal institutional logic of a country can be expected to play an important role in shaping its foreign policy on trade relations and negotiations. Since all nations have unique institutionalized political economies, we can see where the possible tensions will arise when states seek to agree on common trade rules with others. This is exemplified in the origins of the modern post-war trading system. The International Trade Organization – the original World Trade Organization – failed to get off the ground after extensive negotiations during 1945-47 because the U.S. Senate refused to ratify the final Charter. This was due to demands from other nations viewed to be ill-suited to US trade interests (Ruggie, 1982, p. 396). Instead, a far more restricted domain of commercial relations were covered by the GATT; while it took a further 48 years for the International Trade Organization to resurrect as the World Trade Organization (WTO) in 1995.

Both the GATT and later the WTO have a fundamental set of principles, rules and norms grounded in liberal economics shared across Anglo-Saxon and Continental European varieties of capitalism. This is logical given those countries were most influential in devising the GATT, while the WTO is an institutional evolution that retains the GATT legal texts at its core (Wilkinson, 2013). An institutional analysis of China's political economy can provide theoretically informed insights into the question of whether China's economic model represents a systemic rival to the liberal market economies and their simulacrum legally inscribed in the WTO trading system.

[6] A given institutionalized form of market economy can also lock-in losers, which may precipitate a social movement seeking change, as for example populist movements that led to Brexit and Trumpism, driven in part by blue collar worker discontent that unfair trade has caused domestic deindustrialization.

3. China's Economic Institutions: A Variety of Market Socialism?

China's economy is often identified as a form of state capitalism.

However, the term 'state capitalism' is widely applied to a heterogeneous array of economies and has no single definition (Du, 2014, p. 410). Furthermore, as others have pointed out in systemically critiquing the concept, state capitalism is used to refer 'to an extremely wide array of practices, policy instruments and vehicles, institutional forms, relations and networks that involve the state to different degrees and at a variety of levels, time frames, and scales' (Alami and Dixon, 2020, p. 71). Broad definitions are reflective of this heterogeneity and include 'a system in which the state functions as the leading economic actor and uses markets primarily for political gain' (Bremmer, 2010, p. 4); or 'a political economy in which the state directs and controls key productive forces in an economy, yet employs capitalist practices' (McNally, 2012, p. 3). Such definitions could include economies as diverse as China, Russia, Vietnam, Malaysia, Singapore and South Africa, while telling us little about the crucial differences and unique ways in which these economies operationalize the state-market nexus. Thus, the concept of state capitalism is analytically useful only at a broad structural level for categorizing China's economy. For greater specificity this paper draws on a growing comparative literature which has sought to elucidate the key institutions and practices that undergird what is unique about capitalism with Chinese characteristics (Blanchette, 2020; Chen and Rithmire, 2020; Gruin, 2019; McNally, 2012; Peck and Zhang, 2013; Wu, 2016). It then applies the paper's conceptual framework to inform the debate over systemic rivalry in the trade system.

3.1 Hybridization as core institutional characteristic

The engagement strategy view of post-Mao economic reforms as occurring along a linear transition from socialist planning to a liberal market economy is a fundamental misconception of China's development. Instead the party-state has remained dominant even as market entrepreneurship flourished from the 1980s onwards. For McNally this suggests that 'successful institutional hybridization in the Chinese system has allowed these two dissimilar types of capital accumulation to coexist and become codependent' (McNally, 2012, p. 751). This state capitalism/market capitalism hybridization, or dual-track liberalization (Qian, 2017; Xu, 2011), is the first fundamental point to note about China's economic model. It represents a unique element of China's opening and reform era. Characteristics include re-tooling the Soviet-style *nomenclatura* system that allows the Party control over all political appointments to be used for 'promotion tournaments', which reward officials that preside over regional economic success, thereby 'melding the calculus of the party state with a style of centrally incentivized local entrepreneurialism' (Peck and Zhang, 2013, p. 375). Other forms of unique combination of free markets with communist economic institutions include the reforms that drove world-beating growth from the late 1970s to 2000s (Qian, 2017). For example, agriculture was only partially liberalized whereby producers could keep excess output only after their state quotas were met. Township and village enterprises (TVEs) underpinned industrial growth, representing 50 percent of output by the beginning of the 1990s (Lin, Cai, & Li, 1996, p. 180), yet these TVEs were communally owned, rather than privately owned. Land has never been privatized in China. Article 10 of China's state constitution outlines that land in cities is owned by the state, while land in rural and suburban areas is owned by collectives, except where state ownership has been legally defined[7]. These hybrid oddities of the early reform period stood in stark contrast to the Washington Consensus liberalization paradigm forced on many other developing countries, but were considered to be transitional institutions on the path to full liberalization. However, transition seems hardly appropriate in light of contemporary institutional development, which highlights powerful continuity in the Party's development of unique institutional forms designed to cement Party and state control over economic life.

Today, China's economy continues to exhibit this 'unique duality that combines top-down state-led development with bottom-up entrepreneurial private capital accumulation' (McNally, 2012, p. 744). In addressing this duality Wu's (2016) influential study has identified three elements of China's hybrid political economy that make it a *sui generis* form of state-capitalism, which Wu argues makes it unmanageable within the World Trade Organization's legal order. First is the state's corporate holding entity the State-owned Assets Supervision and Administration Commission of the State Council (SASAC). While Chinese SOEs often compete against one another internally, as well on international markets, Wu argues that it is misleading to view them as functionally autonomous commercial entities. SASAC has governance control over these entities, and may allow management operational autonomy 'so long as it delivers along the agreed-upon metric. The difference [compared to properly commercial SOEs in other countries] is that the metric is not pure profit, but rather the Chinese state's interest, broadly defined' (2016, p. 272). Furthermore, Wu argues that unlike other state economies that do not possess the governance complexity and institutionalized capability of China's Leninist party structure, the SASAC provides a unique governance capability to China's leaders. It allows control over all SOEs in China through a vast nested vertical and horizontal governance network, whereby provinces and municipalities each form their own SASAC governing provincial SOEs, but which sit under the central SASAC. This makes it one of the world's largest controlling shareholders and 'one of the most powerful economic actors in the world today' (2016, p. 271).

A second key element is Beijing's control over financial institutions through Central Huijin Investment Ltd. China's big four banks each sit within the top 10 list of the world's largest financial institutions. These are the Industrial and Commercial Bank of China, the China Construction Bank, the Agricultural Bank of China and the Bank of China. Central Huijin operates as a subsidiary of China's sovereign wealth fund, the China Investment Corporation, and like SASAC allows the state a tool to direct lending for its policy objectives, while second tier financial institutions are controlled through more complex shareholdings, with the example given of Shanghai Pudong Development Bank's top shareholders all being holding companies of the Shanghai SASAC (Wu, 2016, p. 275). While Central Huijin initially acted as a vehicle for restructuring China's largest financial firms, it has since been developed for increasing influence over the private sector through state investment and shareholding (Chen and Rithmire 2020; Pearson, Rithmire, and Tsai 2021). Beijing also established the China Securities Finance Corporation (CSF) in 2011, which like Central Huijin was originally intended to assist in general market liquidity, this time by facilitating securities trading. However, both Central Huijin and CSF began largescale investments in non-state shares during the 2015-2016 stock market meltdown – investments that were maintained even after market stabilization was secured (Chen and Rithmire 2020, 268). In 2020 Central Huijin was the largest shareholding company in China, holding 4.3 trillion RMB in assets under management.

A third pillar of China's hybrid system is the National Development and Reform Commission (NDRC), formerly the State Planning Commission during China's pre-1978 pure command economy era. Planning ministries are common in nations across the globe. However, the NDRC stands out as unique because of the levers it has available to drive economic policymaking and outcomes (McNally, 2012, p. 754; Wu, 2016, p. 276). The NDRC oversees China's five-year development plans, and is a key institution for translating vast shareholder control vested through the SASAC into an actual means to drive coordinated policy objectives. Some of the actions of the NDRC include setting prices for key commodities, such as electricity, oil, natural gas and water, thereby affecting the cost structure of the entire economy. The NDRC is the final authority whenever a large infrastructure project or investment requires government approval, affecting supply and capacity, as well as having a role in deciding the allocation of the state's investment funds. It can implement major economic policy, including industrial policy, service sector development, sustainable development policy, and also acts as an enforcer of regulations such as the Anti-Monopoly Law.

Similar to how the SASAC governance structure is replicated at the subnational level, the NDRC is replicated at province and municipal levels, where each authority has a Development and Reform Commission (DRC), and each of these report vertically to the National DRC, as well as horizontally to related Party-state authorities. This ensures 'that the state has the full ability to coordinate economic policies both within and across sectors and regions...The presence of a single economic coordination agency with wide-ranging scope both horizontally and vertically also helps to render China unique' (Wu, 2016, pp. 277, 278). McNally notes that the NDRC can suffer incoherence due to intense provincial competition for foreign investment and thus competition between subnational NDRCs, yet also suggests this should not be overstated since 'the Chinese state has retained enormous leeway in its ability to intervene in the economy via the Leninist party-state, control over the commanding heights of industry and finance, and the substantial regulatory purview of local and central state formations' (McNally, 2012, p. 754). A number of other important Leninist institutions of control are listed in the box with brief descriptions to reinforce the above analysis. Next, I turn to the Party institution itself, which is the critical central institution of China's model.

[7] Constitution of the People's Republic of China, adopted at the First Session of the Thirteenth National People's Congress on March 11, 2018. Available at: https://english.www.gov.cn/archive/lawsregulations/201911/20/content_WS5ed8856ec6d0b3f0e9499913.html

Table 1 Leninist institutions of control

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State Asset Supervision and Administration Commission (SASAC)	Manages and regulates state-owned assets, including administration of 200 central-level SOEs; local-level administered SOEs are managed horizontally by provincial-level SASACs that report up to the national SASAC.
Central Huijin Investment Ltd	Allows the state to direct credit lending by the big 4 banks; complex shareholdings used to control second tier financial institutions' lending.
National Development and Reform Commission (NDRC)	Sets prices for key commodities impacting overall cost structure of China's economy; implements major domestic development policy; enforces regulations; provincial NDRCs report up to national NDRC, ensuring vertical and horizontal governance coverage.
Central Commission for Discipline Inspection	Reformed with enhanced powers under Xi. It can arrest without charge; decisions cannot be overturned by any other entity in China, not even the supreme court, i.e. it is above the law.
Cyberspace Administration of China (CAC)	Founded in 2011, CAC policies heavily censor online content, and has extensive control over data management and flows within China and across its borders.
State Administration for Market Regulation (SAMR)	Founded in 2018 through the merger of three existing regulators. SAMR has wide-ranging authority over the country's private sector through an expansive interpretation of anti-trust law.
Central Political and Legal Affairs Commission	Tasked with overseeing activities of legal enforcement authorities, including judges, prosecutors and police (Yang, 2017). When an issue is deemed "politically sensitive" the Commission prescribes the legal outcome that must be delivered by the relevant authorities in question. If that is a judicial decision then as noted in a 2009 National People's Congress, judges 'must remain loyal – in order – to the Party, the state, the masses and, finally, the law' (McGregor, 2012, p. 24).

3.2 The Party Institution

The central pillar of China's market socialism is the Party institution.

A defining aspect of Xi Xinping's tenure as General Secretary of the Party since 2012, and China's President since 2013, has been a concerted effort to further institutionalize and strengthen Party presence, surveillance, and influence across all societal domains (Blanchette, 2020; Minzner, 2018). When Xi took the reins, the Party already had a vast Leninist single-party system of political control comprising 80 million or so members, and used to manage and influence the state, the economy, the civil service, the military, police, education, civil society and the media in ways that maintain Party control (Heath, 2014; McGregor, 2012). In the economy Xi has used this political machinery to strengthen control over SOEs, which became necessary after decades of high growth meant their size, organizational complexity and internationalization left the national SASAC struggling to monitor them to the desired degree (Leutert and Eaton, 2021, p. 20). Xi has used the cadre management system to increase party control over SOEs by legally clarifying the leading role of the Party in corporate charters, re-invigorating party building within SOES, increasing ideological education of SOE leaders and strict management of SOE leadership appointments[8].

The degree of Party control may not always be immediately apparent, since it is not stated in SOE prospectuses and corporate law indicates SOEs have legal autonomy, and lastly because as a matter of daily life the Party does not seek to micro-manage every aspect of economic activity. However, when required, SOE Party cells can be utilized to ensure implementation of Beijing policies and political agendas. Furthermore, since the Party stands outside the law in China's legal system (McGregor, 2012, pp. 22-26) precise legal delineation of the exact nature of authority over SOEs is not required. As one Chinese lawyer stated: 'In corporate law, the boards [of Chinese state companies] can choose to disregard the Party's advice. As a fact of life they cannot' (quoted in McGregor, 2012, p. 49).

Directives to SOEs can be given informally through the Party cell system free from any paper trails. This lack of transparency makes prosecuting a WTO trade case against SOEs suspected of acting politically rather than commercially difficult if not impossible[9]. Studies have documented extensive use of SOEs by Beijing for political purposes, including coercion (Kurlantzick, 2016, pp. 203-224; Vekasi, 2019).

Reforms similar to those used for increasing Party control and surveillance over SOEs are also being expanded into the private sector, albeit at a slower pace and through a mix of formal and informal actions (Chen and Rithmire, 2020; Norris, 2021; Pearson, Rithmire, & Tsai, 2021). Reforms include the 2017 National Intelligence Law which requires organizations to support state intelligence entities in any manner required for national security broadly defined – thus actions ranging from intelligence gathering, commercial discrimination, technology transfers and economic coercion are conceivable. In 2018 Article 5 of 'Guidelines for the Governance of Listed Companies' issued by the China Securities Regulatory Commission[10] requires private firms to 'provide for the activities of the Party committees, which they are notably obligated to bring into their equity structure' (Norris, 2021, p. 25). This was done to further Xi's goal, as outlined in 2017 at the 19th Party Congress, to revitalize Party leadership across all societal domains. In the section of Xi's keynote speech titled 'Ensuring Party leadership over all work' he noted that "The Party exercises overall leadership over all areas of endeavour in every part of the country…We must improve the institutions and mechanisms for upholding Party leadership"[11]. Establishing new Party cells in non-state firms, as well as invigorating the role and status of existing cells has been a central element of firming up Party leadership across the economy. By the end of 2017 the Party claimed that 1.88 million private firms had created such cells, including foreign firms, a figure representing over 73 percent of all private firms (Pearson, et al., 2021, p. 209).

[8] As laid out by the General Office of the Central Committee of the Communist Party of China document "关于在深化国有企业改革中坚持党的领导加强党的建设的若干意 见" [Several Opinions on Adhering to Party Leadership and Strengthening Party Building in Deepening the Reform of SOEs], Chinese Central Government Portal, September 20, 2015, http://www.gov.cn/zhengce/2015-09/20/content_2935714.htm.

[9] McGregor (2019, p. 68) notes that China adopted such informal mechanisms during a blockage of Australia's thermal coal in 2019 to ensure no incriminating paper trail could be found or leaked later, having learned from previous instances where leaks had occurred and exposed activity in breach of WTO commitments.

[10] "上市公司治理准则" [Guidelines for the Governance of Listed Companies], China Securities Regulatory Commission, September 30, 2018, http://www.csrc.gov.cn/pub/zjhpublic/zjh/201809/t20180930_344906.htm.

[11] Xi Xinping, 'Secure a Decisive Victory in Building a Moderately Prosperous Society', 19th Party Congress 中国共产党第十九次全国代表大, October 18, 2017. Available at: http://www.xinhuanet.com/english/special/2017-11/03/c_136725942.htm

While acknowledging that the Party does not micromanage everyday commercial life in the way a full command economy would, the deep fusion of party cells across both SOEs and private firms means that an already blurred line between public and private becomes even more diffuse. As Blanchette puts it, 'it is difficult (if not impossible) to delineate with any precision where CCP influence ends and where firm autonomy begins' (2020, p. 2). The CCP has institutionalized a web of vertical and horizontal Leninist party networks as the overarching integument of a vast and highly developed array of regulatory institutions, all designed to allow the Party maximum flexibility and capability for implementing a whole-of-society development plan. Its economic model 'entails intensifying blending of not just ownership, but also function and interests, in a manner that upends the familiar public/private binary and illustrates the distinctive political logic of party state capitalism' (Pearson, et al., 2021, p. 210). SASAC Party Chair Hao Peng puts the logic of Party capitalism this way:

> Regardless of whether state-owned or private enterprises, they are all Chinese enterprises. [We] will firmly promote the upstream and downstream *integration of firms of various ownership structures*, the integration of large, medium, and small, and the coordinated and innovative development of various market entities to jointly build a group of world-class enterprises[12] [emphasis added]

Consider what Peng is saying here, namely that the fundamental binary organizing Western political economy, public versus private ownership structure, is secondary within China's political economy. Instead, their status as *Chinese* enterprises becomes primary, making them equally subject to being interpolated into the Party's Leninist control system. China's Party capitalism thus denotes a capitalist market economy internalized within, and subservient to, a Leninist one-party political economy, producing what the Party terms a *socialist* market economy. Consequently, private property rights undergirding capitalist commercial relations protected by rule of law as understood in liberal democracies simply do not exist in China. Free markets and entrepreneurialism do exist in China, but under very different legal and normative conditions than liberal market economies. The institutional development of China appears to represent an idea fleshed out by Deng Xiaoping in 1979, at the beginning of China's opening up period:

[12] 郝鹏接受中央主流媒体采访谈当前中央企业发展态势 [Hao Peng interview for central mainstream media about current development of central enterprises], 11 August, 2020, available at http://www.sasac.gov.cn/n2588020/n2877938/n2879597/n2879599/c15343606/content.html

> Why can't we develop a market economy under socialism? Developing a market economy does not mean practicing capitalism. While maintaining a planned economy as the mainstay of our economic system, we are also introducing a market economy. But it is a ***socialist*** market economy...taking advantage of the useful aspects of capitalist countries, including their methods of operation and management, does not mean that we will adopt capitalism (Xiaoping, 1994, pp. 232-234) [emphasis added].

The Party's paramount leaders have consistently used the term 'socialist market economy' in key speeches since, and the term is enshrined in both the Constitution of the Communist Party of China and the Constitution of the People's Republic of China. In the Party Constitution the General Program states that 'The Communist Party of China shall lead the people in developing the socialist market economy'[13], while the state Constitution's Article 15 opens with 'The state shall practice a socialist market economy'. Deng's vision of capitalist markets as a useful but nonetheless subordinate tool within a socialist system has been reiterated consistently since. In reflecting on the aftermath of the 2008 global financial crisis Wen Jiabao stated "we came to the conclusion that . . . [while continuing to rely on the basic role of markets], we must fully bring into play the superiority of the socialist system, which is efficient decision-making, powerful organization, and concentration of resources to achieve big things" (quoted in Naughton, 2021, p. 7). In a 2013 speech titled 'Uphold and Develop Socialism with Chinese Characteristics' Xi Xinping acknowledged that "socialism in its primary stage will exist alongside a more productive and developed capitalist system" but that China was "building a socialism that is superior to capitalism" (quoted in Tobin, 2020, pp. 12-13). In 2017 Xi stated the meaning of China's success as follows:

> It means that the path, the theory, the system, and the culture of socialism with Chinese characteristics have kept developing, blazing a new trail for other developing countries to achieve modernization. It offers a new option for other countries and nations who want to speed up their development while preserving their independence; and it offers Chinese wisdom and a Chinese approach to solving the problems facing mankind[14]

The Party has displayed remarkably consistent political messaging concerning the role and place of *capitalist* markets within a *socialist* market economy as supporting a developmental transition from a full but ineffective Soviet-style command economy to a hybrid form of *embedded* socialist market economy.

The engagement strategy, however, has operated on the assumption that such statements and terms concerning China's socialist system were a sort of double-speak, ideological tools used for political sloganeering with little or no material substance. Whereas the institutional development outlined above is material evidence that the Party has matched its rhetoric with real actions, and developed a *sui generis* institutional order along the lines identified by Deng and later leaders; building an economy where the public sector is hailed as the leading sector and free markets are in strict subordination to the Party's political order. Hence, it is a well-founded point made by Gruin that 'one must look beyond traditional notions of market liberalization and state regulation' (2019) to analytically grasp China's developmental logic.

To sum this section up, the common threads within the comparative literature are as follows: China's economy cannot be captured in requisite detail by the concept of state capitalism. Its developmental arc has followed a unique trajectory grounded in China's institutional history under Party leadership. That trajectory is a consequence of unique institutions that allow markets a major role in production and allocation while simultaneously maintaining extensive *executive*, rather than just regulatory, political control over all facets of the economy. State ownership of key factors of production has been maintained and progressive institutionalization of political control over the economy's commanding heights and increasingly its lesser heights is evident.

[13] 中国共产党章程 (Constitution of the Chinese Party of China), Revised and adopted at the 19th National Congress of the Communist Party of China on October 24, 2017. Available at: http://www.xinhuanet.com//english/download/Constitution_of_the_Communist_Party_of_China.pdf

[14] Xi Xinping, 'Secure a Decisive Victory in Building a Moderately Prosperous Society', speech delivered at 19th National Congress of the Communist Party of China on October 18, 2017. Available at: https://www.chinadaily.com.cn/china/19thcpcnationalcongress/2017-11/04/content_34115212.htm (accessed 1/11/2021

4. China, A Systemic Rival with Implications for an Engagement Strategy

Trade agreements require making universal rules for interaction. If major players are playing fundamentally different games, the degree of structural overlap for shared rule-making becomes smaller, and the competition to devise rules becomes greater. Furthermore, recall that a nation will logically prefer a form of multilateralism that will maximize the advantages of its economic model. This implies that the internal institutional logic of a country will impact its willingness to abide by rules that undermine its institutional comparative advantage. Theory also tells us China can be expected to externalize its preferences onto the multilateral system. This may be both informally, for example, through practices that challenge WTO rules and norms but are unofficially unacknowledged by Beijing; and formally, by contesting rules and norms within international forums designed to develop new rules and standards. This section identifies both formal and informal modes of contestation.

4.1 Informal Contestation of the Liberal Trade System

Analysis of China's trade law compliance as a form of 'paper compliance' (Webster, 2013) supports the theoretical expectation of informal contestation of WTO rules. Webster notes that China has a good record of implementation according to the letter of the law, but breaches the spirit of the law by continuing 'to introduce policies that clearly run afoul of basic tenets of the multilateral trading system' (2013, p. 534). These include maintaining large subsidy regimes, a general lack of transparency, ongoing market access barriers, forced technology transfers, export restrictions and domestic market barriers for foreign entities. Thus, while China has a good compliance record for disputes lost at the WTO's Dispute Settlement Body (DSB) Webster warns that focusing narrowly on the DSB cases 'overlooks other modes of resistance China deploys to avoid complying with basic WTO norms' (Webster, 2013, p. 530; see also Weinhardt and ten Brink, 2020, p. 265).

This is the same wider point made by Wu (2016), who rejects claims that the WTO has largely managed China's trade relationship with other Members within the scope of the institution's rules. He argues that only a small range of disputes with China are manageable within the current rules, those being areas where China's policies and practices resemble the liberal economies. Outside of that defined area major incompatibilities exist. Particularly, Wu argues that core WTO legal concepts and norms including requirements for a clear distinction between government and/or public entities, a normative commitment to competitive neutrality and the requirement that SOEs act according to commercial considerations are in conflict with China's economic model.

A second way China challenges the rules based norms of the liberal trade order is its increasing resort to economic coercion. Such coercion falls under the general concept of economic statecraft, defined as 'the application of economic means of power by states so as to realize strategic objectives' (Scholvin and Wigell, 2018, p. 74). There is growing evidence of Beijing's systematic approach to using its economic heft for strategic, militaristic and political ends. Some examples including arbitrarily reducing its export quota for rare earth elements in 2010 to Japan when tensions flared up over the Tokyo-controlled Senkaku islands, which both nations claim as their territory (Vekasi, 2019); when the Senkaku island dispute flared up again in 2012 Chinese SOEs were encouraged to stop buying Japanese goods where possible, which is estimated to have cut 1% of Japan's growth for the final quarter (Kurlantzick, 2016, p. 207); Beijing informally banned Norwegian salmon in response to the Nobel peace prize being awarded to Chinese dissident Liu Xiaobao in 2010; during the 2010s countries that allowed a Dalai Lama visit suffered an 8 percent drop in trade with China for the next two years, significantly above normal trade fluctuations, indicating causality rather than correlation (Kurlantzick, 2016, pp. 209-210); during 2012 imported bananas from the Philippines were left to rot on spurious grounds in response to Manila challenging Beijing's annexation of the Scarborough Shoals (Yahuda, 2020, p. 274); in 2017 when South Korea allowed a THAAD missile system to be deployed on its territory Beijing instigated an informal ban on Chinese group tourism to the country, and used contrived regulatory issues to close down Lotte stores in China (Lim and Ferguson, 2021); and more recently, when Australia called for an international investigation into the origins of coronavirus Beijing applied wide-ranging economic sanctions on coal, wine, barley and lobster exports (Laurenceson and Pantle, 2021).

What is also noteworthy about the above sanctions is that Beijing often makes public threats that such sanctions will be applied in attempts to coerce and shape the target state's behaviour. When the Australian government first proposed an independent inquiry into the COVID-19 the Chinese Ambassador to Australia, Cheng Jingye, made a series of remarkable public threats of economic sanctions, covering tourism, education, wine and beef, stating "Maybe the ordinary people will say 'Why should we drink Australian wine? Eat Australian beef?" (Probyn, 2020). Such elliptical statements are designed to indirectly inform targeted countries of the reasons for such actions, while also allowing Beijing plausible deniability if a WTO dispute settlement case was actioned. Furthermore, while Australia announced it would bring a WTO case against Chinese wine tariffs, this will take years to complete. And since there is no possibility of retroactive damages being awarded even if Canberra wins the case, the damage to Australia's wine exports to China will be permanent, highlighting a major weakness in WTO litigation.

The reality is that if a structurally important economy like China regularly acts in broad-based conflict with the spirit of the rules, then it cannot be brought into alignment by litigation. The latter is too time and resource intensive[15], and only suitable for managing occasional breaches, as well as for reinforcing group norms. This is analogous to a civil judicial system, which can manage rule-breaking at the margins but cannot cope with mass civil disobedience. From that perspective one could view China's economy as representing a form of generalized trade disobedience against WTO rules. Lastly, while the WTO litigation process can 'shear away layers of non-conformity (if the state agrees to do so), [it] cannot add them on' (Webster, 2013, p. 534), making dispute settlement along with China's WTO-plus rules an inadequate solution to China's socialist market economy.

4.2 Formal Contestation of the Liberal Trading System

As China's relative economic heft has steadily grown Beijing is increasingly willing to engage in formal 'selective contestation' of liberal order rules, particularly those with behind-the-border consequences. The goal of behind-the-border trade rules is to ensure a level playing field between foreign and domestic firms. Recent studies argue that in situations where liberal order rules and norms directly clash with the Chinese Communist Party's (CCP) domestic governance preferences, the Party is likely to engage revisionist actions that contest existing international institutions and norms (Weinhardt and ten Brink 2020, 261; Weiss and Wallace 2020). For example, China has formally contested the ongoing application of non-market economy (NME) status by its trading partners when applying anti-dumping rules[16], pressurizing countries to normalize China's status as a market economy despite remaining misgivings that it is in fact a market economy. Article 15 of China's WTO-Plus agreement, which originally allowed WTO members to treat China as an NME, envisaged a 15 year expiration date after its 2001 accession. China challenged the EU at the WTO over its refusal to drop its NME classification of China after the lapse date of 2016, however Beijing later dropped the case in 2019 when it appeared likely to lose.

China has also started to officially challenge core concepts of the liberal trade order concerning *competitive neutrality*. In competition policy 'competitive neutrality' recognizes that state-owned enterprises must be subject to special legal measures to ensure they do not receive unfair advantages by way of their ownership status. This is necessary since SOEs are owned by the government, who is the rule-maker and rule enforcer of economic regulatory systems, and also typically the biggest single spender in a national economy through government procurement contracts. Private firms need competitive neutrality laws to ensure they can compete fairly with SOEs, as has been acknowledged since the original 1947 GATT under Article XVII on state-trading enterprises. However, senior Chinese trade officials are reported to 'regularly complain that existing rules unfairly discriminate against Chinese SOEs and call for the WTO's liberal trade order to be adapted in order to accept a strong reliance on SOEs' (Weinhardt and ten Brink, 2020, p. 266). More tellingly, in 2018 SASAC's Vice-Secretary at the time, Peng Huagang, advocated for the concept of 'ownership neutrality' to replace 'competitive neutrality', stating the following: "we also advocate '*ownership neutrality,'* and are opposed to setting different rules for enterprises subject to different ownership systems, and opposed to discriminatory treatment of SOE's in the formation of international rules"[17]. In this way China is seeking to repurpose institutional norms and rules to be more amenable to its social market economy preferences.

Such conceptual boundary pushing by China holds significant ramifications. The difference between competitive neutrality and ownership neutrality is not a difference in degree, whereby a negotiated consensus can be forged. Rather, it is a difference in kind, the implications of which trace their way back to the foundations of social organization itself, and core differences in political philosophies concerning the proper place of government authority in the economy.

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[15] Consider that the subsidies spat between the US and EU over government support to Boeing and Airbus respectively has taken 17 years to resolve. See WTO case DS316: Measures Affecting Trade in Large Civil Aircraft.

[16] GATT Article VI:1 allows a complainant to deviate from standard methodology for calculating the normal value of a good dumped below cost into its market by another country, essentially allowing the use of third country prices instead of the offending NME country – since the latter is not viewed as having true market prices.

[17] *China Banking News*, 'Let China's State-owned Enterprises Become Independent Market Actors: SASAC', 16 October, 2018. Available at: https://www.chinabankingnews.com/2018/10/16/let-chinas-state-owned-enterprises-become-independent-market-actors-sasac/ (accessed 02/11/2021).

5. Conclusion

Trade policy is never a question of pure economics. It is a question of managing socio-political interactions defined by the need to create shared rules in an anarchic international state system. Lacking a final authority that can enforce those rules means national commitment is the fundamental requirement for effective multilateralism. During most of the post-war era the benefits of joining the GATT/WTO club ensured a high level of commitment among large and structurally important members. This was galvanized by the successful U.S. and Western European economies as economic exemplars. Nations less committed to liberal reform could be tolerated to the extent that they were neither structurally important trade actors, nor direct economic competitors. China is both, and in the context of its unique development path it should be considered a 'systemic rival' to the incumbent liberal trading system incorporated within the institutions of the GATT/WTO trading order. Policy thinkers should therefore adopt a new engagement strategy, version 2.0. This should be undergirded by a new preconception of China as being in transition to a *socialist* market economy. From that perspective, when we are told that there are free markets everywhere in China[18] we must avoid confusing an empirical fact (free market activity) with a qualitative fact (liberal market economy).

That is because China's free markets exist within a fundamentally different socio-political integument, and operate within the logic and constraints of the Party's socialist governance.

Engagement strategy 2.0 would usefully, from a trade perspective, bear that in mind; acknowledging the nature of China's economic model and the tension points this will entail for liberal market economies, based on a new preconception of China as a socialist market economy as its starting point. In doing so trade policy that accurately reflects and accounts for China's actual development path, and the difficulties this poses for its trading partners will allow for better trade policy analysis, followed by more realistic expectations about what is and is not likely to follow in practice. Each nation has the right to decide its development path and political system. Therefore, managing expectations around trade relations with China, and delimiting those relations where irreconcilable tensions exist can lead to a less fractious relationship between China and its trading partners. This is particularly true in an era of trade integration where extensive convergence on behind-the-border rules is required for managing the liberalization of 21st century trade relations that require free-flowing data, high-quality IP protection, strong property rights and consistent rule-of-law enforcement of such rights. National security vulnerabilities are increasingly implicated in many 21st century technologies and related connectivity, further reinforcing the need for shared rules, norms and protections from arbitrary state power in the economy. Under such conditions systemic rivalry touches broad swathes of the economy, and holds implications for multiple and interconnected policy domains.

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[18] As for example Yan Dong, Director of the WTO Affairs of the Ministry of Commerce recently noted during a press conference responding to a 2021 WTO trade policy review of China's trade practices: "At present, more than 97% of commodity prices and service prices in China are determined by the market". Available at: https://www.chinatrademonitor.com/china-holds-press-conference-on-wto-trade-policy-review/ (accessed 02/11/2021).

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