Decentralization, Industrial Geography, and Politics of Export Regulation

Case of Sino-Japan Trade Disputes

Megumi Naoi*
Department of Political Science
University of California, San Diego
mnaoi@ucsd.edu

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Introduction

Developing countries today face various external pressures to regulate exports. China is the most targeted emerging economy in this sense. Since its economic opening in 1979, 34 countries and regions launched a total of 665 disputes of anti-dumping, counter-veiling duty, and safeguard investigations against Chinese products at GATT and WTO. More than 4,000 commodities have been involved. Outside of multilateral arenas, moreover, China was involved in numerous bilateral negotiations for voluntary export restraints with the United States, Europe, Japan, and South Korea to name a few.

The ways in which these disputes were settled, however, substantially differ across commodity cases and over time. In some cases, disputes were settled via bilateral Voluntary Export Restraints (VERs) negotiations, while in other cases they escalated into the use of multilateral rules such as the adoption of safeguard and anti-dumping measures by China’s trading partners. The use of bilateral VERs negotiations has been declining over time and, instead, an increasing number of disputes have been settled using multilateral rules. While a vast amount of political economy literature studying trade conflicts exits, how states choose among different fora of dispute settlement mechanisms is still poorly understood. The question is important because it raises the issue of the efficacy of international institutions in shaping states’ behaviors. While scholars argue that international trade has become multilateralized and legalized, states use these rules selectively and strategically.

This chapter explores states’ dispute settlement choice by analyzing the cases of Sino-Japan trade conflicts since 1976. The Sino-Japan case provides several advantages in exploring why some disputes are settled bilaterally while others are solved using multilateral rules. First, Japan has consistently sought to negotiate bilateral VERs with China and fiercely avoided the use of multilateral rules until the year 2001. Thus, the choice between bilateral vs. multilateral dispute solutions was largely a function of what the Chinese side desired. This allows us to analyze Chinese government and industry’s preferences for dispute settlement venues while holding the

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1 “China suffers the most in anti-dumping disputes for nine consecutive years,” People’s Daily, October 26, 2004.
2 Prusa 1999; Rodrik 1997; Martin and Goldstein 2001; Kahler 2001; Mattli 2001; Busch and Reinhardt 2003.
Japanese side preferences relatively constant. Second, since the late 1980s, the Japanese government and industries have increasingly struggled to induce VERs from China. As discussed in detail later, the Chinese government has rejected Japan’s requests to restrain exports on numerous occasions. Even when China agreed to voluntary restrain its exports, such agreement did not led to a reduction of exports in an increasing number of cases. What explains the shift from bilateralism to multilateralism in how Sino-Japan disputes were settled? And why has bilateral VERs negotiation become ineffective?

This chapter argues that the Chinese government’s dispute settlement choice is a response to two types of costs that arise during export regulation: (i) the cost of negotiating the export restraints with domestic firms and foreign countries and (ii) the cost of enforcing the export quota on Chinese exporting firms. I further demonstrate that these negotiation and enforcement costs are sensitive to two “decentralization” factors: the degree of decentralization in a government’s export administration and the degree of geographical concentration of industries. As discussed in detail below, bilateralism has declined since mid-1980s due to the rise of costs in enforcing the export quota on provincial and municipal governments and foreign trade corporations (FTCs) under the highly decentralized export administration system. The rise of multilateralism to solve disputes—i.e., the use of WTO rules such as safeguard and anti-dumping measures by trading partners—is due to the Chinese government’s attempt to transfer the negotiation and enforcement costs to industries and foreign governments. By replacing informal negotiation and enforcement process with WTO-legal rules, the Chinese government shifts the liability to enforce the export regulation to exporting firms, local governments, and foreign governments.

The approach of this chapter differs from the existing literature in four respects. First, instead of looking at China as a unitary actor, this chapter demonstrates that the central government, sub-national governments, and exporting industries have different policy preferences for various forms of export regulation in China. Second, this study explicitly links changes in domestic institutions (i.e., decentralization) with the government’s choice across different venues of export regulation. I examine how decentralization of export administration has given rise to sub-national actors in foreign trade and changed the relative effectiveness of bilateral vs. multilateral forms of export regulation. Third, while emerging “forum-shopping” literature looks at expected

4 In this sense, I follow Stigler (1971) and Peltzman’s view (1976) that “the primary determinant of the form of regulation is the way in which it transfers wealth among members of society”. Viscusi, Vernon, and Harrington 1995, p.800. On the literature on endogenous regulation, see Stigler 1971; Peltzman 1976; Fiorina 1982; Campos 1989.
negotiation outcomes to be an important determinant of states’ choice across different dispute settlements,⁵ I argue that the expected level of enforcement also plays an important role in choosing a venue for export regulation. Finally, studies on Sino-Japan trade disputes so far focus primarily on economic and political conditions of the Japanese side as major determinants of the choice. I will show that the dispute settlement choice has also been a reflection of what the Chinese side wanted and identify the sources of the Chinese government’s and industries’ preference.

The remainder of this chapter proceeds as follows. The next section discusses the puzzle—cross-commodity and variations in Sino-Japan dispute settlements over the past three decades. The second section develops my argument that decentralization of export regulation and industrial geography interact to affect a government’s choice between bilateral vs. multilateral venue of export regulation. The third section provides a study of two polar cases from the 2001 Sino-Japan disputes: rush and rush-woven products (tatami) and seaweed. In the tatami industry case, the Chinese government rejected Japan’s proposal to bilaterally negotiate VERs and instead let the Japanese government adopt a temporary safeguard measure for the first time in Japan’s history. On the other hand, seaweed industries successfully negotiated VERs without much government’s intervention. I show how a high degree of geographic concentration within the seaweed industry led to successful industry-level VERs negotiations without major government involvement, while the low degree of geographic concentration within the tatami industry led to the failure of industry-level negotiations and the Japanese government’s use of safeguard measure. Finally, I conclude by discussing broader implications of the analysis for the study of domestic politics and international institutions.

Section 1: The Puzzle

Since the first major Sino-Japan trade dispute regarding silk yarn between 1976 and 1980, Japan has consistently sought bilateral VERs negotiation to deal with the rise of Chinese exports. Japan fiercely avoided the use of multilateral rules, such as anti-dumping, counter-veiling, and safeguard measures, which are legal under GATT/WTO, for several reasons. First, historically, Japanese export industries have been a target, rather than an implementor of these measures adopted by the United States and Europe. The government has officially taken a position at GATT/WTO

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⁵ Mattli 2001; Reinhardt and Busch 2003; Davis 2004.
negotiation rounds to support more restrictive use of these measures. Second, Japan feared that use of multilateral rules to regulate imports will invoke retaliation by trading countries which will harm its exporting sector. Finally, China was not a member of GATT or WTO until 2001 and hence was not obligated to comply with Japan’s use of multilateral rules.

Since the late 1980s, however, Japan increasingly struggled to induce VERs from China. The Ministry of International Trade and Industry (the MITI) attempted numerous times, in vein, to negotiate VERs with China with respect to textiles (1988), alloy (1991), textiles (1994, 1995), cotton and cotton fabrics (1996), and ginger and garlic (1996) and so on.\(^7\) In all of these cases, MITI proceeded to investigate potential anti-dumping and safeguard adoptions and investigations eventually led China to agree to restrain its exports. In other words, Japan used the shadow of multilateral rules to induce bilateral VERs from China throughout the late 1980s and 1990s.

After a series of failed bilateral attempts, Japan adopted a temporary safeguard measure for the first time in its history with respect to tatami products, scallion, and *shiiitake* mushroom industries in 2001. Scholars point to several factors in an attempt to explain why Japan ultimately resorted to the use of WTO safeguard measures": (i) special interest politics; (ii) electoral cycles; and (iii) bureaucracy’s shift from bilateral to multilateral diplomacy.\(^8\) These studies, however, tend to suffer from case selection bias—i.e., they look only at the three commodity cases that were granted safeguard protection in year 2001 and infer their causes. What these studies fail to notice is that there were industries that successfully negotiated VERs with China during the same time period such as eel and seaweed industries. These industries negotiated VERs without much government involvement, which also poses a puzzle. Why were these private-level VERs negotiations successful and credibly committed by Chinese exporters without legal obligations or government involvement? Two points are worth highlighting from the above discussion.

One, we need to ask not just when Japan and China resort to multilateral rules to solve disputes, but when they choose across different venues of export regulation. In particular, cases where industries successfully negotiated VERs without government

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\(^7\) Commodity-level dataset on Sino-Japan trade disputes and outcomes (1976-2005) collected by the author using newspaper articles in Japanese, Chinese, and English.

intervention ("private ordering")\(^9\), such as seaweed and eel, are intriguing. Two, the Sino-Japan dispute settlement outcomes have been largely a function of what the Chinese-side wanted. When China agreed to VERs, bilateralism was chosen; when China disagreed, its trading partners proceeded to use multilateral rules. It is important, therefore, to explore sources of Chinese preferences for different venues of export regulation.

Section 2: Argument and Hypotheses

Why did some Sino-Japan dispute cases settle with bilateral VERs agreements while others escalated into the use of multilateral rules? I argue that two “decentralization” factors—decentralization of government’s export administration and geographical concentration of industries—interact to affect the government’s choice. The two factors are important because they affect two types of costs that arise during the negotiation and enforcement stages of VERs. First, the degree of centralization in a government’s export regulation affects costs of negotiating VERs. The fewer the number of actors involved in the negotiation (\textit{i.e.}, higher centralization in export regulation), the lower the costs of negotiation will be. Second, whether an industry is geographically concentrated or not affects the costs of negotiating VERs as well as costs of enforcing the export quota. I will explain the logic behind each factor in detail below.

2.1. Centralized vs. Decentralized Export Regulation

The process to adopt VERs can be considered as a three-stage decision: (i) domestic decision-making as to whether to negotiate VERs; (ii) negotiation with importing countries, or firms; and (iii) enforcement of the agreement. These processes can be centralized (\textit{i.e.}, the central government agency decides, negotiates, and enforces arrangement) or decentralized (\textit{i.e.}, many government agencies, firms, or lower-level governments are involved). The degree of centralization in a government’s export administration affects the government’s choice between bilateral vs. multilateral venues of export regulation by shaping (i) the number of actors involved in the process and (ii)

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who bears the costs of enforcing and monitoring the agreement (“liability”).

Under the centralized export regulation system, negotiating VERs is easier for two reasons. First, the costs of negotiation are lower because fewer actors are involved.\(^{10}\) Second, once an agreement is reached, the costs of enforcing the quota restriction are also lower under a centralized export administration system because collecting information and monitoring the enforcement is easier when fewer actors are involved.

Finally, it is not just the total amount of costs involved in negotiation and enforcement that matter; distributional issues arise, \(i.e.,\) who bears the costs of the negotiation and enforcement. Here, bilateral and multilateral instruments of export regulation differ fundamentally in who bears the costs. With bilateral VERs agreement, the Chinese government and/or exporting firms are responsible for enforcing the quota restriction. With multilateral rules, tariffs are imposed on commodities and therefore the Chinese government does not bear the costs of allocating and enforcing the quota. Instead, importing countries need to allocate import quota to firms and monitor its enforcement.\(^{11}\) Thus, when the costs of enforcing the quota are low \((i.e.,\) centralized export administration and geographically concentrated industry), the Chinese government is more likely to use bilateral VERs over multilateral rules to regulate exports.

### 2.2. Concentrated vs. Diffused Industrial Geography

Under the decentralized export administration system, industry geography affects the government’s dispute settlement choice by changing (i) the number of actors involved in the process, (ii) geographical proximity of firms and regulatory agencies, and (iii) the level of competition among sub-national governments. First, under a decentralized system in which sub-national governments promote and regulate exports, geographic diffusion of industry is a proxy for the number of actors involved in the VERs process—its decision-making, negotiation, and enforcement stages. The more geographically diffused an industry is across provinces, the more actors are involved in the VERs process.

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\(^{10}\) Olson 1965; Axelrod 1984.

\(^{11}\) Existing literature on rent-seeking in trade suggests that a rent-seeking government prefers VERs to tariffs precisely because the former creates rents through quota allocations. VERs also offers an opportunity for exporters to collude with importers by setting the price higher than the world price as seen by the Japanese auto industry’s adoption of VERs with the United States in the 1980s. See Krueger, Anne O. “The Political Economy of Rent-Seeking,” *American Economic Review* 3 (1974): 291-303.
Second, geographic concentration of an industry may affect costs of enforcement because geographic proximity of firms and regulatory agencies allow easier monitoring and enforcement of the export regulation. The higher an industry’s geographic concentration is, the easier it is to enforce VERs.

Finally, under a decentralized export regulation system, the degree of geographic concentration is a reflection of the level of competition to obtain higher shares of export market among sub-national governments and local firms. The higher the level of competition among sub-national actors (i.e., the more diffused an industry is across different provinces), the stronger the actors’ incentives to defect from the assigned quota restriction by exporting more products. Multilateral legal forms of export regulation, such as GATT/WTO-legal safeguard and anti-dumping measures, are more likely to be chosen by diffused industries because imposing and monitoring tariffs are the responsibility of an importing country. Thus, the multilateral form of export regulation can significantly reduce the costs of enforcing the export regulation for the Chinese government. On the other hand, when an industry is geographically concentrated, it is easier to achieve VERs because fewer exporters are involved.

Table 1 in the Appendix to this chapter presents my hypotheses discussed above. The X axis shows whether the Chinese government’s export administration is centralized or decentralized and the Y axis shows whether an industry is geographically concentrated or diffused. Each of the Sino-Japan dispute cases since 1976 is placed into appropriate quadrant of Table 1. As discussed in detail below, Chinese export administration has decentralized over time since the 1980s (which represents a shift from the left to the right row in Table 1). Geographic concentrations of industries vary across commodities and over time. The next section will give an overview of the decentralization reform in export administration and explain why decentralization interacts with industrial geography and shapes a government’s choice between bilateral vs. multilateral forms of export regulation.

Section 3: Overview—Decentralization of Export Regulation

China’s export administration has undergone a series decentralization reforms which granted power to provinces and municipalities to promote and regulate exports in three respects: (i) the ownership and management structure of foreign trade corporations (FTCs); (ii) a fiscal system in which localities and the central government share gains from foreign trade; and (iii) decision-making and enforcement process of export quota and licensing.
First, the ownership structure of foreign trade corporations (FTCs) became decentralized and internationalized. Before China’s open policy was adopted in 1978, only one dozen nationally-owned FTCs monopolized foreign trade. Within a decade, the number of local FTCs increased dramatically to approximately six thousand. Yet the central government’s agency, the Ministry of Foreign Economic Relations and Trade (MOFERT) regulated trade composition and flows by issuing FTC export licenses and subsidizing their activities. Under the centralized control by MOFERT, FTCs had a strong incentive to comply with the quota because MOFERT was the source of subsidies and permission to engage in foreign trade. In 1985, local FTCs were granted autonomy to engage in foreign trade and became under the control of provincial and municipal governments. An increasing number of local FTCs entered into joint ventures with foreign companies as well [Table 4]. Under the decentralized ownership structure, local and international FTCs compete with each other to win exporting contracts with producers.

Second, a decentralized fiscal contracting system was adopted between 1980 and 1994 in which provincial governments could retain tax revenues from local enterprises (Wang 1997; 2001). The foreign exchange contract system (waihui baogan) also gave an incentive to local governments to promote exports because they could retain 80% of such earnings under the assigned quota. As a result, local governments play a dual role. In addition to being agents of the central government that enforce the export regulation they are also independent actors that seek to maximize gains from foreign trade. Local FTCs owned by provincial and municipal governments also face the same dilemma. They are encouraged to compete against one another to win contracts with producers but once the government agrees to VERs they need to restrict their exports under the quota.

Finally, a decentralization reform was adopted at the implementation and enforcement stages of export regulation as well. This is so for two major policy instruments for export regulation: export licensing and export quota. The authority to

15 Zweig Chap 3. p.111.
17 On the early development of the export license system, see Lardy 1992, Chapter 3, pp.45-46. China restored its export licensing system in 1980 and expanded the number of commodities that were covered by the system (Lardy, Chapter 3). The share of trade values that were regulated by export and import licensing has risen sharply since 1980. Export licenses were
issue export licenses to FTCs was extended from MOFTEC to the Foreign Economic Relations and Trade Commissions of various provinces, autonomous regions, and municipalities in 1996. In 2001, the central office of the Ministry of Commerce issued approximately fifteen percent of the newly-licensed export commodities, while local authorities (local branches of the Ministry of Commerce and municipal and provincial-level Foreign Economic Relation and Trade Commission) issued approximately 85 percent.

Another instrument of export regulation, the export quota system, has been the subject of decentralization reforms as well. Before 1994, the decision-making process of setting and allocating quotas to FTCs was centralized and controlled by MOFERT, which decided quota allocations in consultation with provincial officials. The quota allocation system became more open and institutionalized during the 1990s. The most notable reform came in 1994 when MOFERT introduced an export quota bidding system introduced.

The quota bidding system is an open process in which the Ministry of Commerce (the successor to MOFERT) announces a minimum bidding price and the quantity of exports which should be subjected to the bidding. FTCs who will participate in the bid need to submit their past record of export revenues and quantity. The bidding process is decentralized in that locally-owned FTCs submit applications to local governments’ Foreign Economic Relation and Trade Commission, while centrally extended from twelve nationally-owned FTCs to FTCs owned by provincial and municipal governments throughout 1980s and 1990s. Lardy 1992; Zweig 2002.

18 MOFERT, Article 3 of “Several Provisions on the Administration of Export License”, January 2, 1996.
19 Ministry of Commerce (2001), “Year 2001: List of commodities that are managed by export license (chukou xuke zheng guanli shangpin mulu)” In the year 2001, 66 commodities were subject to export licenses. Among them, the central office of Ministry of Commerce issued license to nine commodities, provincial and municipal branches of Ministry of Commerce issued 46 commodities, and the remaining eleven were subject to local-level governmental organizations such as municipal and provincial-level Foreign Economic Relation and Trade Commission.
20 An example is reported in the news covering a meeting to set quotas for the tin industry in 1995. Participants at the meeting included officials from MOFTEC and CNIEC, and senior officials from the China National Nonferrous Metals Import and Export Corp. and the China National Metals and Minerals Import and Export Corp., as well as provincial trade officials from Xiamen in Fujian Province. See “China setting quotas this week”, Metals Week, 18 December 1995, 4 Vol. 66, No. 50.
21 There are two types of export quota—active and passive quota. Active quota are controlled by the Chinese government while passive quota are controlled by foreign governments. For instance, in the year 2000, 32 commodities were subject to open quota bids. Among 32 commodities, eleven were subjected to active quota (i.e., quantity controls by China) while twenty one cases were subjected to foreign countries setting the limits.
managed corporations apply directly to the Foreign Economic Relation and Trade Commission at the central government.\textsuperscript{22} Information regarding when and how the bidding is done, its participants, minimum bidding prices, and who won how much of the bids are made available to the public at provincial or central government’s offices and on the official web site of the Ministry of Commerce.\textsuperscript{23} The open bidding system has encouraged competition and lobbying by local governments and FTCs to win a higher share of the quota.\textsuperscript{24} The export bidding system was internationalized in 1995. Joint-ventures with foreign firms and foreign-owned companies are now allowed to participate in the bidding.\textsuperscript{25}

By these reforms, the open bidding system strengthened the position of local governments vis-à-vis the central government and vis-à-vis FTCs by giving them jurisdiction over export quota allocations. These reforms also provide greater room for locally-owned FTCs to lobby and influence the decision-making process at local governments. Once export quota are granted to FTCs, enforcement of the quota is largely delegated to provincial and municipal-level governments, which have a strong incentive to allow the FTCs to export more than their permitted quota in order to raise higher revenues and foreign exchange earnings and to promote export-led economic growth.

Section 4: Case Study: Rush and Rush-woven Products (Tatami) and Seaweed

Cases:

Both the \textit{tatami}-mat\textsuperscript{26} and the seaweed industry were severely hit by Chinese exports since the 1990s. These Japanese industries lobbyed the ministries and politicians to regulate the Chinese exports. Both industries initially sought to negotiate VERs

\textsuperscript{22} Ministry of Commerce (2001), “Method of Managing Export Commodity Quota Allocation” (\textit{chukou shangpin peie guanli banfa}), Chapter 4, Section 13.
\textsuperscript{23} One of the rationales behind the quota reform was to balance the power between MOFERT and producers and between FTCs and producers of commodities. On this see Zweig (2003) p.115.
\textsuperscript{24} Zweig 2002.
\textsuperscript{25} Ministry of Commerce (2001), “Method of Managing Export Commodity Quota,” 12\textsuperscript{th} Order.
\textsuperscript{26} Tatami-mats are a form of Japanese flooring made from rush woven together in a knit-like pattern. Japanese people started using \textit{tatami}-mats during the \textit{Nara} period in eighth century. Japanese traditional houses usually have rooms with \textit{tatami}-mats and even modern apartments often have one room with \textit{tatami}-mat flooring. However, during the past fifteen years hard wood floors have become more popular among younger generations and, as a result, the use of \textit{tatami}-mats has been declining.
with China. In the case of tatami, the Chinese government rejected Japan’s VERs proposal knowing that it would then adopt WTO-legal safeguard measures, while in the seaweed case, industry-level VERs were successful and credibly committed.

**Tatami Industry**

Table 2 in the Appendix to this Chapter shows the rapid increase of tatami exports to Japan from China in the 1990s. From 1996 to 2000, the quantity of tatami imports, as well as its import penetration ratio, has doubled. The domestic sales price of tatami products fell sharply during this period to 25% of the price in 1996. Responding to the rise of tatami imports from China, Japanese tatami industry associations organized demonstrations and lobbied members of parliament and prefectural-level representatives for regulated import.

Fearing that Japanese government may impose safeguard tariffs on tatami imports, MOFTEC issued an annual open export quota bidding for tatami products to restrain exports in 1999. The quota restriction, however, was ineffective as FTCs competed to export more products. Between 2000 and 2001, the Japanese tatami industry attempted, in vein, to negotiate VERs and make the existing export regulations by MOFTEC effective. Long Yongtu, a vice Minister of the Ministry of Foreign Trade and Economic Cooperation, proposed that “guidelines between private actors, not voluntary export restraints between the states, should be considered” (Yoshimatsu 2001, p. 401). The Japanese government requested the Chinese government to participate in bilateral negotiations and enforce export quota restrictions because the Japanese government believed that industry-level agreements would not be enforced.

As a result, the Japanese government resorted to the use of temporary safeguard measures for the first time in history in 2001. The adoption of safeguard measures provoked retaliation from China’s—imposition of 100% tariffs on Japan’s exports of automobiles, mobile phones, and air conditioners. The estimated economic loss to the Japanese economy was 25 billion yen—seven times more than the benefits enjoyed by the three commodities that were granted the safeguard protection.²⁹

Why did China insist on having an industry-level VERs negotiation in the face of repeated Japanese requests that the Chinese government formally commit to regulate exports? The vice Minister of MOFERT argued that China needed to comply with new WTO rules which prohibited a governments’ involvement in the VERs process (Yoshimatsu 2001). However, the argument does not hold up to close scrutiny because the Chinese government did negotiate VERs in other cases such as a textile dispute with the United States in 2005. The government also committed to VERs for cases such as honey (vis-à-vis U.S.) and garlic (vis-à-vis South Korea) by using the open quota bidding system. I argue that the decentralization and export administration reforms during the past decades have decreased the effectiveness of bilateral VERs agreement, and instead, have given rise to the use of multilateral rules in Sino-Japan disputes.

The effect of decentralization reforms on export regulation, moreover, differs across industries depending on their degree of geographical concentration. While Chinese tatami production and exports are characterized by low geographical concentration, the seaweed industry is highly concentrated geographically. I will explain below how the decentralization of export regulation interacting with high vs. low geographical concentration of an industry shapes China’s choice to use bilateral vs. multilateral instruments for export regulation.

**Rush Industry in China**

Graph 3 in the Appendix to this Chapter shows the allocation of export quota of rush and rush-woven products by province in 2002. It suggests a low degree of geographical concentration of rush and rush-woven production and exports in China. Ningbo city won the highest proportion of quota while retaining a modest 27% of total export volume. The rest of the quota was distributed broadly to FTCs in other coastal provinces such as Zhejiang, Jiangsu, and Shanghai.

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32 It is important to distinguish geographical concentration of production and export activities. Ningbo port, for instance, exports around 80% of total rush and rush-woven products due to its proximity to neighboring rush production sites. See, Tatami exports to Japan face pressure (*woguo lincaoxi chukou riben jiang shou chongji*), 01/12/2004, [http://chinaningbo.com/detail_new.php?newld=17182](http://chinaningbo.com/detail_new.php?newld=17182), Zhang, Shuying, “Probing
Industry-level VERs negotiation is more difficult to achieve and requires a government’s intervention when an industry is geographically dispersed. First, the number of sub-national actors involved in VERs negotiations will be larger making it difficult to reach collective decision. Second, the more dispersed the production and export activities across different provinces, the more competitive local FTCs and producers will be to promote export and secure the higher market share abroad. Finally, when a large number of local enforcement agencies (i.e., local governments) are involved, it becomes harder for them to cooperate and enforce the export quota collectively. Thus, in the case of the tatami industry, China did not agree to voluntary restrain its export. Without an attempt to negotiate industry-level VERs, China let Japan adopt temporary safeguard measures with respect to tatami. After the temporary safeguard measure expired, the Chinese government instituted an open bidding export quota system to regulate tatami exports to Japan. In sum, while Japan sought to negotiate VERs with China on a bilateral basis, China chose to regulate exports multilaterally. Even after the safeguard protection expired, the Chinese government instituted a legal and more transparent method of regulating exports, an open bidding export quota system.

Seaweed: Successful VERs Negotiation

Japan’s seaweed industry also suffered under a deluge of exports from China. During the 1990s, dried seaweed exports increased by fifty percent and fresh seaweed exports increased by thirty percent. In 2000, Chinese exports comprised eighty percent of domestic seaweed sales. The Japan Fishery Cooperative (the JF) and Iwate and Miyagi prefecture’s Fishery Cooperatives requested that the government use safeguard measure to regulate Chinese exports in 2000. Yet the dispute was ultimately settled by industry-level VERs negotiation and the agreement was successfully committed to without major government involvement.

The Japanese side initiated the bilateral VERs negotiation with China in 2000. The JF sent a letter to Dalian Seaweed Association in Dalian City requesting bilateral

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negotiations.\textsuperscript{34} In March 2001, the first Japan-China seaweed export-import negotiation was held in Beijing. The number of participants at the meeting was quite small. It included the Seaweed Association in Dalian, the China Chamber of Commerce for Import and Export of Foodstuffs, Native Produce and Animal By-Products (CCCFNP), officials from Japan Fishery Cooperatives and the Miyagi and Iwate seaweed producers. The small number of participants supports the hypothesis that when an industry is geographically concentrated, the number of actors involved in VERs negotiation will be smaller.

One month after the producer-level negotiations, Chinese export companies and Japanese import companies met in Tokyo and discussed the details of VERs. At the third industry-level negotiations in June 2001, executives from industry associations from Japan and China met in Beijing and agreed on final export restraints. China agreed to voluntary restrain its seaweed exports to Japan\textsuperscript{35} and to “do its best to balance the demand and supply of seaweed for sustainable seaweed farming.”\textsuperscript{36} The Japanese side agreed to “make the best effort to commit to the agreement while keeping an eye on future efforts made by China.” The number of participants at this meeting was quite minimal including Iwate and Miyagi prefectures’ JF presidents, the national-level JF executive (Japanese participants), the CCCFNP’s vice president, and Dalian Seaweed Association’s president (Chinese participants). The participants also agreed to establish bi-annual meetings to regulate the supply and demand of seaweed and to jointly promote domestic consumption of seaweed in China and Chinese seaweed export to other foreign markets besides Japan.

While negotiating VERs with China, Japanese domestic seaweed producers also lobbied the Japanese government to seek safeguard protection.\textsuperscript{37} Both the Japanese industry players and the Chinese industry players, however, had strong incentives to avoid the use of multilateral rules. From the Chinese perspective, VERs were preferred because they are a more temporal form of export regulation. VERs are also preferred because they provide exporters an opportunity to collude with Japanese importers by setting the price higher than before the VERs.\textsuperscript{38} From the Japanese

\textsuperscript{34} Japan Fisheries Cooperatives (JF), “Chronology of Safeguard Investigation on Seaweed,” an internal document obtained at headquarter of the JF.
\textsuperscript{38} As Harris (1985) aptly put it: “VERs serves as a devise through which partial collusion on
perspective, there was a split between domestic seaweed producers and producers that began outsourcing seaweed farming to China in the 1990s. While the former preferred the government adopting safeguard measures, the latter pursued bilateral VERs. The domestic seaweed companies also lobbied the government to enact a law that would force seaweed producers to disclose a product’s country of origin in order to differentiate their products from those imported from China.

In sum, the Chinese government’s intervention to export regulation was minimal in the seaweed case. Japanese and Chinese seaweed industries successfully negotiated industry-level VERs and no export quota order on seaweed exports was issued by the central government. Why was such private ordering possible under the highly decentralized export administration system? As I have argued previously, the high geographical concentration of an industry is a key to understanding why private-level negotiations were successful and credibly committed.

Seaweed Industry in China

The seaweed case differs from other dispute cases that have required the multilateral rules and government’s intervention in two major respects. First, geographical concentration of seaweed production and export activities in China is very high—Dalian city occupies around 90% of total production and export of seaweed to Japan. Second, seaweed production in Dalian is highly multi-nationalized. Japanese seaweed production companies have established factories and joint-venture companies in Dalian since the early 1990s. Under these two conditions, industry-level negotiation of VERs is easier as producers, exporters, and importers share common interests in avoiding an escalation of the dispute to the use of multilateral rules. The negotiations were also less costly because the number of actors involved was smaller. Most importantly, costs of monitoring and enforcing the VERs agreement were much smaller when the majority of a given industry’s exports are concentrated in one region.

What Lies Ahead? Geographic Concentration of Export-oriented Industries in China

The two cases discussed above have shown that geographic concentration of exporting industries has substantial effects on a government’s choice between bilateral price is achieved leading to higher profits for [exporting and importing] firms.” Harris 1985, p. 800.

39 Phone interview with Miyagi prefecture’s member of prefectural parliament, Tokyo, March 2002.
vs. multilateral solutions to trade disputes in China. This finding begs another question. Why are some industries geographically more concentrated than others? The degree of geographical concentration is not exogenous to China’s position in the international economy. Exporting industries in general and agricultural products in particular tend to be geographically concentrated in coastal areas because they require geographic proximity to ports and foreign markets. As a result, Chinese agricultural producers often differentiate production sites depending on whether commodities are intended for domestic or foreign markets. In addition, more than a half of Chinese export values are generated by joint ventures with foreign firms and foreign-owned companies. Foreign investments tend to be located in coastal provinces due to proximity to ports and favorable investment and tax privileges granted during the 1980s. Finally, both foreign and domestic producers recognize the economy of scale and tend to invest in clusters.

These geographical characteristics of exporting industries in China offer several predictions about the future of China’s export regulation. First, the new WTO-rule prohibiting the government’s involvement in VERs will not deter China’s use of VERs for geographically concentrated industries. As shown in the seaweed case study, industry-level VERs can be credibly committed to and enforced without a government’s involvement when an industry is geographically concentrated.

Second, a dispute is more likely to be resolved by multilateral, legal rules for geographically diffused industries. As an increasing number of local FTCs and sub-national governments enter export competition in the future, it will be even more difficult for the Chinese government to negotiate and enforce informal VERs. We expect to see a more legal, open, and transparent export regulation process institutionalized in China as seen in its introduction of the open quota bidding system.

Finally, China’s entry to the WTO in December 2001 is expected to constrain China’s retaliation against Japan’s future adoption of WTO-legal safeguard protection. Under the WTO’s Agreements of Safeguard (Article 8), 40 targeted states are not allowed to retaliate against a safeguard measure for a period of three years. If China complies with this rule, then Japan is more likely to pursue multilateral rules to protect industries that suffer under a deluge of Chinese exports.

Conclusion

40 WTO (1994), Agreement on Safeguards, Article 8: Level of Concessions and Other Obligations.
This chapter has explored why some trade disputes are settled via bilateral VERs negotiations while others are settled using multilateral rules. Contrary to what has been argued elsewhere, it has shown that two “decentralization” factors—the decentralization of export administration and geographical concentration of industries—account for Sino-Japan dispute settlement choices. The two dispute cases discussed here, the tatami and seaweed industries, reached multilateral and bilateral solutions, respectively, due to their different degree of geographical concentration. Degree of geographical concentration of an industry is a key to understanding the dispute outcomes because it affects the costs of negotiation and enforcement in export regulation.

The broader implications of these findings are three-fold. First, we need to reconsider a unitary actor assumption often employed in the existing “forum-shopping” literature. Even in an authoritarian and state-controlled economy like China, domestic actors—the central government, local governments, and exporting industries—have various preferences for different venues of export regulation responding to the distribution of negotiation and enforcement costs of VERs. The process of export regulation has also become more decentralized, open, and transparent.

Second, domestic institutional changes, such as decentralization of export administration, may significantly affect a government’s incentive to use bilateral vs. multilateral venues of export regulation. One must analyze how industry-level characteristics interact with domestic institutional changes and shape the government’s choice across different dispute settlements.

Finally, it is not simply expected negotiation outcomes that influence a government’s choice among different venues; rather, negotiation and enforcement costs and who bears these costs have a substantial effect on how a government will choose among different venues of export regulation.

In concluding, I suggest a few promising directions for future research. First, comparative study of how the Chinese government chooses bilateral vs. multilateral venues of export regulation vis-à-vis other major trading partners such as the United States and South Korea will be a promising line of research. Second, the open export quota bidding system introduced by China in 1994 offers interesting data over time to test various political economy hypotheses. For example, why were some industries subjected to the open bidding while others were not? Why did some firms and localities obtain more favorable quota allocations than others? Finally, research on how provincial elites choose between compliance with the center and promotion of
exports will be another promising line of future research.
Appendix

[Table 1] Hypotheses and Possible Cases

Export Administration

<table>
<thead>
<tr>
<th>Centralized</th>
<th>Decentralized</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bi/VERs</td>
<td>Private Ordering/VERs</td>
</tr>
</tbody>
</table>

Industrial Geography

<table>
<thead>
<tr>
<th>Bi/VERs</th>
<th>Multilateral/Legal</th>
</tr>
</thead>
</table>

[Table 2] Changing Domestic Productions and Imports of Tatami mat in Japan, 1996-2000

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Production (Thousand mats)</td>
<td>26937</td>
<td>25088</td>
<td>21302</td>
<td>15923</td>
<td>13872</td>
</tr>
<tr>
<td>Imports (Thousand mats)</td>
<td>11369</td>
<td>8628</td>
<td>10344</td>
<td>13569</td>
<td>20300</td>
</tr>
<tr>
<td>% of Imports per Total Domestic Sales</td>
<td>29.7</td>
<td>25.6</td>
<td>32.7</td>
<td>46</td>
<td>59.4</td>
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</table>

[Graph 3] Export Quota Allocation of Rush and Rush-woven Products to Chinese Provinces after the Open Quota Bidding

Export Quota Allocation of Rush and Rush-woven Products to Chinese Provinces and Cities, 2002

Source: Author calculated the data using Ministry of Commerce, “Announcement of the results of the bidding for export quota on rush and rush-woven products for the year 2002” (lincao ji qizhipin chukou peie dyici xieyi zhaobiao gonggao), December 3, 2001.
Note: Ningbo city has an equal administrative status as a province, although it is geographically a part of Zhejiang province.
### Table 4  Province Export by FTCs’ Ownership

<table>
<thead>
<tr>
<th>Province/city</th>
<th>SOEs</th>
<th>Foreign</th>
<th>Others</th>
<th>Foreign %</th>
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</thead>
<tbody>
<tr>
<td>Total</td>
<td>16881321</td>
<td>44420928</td>
<td>14897665</td>
<td>58.30</td>
</tr>
<tr>
<td>Guangdong</td>
<td>4456248</td>
<td>15467100</td>
<td>3892911</td>
<td>64.94</td>
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<tr>
<td>Shenzhen</td>
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<td>6758494</td>
<td>1378980</td>
<td>66.57</td>
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<tr>
<td>Jiangsu</td>
<td>1437164</td>
<td>9422830</td>
<td>1438221</td>
<td>76.62</td>
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<tr>
<td>Shanghai</td>
<td>2068186</td>
<td>6157921</td>
<td>845861</td>
<td>67.88</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>1629366</td>
<td>2726244</td>
<td>3324687</td>
<td>35.50</td>
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<tr>
<td>Ninbo</td>
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<td>748138</td>
<td>919036</td>
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<tr>
<td>Shandong</td>
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<td>1220138</td>
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<td>201401</td>
<td>80.31</td>
</tr>
<tr>
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<td>413398</td>
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<td>189013</td>
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<td>345288</td>
<td>377746</td>
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</tr>
<tr>
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<td>150275</td>
<td>146757</td>
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<td>Xinjiang</td>
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<td>Hubei</td>
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