China's Foreign Trade Policy

The new constituencies

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3 Decentralization, industrial geography and the politics of export regulation

The case of Sino-Japanese trade disputes

Megumi Naoi

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 antidumping duty, counterveiling duty, and safeguard investigations against Chinese products at the GATT and WTO.[1] More than 4000 commodities have been involved. Outside of multilateral arenas, moreover, China was involved in numerous bilateral negotiations for voluntary export restraints with countries such as the United States, Europe, Japan and South Korea, to name but 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 antidumping 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 there exists a large body of literature on the political economy of trade conflicts, how states choose between different dispute settlement mechanisms is still poorly understood. Nevertheless this question is important because it raises questions about the efficacy of international institutions in shaping states' behavior. While scholars (e.g. Prusa, 1999; Rodrik, 1997; Goldstein and Martin, 2000; Kahler, 2000; Mattli, 2001; Busch and Reinhardt, 2003) 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 Sino-Japanese trade conflicts since 1976. The Sino-Japanese case provides several advantages to the exploration of 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.[2] Thus, the choice between bilateral vs. multilateral dispute solutions was largely a function of what the Chinese side desired. This

allows us to analyze the preferences of the Chinese government and industries for dispute settlement venues while holding the 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 voluntarily restrain its exports, such agreements did not lead to a reduction of exports in an increasing number of cases. The question that merits further investigation, therefore, is what explains the shift from bilateralism to multilateralism in Sino–Japanese trade disputes and why have bilateral VERs negotiations 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: the cost of negotiating the export restraints with domestic firms and foreign countries *and* 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 the mid-1980s due to the rise of the costs of enforcing the export quotas on provincial and municipal governments and foreign trade corporations (FTCs) under the highly decentralized export administration system. The rise of multilateralism to solve disputes, that is, the use of WTO rules such as safeguard and antidumping 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 processes with WTO legal rules, the Chinese government shifts the liability of enforcing the export regulation onto 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.[3] Second, this study explicitly links changes in domestic institutions (decentralization) to 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 has therefore changed the relative effectiveness of bilateral vs. multilateral forms of export regulation. Third, while the emerging "forum-shopping" literature (e.g. Mattli, 2001; Busch and Reinhardt, 2003; Davis, 2003) looks at expected *negotiation outcomes* as an important determinant of states' choice across different dispute settlements, I argue that the expected level of *enforcement* also plays an important role in choosing a venue for export regulation. Finally, studies on Sino-Japanese trade disputes so far focus primarily on economic and political conditions of the Japanese side as major determinants of the choice. By identifying the sources of the Chinese government's and industries preferences, this chapter will show that the dispute settlement choice has also been a reflection of what the Chinese side wanted.

The remainder of this chapter proceeds as follows. The next section discusses the puzzle: cross-commodity and temporal variation in Sino-Japanese dispute settlements during the past three decades. The second section develops my argument that the decentralization of export regulation and industrial geography interact to affect a government's choice between bilateral and multilateral venues of export regulation. The third section provides a study of two polar cases from the 2001 Sino-Japanese 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 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 a safeguard measure. Finally, I conclude by discussing the broader implications of the analysis for the study of domestic politics and international institutions.

The puzzle

Since the first major Sino-Japanese trade dispute regarding silk yarn between 1976 and 1980, Japan has consistently sought bilateral VERs negotiations to deal with the rise of Chinese exports. Japan fiercely avoided the use of multilateral rules, such as antidumping, counterveiling, and safeguard measures, which are legal under GATT/WTO, for several reasons. First, historically, Japanese export industries have been a target of these measures adopted by the United States and Europe. The government has officially taken a position at GATT/WTO negotiation rounds to support the more restrictive use of these measures. Second, Japan feared that the 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 the GATT/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 (MITI) attempted numerous times, in vain, to negotiate VERs with China with respect to textiles (1988), alloy (1991), textiles (1994, 1995), cotton and cotton fabrics (1996), ginger and garlic (1996), and so on.[4] In all of these cases, MITI proceeded to investigate potential antidumping and safeguard measures and the investigations eventually led to China agreeing 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.

The Chinese government's unwillingness to adopt VERs is puzzling given that VERs create rents through the allocation of export quotas and licenses to exporting firms. The government's unwillingness is also puzzling because Chinese exporters

should prefer VERs to tariffs (such as the adoption of safeguards, antidumping and counterveiling measures by trading countries) for two reasons. First, VERs represent a more temporal form of regulation than tariffs. Second, VERs give exporters an opportunity to collude with Japanese importers by setting the price higher than before the VERs. Given these benefits, why would the Chinese government not agree to voluntarily restrain its exports?

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 *shiitake* mushroom industries in 2001. Scholars (e.g. Pekkanen, 2001; Hiroomi, 2001) point to several factors in an attempt to explain why Japan ultimately resorted to the use of WTO safeguard measures: special interest politics; electoral cycles; and the bureaucracy's shift from bilateral to multilateral diplomacy. These studies, however, tend to suffer from case selection bias: they look only at the three commodity cases that were granted safeguard protection in the year 2001 and infer their causes. What these studies fail to notice is that there were industries, such as the eel and seaweed industries, that successfully negotiated VERs with China during the same time period. These industries negotiated VERs without much government involvement, which also poses a puzzle. Why were these private-level VERs negotiations successful and were credibly committed to by Chinese exporters without legal obligations or government involvement? Two points are worth highlighting from the above discussion.

First, 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 intervention (the so-called "private ordering"[5]), such as seaweed and eel, are intriguing. Second, the Sino-Japanese 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 the sources of Chinese preferences for different venues of export regulation.

Argument and hypotheses

Why were some Sino-Japanese dispute cases settled with bilateral VERs agreements while others escalated into the use of multilateral rules? I argue that two "decentralization" factors – decentralization of the 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 the costs of negotiating VERs. The smaller the number of actors involved in the negotiation (that is, the higher the degree of centralization in export regulation), the lower the costs of negotiations will be. Second, whether an industry is geographically concentrated or not affects the costs of negotiating VERs as well as the costs of enforcing the export quota. I will explain the logic behind each factor in detail below.

Centralized vs. decentralized export regulation

The process leading to the adoption of VERs can be considered as a three-stage decision:

(a) domestic decision-making as to whether to negotiate VERs;
(b) negotiation with importing countries or firms; and
(c) enforcement of the agreement.

These processes can be centralized (the central government agency decides, negotiates and enforces arrangement) or decentralized (where 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 both by shaping the number of actors involved in the process and by influencing who bears the costs of enforcing and monitoring the agreement (that is, who bears the "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.[6] Second, once an agreement is reached, the costs of enforcing the quota restrictions 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 the process of negotiation and enforcement that matters. One would also need to take into consideration distributional issues: the matter of who bears the costs of the negotiation and enforcement. Here, bilateral and multilateral instruments of export regulation differ fundamentally in the matter of 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.[7] Thus, when the costs of enforcing the quota are low (that is, with centralized export administration and geographically concentrated industry), the Chinese government is more likely to use bilateral VERs over multilateral rules to regulate exports.

Concentrated vs. diffused industrial geography

Under the decentralized export administration system, industry geography affects the government's dispute settlement choice by changing the number of actors involved in the process, the geographical proximity of firms and regulatory agenciesa nd the level of competition among sub-national governments. First, under a decentralized system in which sub-national governments promote and regulate exports, the geographic diffusion of industry is a proxy for the number of actors involved in the VERs process, including the decision-making, negotiation

and enforcement stages. The more geographically diffused an industry is across provinces, the more actors are involved in the VERs process.

Second, the geographic concentration of an industry may affect the costs of enforcement because the geographic proximity of firms and regulatory agencies allows easier monitoring and enforcement of the export regulation. The higher an industry's geographic concentration, 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 needed to obtain higher shares of export market among sub-national governments and local firms. The higher the level of competition among sub-national actors (the more diffused an industry is across different provinces), the stronger the actors' incentives to defect from the assigned quota restrictions by exporting more products. Multilateral legal forms of export regulation, such as GATT/WTO legal safeguard and antidumping 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.

Figure 3.1 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-Japanese dispute cases since 1976 is placed into an appropriate quadrant of Figure 3.1. As discussed in detail below, China's export administration has decentralized over time since the 1980s (which represents a shift from the left to the right row in Figure 3.1). The level of geographic concentration of industries varies across commodities and over time. The next section will provide an overview of the decentralization reform in export administration and explain why decentralization interacts with industrial geography to shape a government's choice between bilateral vs. multilateral forms of export regulation.

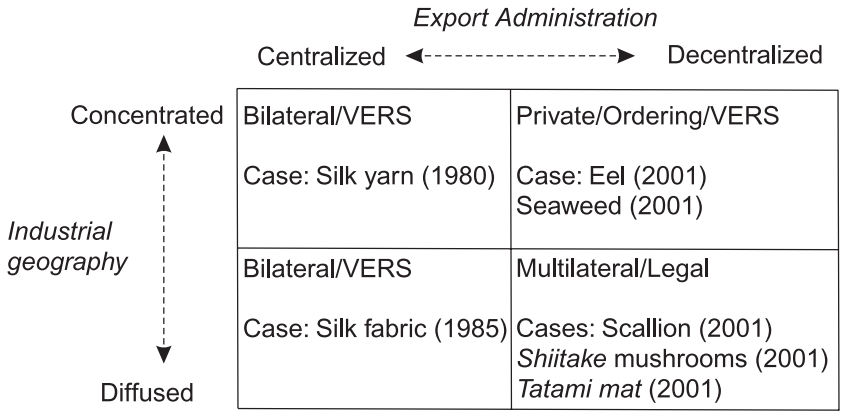

Figure 3.1 Hypotheses and possible cases

Overview: decentralization of export regulation

China's export administration has undergone a series of decentralization reforms. These reforms granted to provinces and municipalities power to promote and regulate exports in three respects:

- the ownership and management structure of foreign trade corporations (FTCs)
- the fiscal system in which localities and central government share gains from foreign trade, and
- the decision-making and enforcement process of export quota and licensing.

First, the ownership structure of foreign trade corporations (FTCs) has become decentralized and internationalized.[8] Before China's open policy was adopted in 1978, only a dozen nationally-owned FTCs monopolized foreign trade.[9] 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 centralized control by MOFERT, FTCs had a strong incentive to comply with quotas because MOFERT was the source of subsidies and its permission to engage in foreign trade was needed.[10] In 1985, local FTCs were granted autonomy to engage in foreign trade and came under the control of provincial and municipal governments.[11] An increasing number of local FTCs also entered into joint ventures with foreign companiesl (see Table 3.1). 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 under 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 up to 80 percent of such earnings under the assigned quota system.[12] 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 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 quotas.[13] The authority to issue export licenses to FTCs was extended from the MOFTEC to the Foreign Economic Relations and Trade Commissions of various provinces, autonomous regions, and municipalities in 1996.[14] In 2001, the central office of the Ministry of Commerce issued approximately 15 percent of the newly-licensed export commodities, while local authorities (that is, local branches of the Ministry

Table 3.1 Provincial exports by FTC ownership (10,000 USD)

Province/city	*SOEs*	*Foreign*	*Others*	*Foreign (%)*
Total	16,881,321	44,420,928	14,897,665	58.30
Guangdong	4,456,248	15,467,100	3,892,911	64.94
Shenzhen	2,014,711	6,758,494	1,378,980	66.57
Jiangsu	1,437,164	9,422,830	1,438,221	76.62
Shanghai	2,068,186	6,157,921	845,861	67.88
Zhejiang	1,629,366	2,726,244	3,324,687	35.50
Ninbo	554,559	748,138	919,036	33.67
Shandong	1,015,562	2,377,119	1,220,138	51.53
Qingdao	442,981	1,070,963	422,863	55.30
Fujian	552,794	2,175,419	756,243	62.43
Xiamen	252,042	1,072,006	402,623	62.09
Beijing	1,751,313	1,191,406	144,342	38.59
Tianjin	337,768	2,199,307	201,401	80.31
Liaoning	597,721	1,332,795	413,398	56.86
Dalian	247,100	945,457	189,013	68.43
Hebei	369,651	345,288	377,746	31.60
Heilongjiang	147,444	47,491	412,136	7.82
Anhui	221,897	150,275	146,757	28.96
Henan	270,176	84,137	154,695	16.53
Xinjiang	161,813	13,677	328,535	2.71
Sichuan	231,846	68,302	169,942	14.53
Hubei	213,517	129,212	100,142	29.18
Hunan	181,817	64,381	128,587	17.18
Shanxi	181,035	51,959	119,878	14.72
Shaanxi	185,709	32,022	89,960	10.41

Source *China Statistical Yearbook* (2005)

of Commerce and municipal and provincial-level Foreign Economic Relations and Trade Commissions) issued approximately 85 percent.[15]

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 the MOFERT, which decided quota allocations in consultation with provincial officials.[16] 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.[17]

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 subject to bidding. FTCs that 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 government Foreign Economic Relations and Trade Commission, while centrally-managed corporations apply directly to the same commission at the level of the central government.[18] Information regarding when and how the bidding is done, its participants, minimum bidding prices, and who won how much of the bids is made

available to the public at provincial or central government offices and on the official website of the Ministry of Commerce.[19] The open bidding system has encouraged competition and lobbying by local governments and FTCs to win a higher share of the quota.[20] 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.[21]

By these reforms, the open bidding system strengthened the position of local governments vis-à-vis both the central government and FTCs by giving them jurisdiction over export quota allocations. These reforms also provided greater room for locally-owned FTCs to lobby and influence the decision-making process at the level of local governments. Once export quotas 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.

Case study: the rush and rush-woven products (*tatami*) and seaweed industries

Both the *tatami*-mat[22] and the seaweed industries have been severely hit by Chinese exports since the 1990s. These Japanese industries lobbied their ministries and politicians to regulate Chinese exports. Both industries initially sought to negotiate VERs 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 successfully and credibly committed to.

The tatami industry

Table 3.2 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 just 25 percent 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 imports.

Table 3.2 Changing domestic production and imports of *tatami* mats in Japan, 1996–2000

	1996	*1997*	*1998*	*1999*	*2000*
Domestic production (000 mats)	26,937	25,088	21,302	15,923	13,872
Imports (000 mats)	11,369	8,628	10,344	13,569	20,300
% of Imports per total domestic sales	29.7	25.6	32.7	46	59.4

Source: Survey by the Japanese Government; Ministry of Agriculture, Forestry, and Fisheries of Japan (2001).

Fearing that the 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.[23] Between 2000 and 2001, the Japanese *tatami* industry attempted, in vain, to negotiate VERs and make the existing export regulations by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) effective. Long Yongtu, a Vice-Minister of the Ministry of MOFTEC, proposed that "guidelines between private actors, not voluntary export restraints between the states, should be considered" (Yoshimatsu, 2001: 401). The Japanese government requested that the Chinese government participate in bilateral negotiations because the government believed that industry-level agreements would not be enforced.

In the end, the Japanese government resorted to the use of temporary safeguard measures in 2001 for the first time in history. The adoption of safeguard measures provoked retaliation from China in the form of 100 percent 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.[24]

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 government's involvement in the VERs process (see Yoshimatsu, 2001).[25] However, the argument does not hold up under close scrutiny because the Chinese government did negotiate VERs in other cases such as the textile dispute with the United States in 2005. The government also committed to VERs in negotiations with the US over honey and with South Korea over garlic 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 agreements, and instead, have given rise to the use of multilateral rules in Sino-Japanese 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 interacts with the degree of geographical concentration of an industry to shape China's choice to use bilateral vs. multilateral instruments for export regulation.

The rush industry in China

Figure 3.2 shows the allocation of export quotas of rush and rush-woven products by province in 2002.[26] 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 quotas while retaining a modest 27 percent of total export volume. The rest of the quotas were distributed broadly to FTCs in other coastal provinces such as Zhejiang, Jiangsu, and Shanghai.[27]

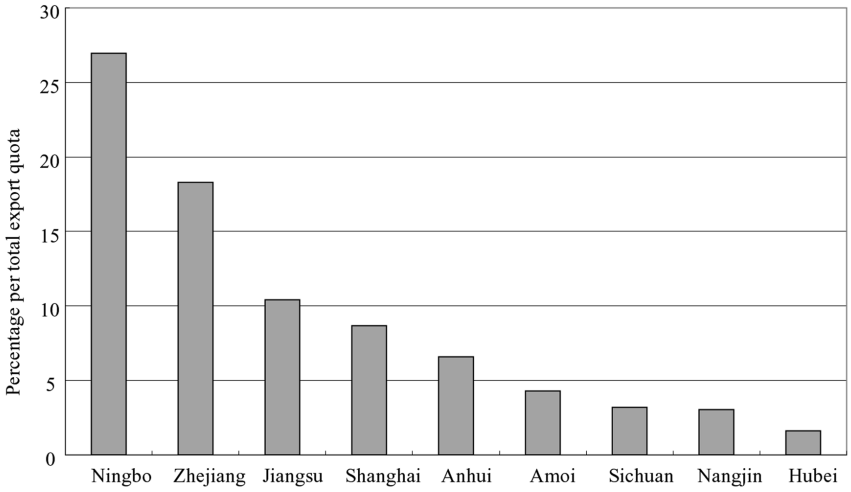

Figure 3.2 Export quota allocation of rush and rush-woven products to Chinese provinces after the open quota bidding

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 more difficult to reach a collective decision. Second, the more dispersed the production and export activities across different provinces, the more local FTCs and producers will compete to promote exports and secure higher market share abroad. Finally, when a large number of local enforcement agencies (that is, 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 voluntarily restrain its exports. 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 a deluge of exports from China. During the 1990s, dried seaweed exports increased by 50 percent and fresh seaweed exports increased by 30 percent.[28] In 2000, Chinese exports comprised 80 percent of domestic seaweed sales. The Japan Fishery Cooperative (the JF) and Iwate and Miyagi prefectures' 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 negotiations.[29] 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 fact that there were so few 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 of industry associations from Japan and China met in Beijing and agreed on final export restraints. China agreed to voluntarily restrain its seaweed exports to Japan and to "do its best to balance the demand and supply of seaweed for sustainable seaweed farming."[30] The Japanese side agreed to "make the best effort to commit to the agreement while keeping an eye on future efforts made by China."[31] The number of participants at this meeting was quite minimal and included 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 exports to other foreign markets besides Japan.

While negotiating VERs with China, Japanese domestic seaweed producers also lobbied the Japanese government to seek safeguard protection.[32] Both the Japanese and the Chinese industries, however, had strong incentives to avoid the use of multilateral rules. From the Chinese perspective, VERs were preferred not only because they are a more temporal form of export regulation, but also because they provide exporters with an opportunity to collude with Japanese importers by setting the price higher than before the VERs.[33] From the Japanese perspective, there was a split between domestic seaweed producers and producers that began outsourcing seaweed farming to China in the 1990s.[34] 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 in 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 Chinese government. Why was such private ordering possible under the

highly decentralized export administration system? As I have argued above, the high geographical concentration of an industry is the key to understanding why private-level negotiations were successful and credibly committed.

The seaweed industry in China

The seaweed case differs from other dispute cases that have required multilateral rules and government intervention in two major respects. First, the geographical concentration of seaweed production and export activities in China is very high as Dalian city alone accounted for around 90 percent 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 ventures 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, the 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 show that the geographic concentration of exporting industries has substantial effects on a government's choice between bilateral and 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 the commodities are intended for domestic or foreign markets. In addition, more than half of China's export values are generated by joint ventures with foreign firms and foreign-owned companies. Foreign investments tend to be located in coastal provinces because of proximity to ports and favorable investment and tax privileges granted by the government 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' export regulation. First, the new WTO rule prohibiting government 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 similar to the introduction of the open quota bidding system.

Finally, China's entry into 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),[35] 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 from a deluge of Chinese exports.

Conclusion

This chapter has explored the reasons 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 been shown that two "decentralization" factors – the decentralization of export administration and geographical concentration of industries – account for Sino-Japanese dispute settlement choices. The two dispute cases discussed above, the *tatami* and seaweed industries, reached multilateral and bilateral solutions, respectively, due to their different degree of geographical concentration. The degree of geographical concentration of an industry is a key to understanding dispute outcomes because it affects the costs of negotiation and enforcement in export regulation.

The broader implications of these findings are threefold. 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 due to the differential 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 the decentralization of export administration, may significantly affect a government's incentive to use bilateral as opposed to 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 the issue of 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 analysis of how the Chinese government chooses between bilateral and 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 since 1994 offers interesting data over time to test various political economy hypotheses. For example, why were some industries subject 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 élites choose between compliance with the center and promotion of exports will be another promising line of future research.

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Notes

1 See People's Daily (2004).
2 On this, see Naoi (2006).
3 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". See also Viscusi, Vernon and Harrington (1995: 800). On the literature on endogenous regulation, see Stigler (1971); Peltzman (1976); Fiorina (1982); Campos (1989).
4 See commodity-level dataset on Sino-Japanese trade disputes and outcomes (1976–2005) collected by the author using newspaper articles in Japanese, Chinese, and English.
5 On various mechanisms through which private actors are able to credibly commit and enforce the agreement without government intervention, see Harold (1967); Ostrom (1990).
6 Olson (1965); Axelrod (1984).
7 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 offer 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 (1974: 291–303).
8 On this, see Lardy (1992: Chapter 3); Zweig (2002: Chapter 3).
9 Lardy (1992: Chapter 2)
10 Ross (1988: 34).
11 Zweig (2002: 111).
12 Fukasaku, Ma and Yang (1999: 25).
13 On the early development of the export license system, see Lardy (1992: 45–46). China restored its export licensing system in 1980 and expanded the number of commodities that were covered by the system (Lardy, 1992: Chapter 3). The share of trade values that were regulated by export and import licensing has risen sharply since 1980. Export licenses were extended from 12 nationally-owned FTCs to FTCs owned by provincial and municipal governments throughout 1980s and 1990s. See Lardy (1992); Zweig (2002).

14 MOFERT (1996).
15 Ministry of Commerce (2001a). In 2001, 66 commodities were subject to export licenses. Among them, the central office of Ministry of Commerce issued licenses to 9 commodities, provincial and municipal branches of Ministry of Commerce issued 46 commodities, and the remaining 11 were subject to local-level governmental organizations such as municipal and provincial-level Foreign Economic Relation and Trade Commission.
16 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 Corporation and the China National Metals and Minerals Import and Export Corporation, as well as provincial trade officials from Xiamen in Fujian Province. See Metals Week (1995).
17 There are two types of export quotas: active and passive quotas. Active quotas are controlled by the Chinese government while passive quotas are controlled by foreign governments. For instance, in the year 2000, 32 commodities were subject to open quota bids. Among these, 11 were subject to active quotas (quantity controls by China) while 21 cases were subject to foreign countries setting the limits.
18 Ministry of Commerce (2001b).
19 One of the rationales of the quota reform was to balance the power between MOFERT and producers and between FTCs and commodities producers. On this see Zweig (2003: 115).
20 Zweig (2002).
21 Ministry of Commerce (2001c).
22 *Tatami*-mats are a form of Japanese flooring made from rush woven together in a knit-like pattern. Japanese people started using *tatami*-mats during the *Nara* period in the eighth century. Japanese traditional houses usually have rooms with *tatami*-mats and even modern apartments often have one room with *tatami*-mat flooring. However, during the past fifteen years hardwood floors have become more popular among younger generations and, as a result, the use of *tatami*-mats has been declining.
23 Testimony by a Chief of the Tariff Section of the Ministry of Finance at Special Tariff Sectional Meeting of Tariff/Foreign Exchange Council, 25 December 2001.
24 Interview with a mid-level official at MAFF, 10 January 2002; interview with *Nominren* official, March 2002, Tokyo; and interview with a member of parliament who lobbied for the adoption of safeguards, 28 July 2006.
25 WTO (1994a).
26 Ministry of Commerce (2001d).
27 It is important to distinguish geographical concentration of production from export activities. Ningbo port, for instance, exports around 80 percent of total rush and rush-woven products due to its proximity to neighboring rush production sites. See, for example, Chinanigbo (2004); Zhang (2005).
28 Internal document submitted by the Japan Fishery Cooperative to the Upper House Research Room on Accounts, 19 March 2001.
29 Japan Fisheries Cooperatives (JF), "Chronology of Safeguard Investigation on Seaweed", an internal document obtained at headquarters of the JF.
30 Mainichi Daily News (2001).
31 Japan Fisheries Cooperatives (2001).
32 Petition letter sent from Miyagi and Iwate prefecture's Fishery Corporative to Fishery Agency, 13 December 2000 and January 2001.
33 As Harris (1985: 800) aptly put it: "VERs serves as a device through which partial collusion on price is achieved leading to higher profits for [exporting and importing] firms."
34 Phone interview with Miyagi prefecture's member of prefectural parliament, Tokyo, March 2002.
35 WTO (1994b), *Agreement on Safeguards*, Article 8: Level of Concessions and Other Obligations.

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