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**THE DYNAMICS OF CHINESE TRADE DIPLOMACY: A  
COMPARATIVE ANALYSIS**

Bachelor's Thesis

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## **ABSTRACT**

This thesis seeks to study the dynamics of China's trade policy within its foreign policy framework. In particular, it studies China's trade policy reaction to international events and the discrepancy between cases during diplomatic tensions with Japan and South Korea and a trade-related dispute in the ongoing trade war with the U.S. To examine and analyse the differences and the core reasons for China's varying reaction in the case studies, a comparative research method is used. The results of the paper suggest that China's reaction depends on what it has at stake both economically and politically in a given situation. China's multilevel and complex policymaking process is strongly influenced by the interests of SOEs and high-ranking individuals in power in the Communist Party, which determines which measures it implements during different disputes. In addition, there is evidence of political factors with partner countries affecting how China's trade policy works in practice. The main goal of China's trade policy is the prioritization of domestic enterprises and demand while keeping its position in the global status quo. This in part explains China's relatively modest reaction to the trade war compared to the politically charged trade disputes with Japan and South Korea that had drastic effects even in the short term.

**Keywords:** Chinese trade policy, trade diplomacy, trade war, diplomatic tensions

## **LIST OF ABBREVIATIONS**

AIIB	Asian Infrastructure Investment Bank
CPC	Communist Party of China
EU	The European Union
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
IP	Intellectual property
IPR	Intellectual property rights
KITA	Korea International Trade Association
LSG	Leading Small Group
MIIT	Ministry of Industry and Information Technology
MOFCOM	Ministry of Commerce
NBS	National Bureau of Statistics in China
NDRC	National Development and Reform Commission
OBOR	One Belt, One Road
PFTZ	Pilot Free Trade Zone
PMI	Purchasing Managers' Index
RCEP	Regional Comprehensive Economic Partnership
RTA	Regional trade agreement
SASAC	State-owned Assets Supervision and Administration Commission
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
THAAD	Terminal High Altitude Area Defence
TPP	Trans-Pacific Partnership
TRIPS	Trade-Related Aspects of Intellectual Property Rights
U.S.	United States
USTIC	United States International Trade Commission
USTR	United States Trade Representative
WTO	World Trade Organization

## **INTRODUCTION**

The purpose of this thesis is to study Chinese trade policy and its dynamics as a part of its foreign policy framework. Traditionally seen as a rising power and the second biggest global economic player in the world, China combines a free-market capitalist trade policy with a strict authoritarian communist political regime and is a member of the World Trade Organization (WTO).

Despite restructuring its economic and trade policies to join the WTO in 2001, China has received criticism over its trade practices. In the Dispute Settlement Mechanism of the WTO, it has been a respondent to 43 cases in contrast to 20 cases which China has initiated as a complainant (WTO 2018a). Recently, the Trump administration has accused China of unfair trade practices including forced transfers of technology, violations of American companies' intellectual property rights, unfair state subsidies and barriers to accessing the domestic market. These issues with the addition of correcting the trade deficit between the countries have materialized in the U.S.-initiated trade war in 2018. In particular, President Trump has highlighted the imbalance in the rules to trade with China: international trade rules apply to Chinese companies operating within the United States, while American companies face restricted market access and unequal treatment compared to domestic companies.

There has also been evidence of China's use of trade policy as a political tool to reach its goals in foreign policy. In particular, the Chinese style of sanctioning partner countries has shown to be informal with the aim to avoid repercussions on the supranational level. Examples of Chinese unofficial sanctions are arbitrarily imposed sanitary measures, cancelling free trade agreement negotiations, selective purchasing and consumer boycotts, which the country imposes via state media to influence its citizens.

The main aim of this thesis is to investigate what are the factors that affect China's behavior in international trade and how it reacts to events on the international stage through its trade policy.

China is seen as a rising power challenging the current United States-led global status quo, which makes investigating the dynamics of Chinese trade policy relevant to the field of international relations. In other words, understanding the aims and mechanisms behind China's unique view on trade can give direction to the analysis and predictions on the factors which may affect trade with China.

The paper is divided into two main sections. The first part assesses how trade policy is made and by which actors in China, and which aspects determine its scope and goals. In addition to introducing the core objectives of Chinese trade policy and its stakeholders, the different contributing factors to Chinese trade behavior are presented. Even though in theory Chinese trade policy follows the trade norms of the WTO, there seems to be a discrepancy in the Chinese trade policy and its implementation in practice. China's reaction to international tensions with different countries also seems to depend on the situation and country in question. While in cases of diplomatic disputes with partner countries China has shown evidence of imposing informal short-lived barriers to trade, in a major international trade dispute such as the trade war with the United States (U.S.) its reaction has been more modest. How this discrepancy can be explained and what are the underlying reasons for such phenomena are studied through using a comparative research method.

The main hypothesis of this paper states that the Chinese reaction and trade behavior during international tensions is determined by how much China has at stake economically or politically in the situation in question. More specifically, there are domestic and international costs and gains to consider in each trade policy decision for China, and it aims to prioritize domestic gains from international trade while showcasing its political influence on the global level.

The comparative section of the thesis aims to explain the discrepancy in the Chinese reaction to bilateral tensions between a situation with the U.S. and smaller countries by testing the hypothesis with case examples. The main example of a major trade dispute with China is the ongoing row over U.S.-imposed tariffs on Chinese imports since the beginning of 2018. Among the examples of minor cases is the political conflict with South Korea over the Terminal High Altitude Area Defence (THAAD) system in 2017 and the embargo of Chinese imports of rare earth minerals to Japan in 2010. The hypothesis will be applied to the cases and the main findings will be analyzed using academic research and trade statistics from Comtrade and national agencies. In addition to the fact that the partner countries in the cases differ in their size

and global political and economic influence, there is a notable difference in the root cause of the examined tensions. In the ongoing trade war the dispute has been explicitly initiated by the U.S. against China and it has been exclusively related to trade from the beginning. In the smaller cases the issues have been political in nature and they seem to emerge unofficially. Nevertheless, comparing the economic outcomes of diplomatic and trade-related incidents with China is relevant for the analysis of the dynamics of Chinese trade policy and its goals related to its foreign policy. As a rising power in the global status quo, the influence of its international trade policy in world politics will be on the rise also in the future.

The main findings of this thesis show that during difficulties in the relationship with another major power such as the U.S., China's economic interests and position in the global status quo are at risk. This makes China's behavior more careful compared to minor diplomatic conflicts where it has more leverage and power over the economically and politically inferior country. "Punishing" its other partner countries economically and often informally during diplomatic disputes is a way for China to showcase its political influence and economic power cost-effectively over a short period of time without hurting its domestic economy. In contrast, policy choices within the China-U.S. relationship not only affect its economic gains, but also determine the risk of losing face which is crucial especially in Chinese political culture. In essence, there is a trade-off between economic gains and political integrity for China. The increased domestic costs in using drastic policy measures with the U.S. can be also seen as a constraining factor for China. In the cases of diplomatic tensions the imposed sanctions appear to be informal in nature, while with the U.S. Chinese authorities are more public in announcing the application of trade measures. In conclusion, China's use of trade policy in practice varies in issues relating to political tensions or bilateral trade.

The first main section covers the main goals and the scope of Chinese trade policy in addition to a more detailed explanation of the policymaking structure in the country. As an export-reliant economy, China is rebalancing its economy by focusing on adjusting to lower and more stable growth through supporting its private sector, domestic consumption and outward investment with projects such as the 'One Belt One Road' and 'Made in China 2025'. However, due to its fragmented and multilevel political system, China's trade policy seems to lack coherence. In addition to Chinese state-owned enterprises, authorities' personal interests and prestige, factors such as the diplomatic relationship between China and other countries seem to affect the policymaking process in China.



The second half of the thesis compares two different types of trade-related disputes in which Chinese trade policy can be analysed in practice. The trade war between the U.S. and China showcases a highly publicised case of trade tensions, whileas the minor cases with South Korea and Japan highlight the trade-politics connection in Chinese trade. In the last sector of the thesis the differences in the case studies are analysed from the perspective of Chinese trade policy.

## **1. DYNAMICS OF CHINESE TRADE POLICY**

As the world's second largest economy that ranks first in merchandise trade, China's trade policy strongly emphasizes export and international trade relations. Since its accession to the World Trade Organisation (WTO) in 2001, it has integrated itself to the global trade system and has become one of the world's largest free-market economies and exporters with the Chinese renminbi being added to the IMF Special Drawing Rights Basket in 2016 (WTO 2018b; IMF 2016). Given the importance and the effect of China's trade policy to the global economy, it is relevant to understand the dynamics of its trade policy.

After gaining WTO accession, China has experienced drastic growth in GDP and volume of exports thanks to its export-focused strategy for growth. After a brief drop in 2008 caused by the worldwide financial crisis and the deepening of the Eurozone crisis in 2012, its growth rate has experienced a slowdown (Figure 1.). The accession process has consisted of the liberalisation of trade to integrate effectively to the global trading system while protecting its domestic state-owned enterprises (SOE) and the advancement of industries to compete on the global arena (Hilpert 2014, 5). After its rapid development and the economic slowdown China has been forced to adjust to a 'new normal'; lower, more stable rates of GDP growth (Zhang 2017, 2491). Higher GDP has contributed to the development of a Chinese middle class with medium to high purchasing power. To counter slowdown and maintaining and vitalizing the growth rate, emphasizing domestic consumption, outward investment, trade liberalisation and the multilateral trade system have become the main goals of Chinese trade policy framework (2017, 2491-2492). Known for its export-driven economy, this shift is a sign of long-term change in China's economic policy model. In other words, the focus has changed to maintaining growth through

increasing domestic consumption and controlling also the higher levels of supply chains, ie. innovation and technology instead of relying on low-value exports.



Figure 1. China's merchandise export, imports and trade surplus.  
Source: WTO Data, <http://data.wto.org/>

### 1.1. China's trade policy framework and objectives

In order to study the core objectives and goals, it is relevant to examine the background and the contributing factors to Chinese trade policy – the internal and external actors in the decision-making process and elements that affect how Chinese trade policy works in practice. China is a socialist state ruled by the Communist Party of China (CPC), whose role has been increasing in trade-policymaking during the last decades (Naughton 2016, 40). The framework for Chinese trade policy is outlined in national five-year plans which are based on the Central Committee of the Communist Party's recommendations. The latest plan is the 13th Five-Year Plan for 2016-2020, which highlights the strategy of opening up and integrating deeper into the global economic system by attracting foreign investment and generating growth (NDRC 2016, 21).

The policymaking process in China is complex and fragmented in nature. Jakobson and Manuel (2016) outline three branches of governance in which the CPC Central Committee represents the Party and the State is represented by the State Council and the National People's Congress. The State Council oversees the operations of ministries, commissions and other organisations

including SOEs (2016, 102-103). The leading board of the CPC Central Committee, consisting of 25 members is the CPC Politburo, from which the most powerful is the 7-member CPC Politburo Standing Committee (2016, 103). In addition to the existing structure, President Xi's administration created Leading Small Groups (LSGs), some of which report directly to the CPC Central Committee (*Ibid.*). Jakobson and Manuel also highlight the role of personal prestige and Party rank in the amount of power each LSG and policy agency has. The higher the rank of the responsible person within the LSG and the Politburo, the higher the issue in question is placed on the priority list (*Ibid.*). In addition, the personal interests and ideological stance of each high-level executive play a role in the nature of issues brought forward. However, when it comes to trade policy, the aforementioned agencies only address trade-related decisions on a higher level, Hilpert claims (2014, 22).

In addition to the governmental agencies, ministries, and high-ranking officials, Hilpert lists industry associations, SOEs, media, think tanks and as influencing factors to forming Chinese trade policy. More specifically, he claims the interests of SOEs and as the main determinants of the direction of China's policy in trade in addition to line ministries (2014, 22-23).

Officially China's trade policy strategy is mainly coordinated and researched in the National Development and Reform Commission (NDRC), while the Ministry of Commerce (MOFCOM) is responsible for compiling and implementing international trade cooperation and investment policies (WTO 2018c, 32). According to Naughton (2016), there is uncertainty about who makes specific decisions in the Party, but it could be concluded that the President has the ultimate authority in economic and trade policy in China. In addition, Premier of the State Council Li Keqiang is seen as having major power in overseeing the interpretation and prioritisation of policies as leading the daily operations of the government (2016, 40).

Hilpert (2014) claims that the importance of trade policy within the government has decreased after China's WTO accession, which has made the policymaking process fragmented and weakly coordinated. More specifically he touches on the status of the MOFCOM, which in practice doesn't have the support from the state or the SOEs or the power over domestic economically prominent actors to make legally binding decisions (2014, 23). Naughton claims that there is also uncertainty about policy goals, which has made lower-level officials and working groups ineffective in creating consistent and specific policy due to over-cautiousness and the lack of resources to implement the Party's vast economic agenda in practice (2016, 42). The other

stakeholding agencies' – the NDRC, the Ministry of Industry and Information Technology (MIIT) and the State-owned Assets Supervision and Administration Commission's (SASAC) sceptical view on trade liberalization due to domestic concerns additionally contributes to the uneven policy coordination within the system (Hilpert 2014, 24). He states that China's failure to comply to all the WTO accession requirements can be explained by this factor and the importance of reaching consensus to some extent (*Ibid.*). In other words, there seems to be a gap between policy goals and the agencies making policy decisions.

There also seems to be a disconnect between the high-level governmental political actors and the local authorities which determine how policy is implemented in practice. Similarly to the political process in Beijing, Hilpert notes that personal and local interests seem to affect the decisions of individual civil servants and local authorities (2014, 25). Noteworthy is Beijing's inability to control the policy-implementation dynamics on the local level, which brings uncertainty for foreign companies to trust China's authorities' commitments to international trade norms for example (*Ibid.*).

In conclusion, the dynamics behind policy-making in trade-related aspects in China seem to be very fragmented and complex without effective coordination between stakeholders. In many cases, issues at hand vary depending on the individuals in power and the related ministries and working groups, which leads to the separation of the national plans and the pragmatic level. This makes analysing and predicting Chinese trade policy and its implementation in practice difficult, and makes it impossible to assess it as a single entity.

The following sections will describe three major projects which showcase the main framework, objectives and the ideology of the government for Chinese trade policy outlined in the most recent Five-Year plan – Chinese Dream, One Belt One Road, and Made in China 2025. Finally, the factors affecting China's foreign trade policy on a more specific level are brought out in addition to the criticism China has received for its behavior in global international trade.

### **1.1.1. Chinese Dream**

After his inauguration in 2012, President Xi Jinping has launched large-scale projects emphasizing infrastructure investments and innovation as a gateway for Chinese economic development. The term "Chinese Dream" appeared first in 2012 in President Xi's keynote

speech as a part of a visit to the National Museum in China starting from which it now serves as an ideological framework for Chinese economic reform and Chinese foreign trade policy initiatives (Xi highlights..., 2012). After the speech the phrase has been used continuously to describe the core goals and objectives of the Chinese national vision of the Communist Party. In essence, the concept highlights mutual benefits, international cooperation and the role of economic diplomacy while promoting peace between countries (Gao 2014).

A major recurring feature in President Xi's speeches and the texts of Chinese officials seems to be the use of the concept of 'opening up'. In the Minister of Commerce Gao Hucheng's speech the phrase is connected to the reform of Chinese domestic policies by promoting the process further (Gao 2014). President Xi specified the phrase in his address to the American public in 2015 by explaining China's ambitions for protecting the rights of foreign investors, adhering to principles of non-discrimination by fair treatment of foreign and domestic goods and services. In addition, he emphasized China's commitment to IPR protection and the importance of a transparent and effective legal system for economic actors to operate in (Xi 2015). In 2017 in his report to the 19th Communist Party of China's National Congress, he stated trade and investment promotion through liberalization as a priority to the Party. In addition, he has mentioned the importance of creating shared benefits and respecting the diversity of different civilizations (Xi 2017).

Taking into account the development of Chinese trade policy and its national economy within a domestically protectionist framework, the promotion of the 'Chinese Dream' shows a shift in the main direction in Chinese trade policy. The philosophy portrays the main goal of transforming the Chinese economy from an export-reliant producer of low value-added goods to an innovation-driven economy that attracts international investment and promotes economic growth via domestic production. Notable is the phrase 'opening up', which implicates China's willingness to develop its legal and economic environment to accommodate foreign enterprises and capital to serve its domestic demand. This is a perspective change from the beginning of the century, when China experienced drastic growth partly by implementing protectionist and discriminatory policies towards foreign enterprises and depended highly the demand for its low-cost exports. Taking into account the dynamics in the policymaking structure in Chinese trade, the implementation of this shift in strategy seems to be a complex process which has created inconsistent outcomes on a practical level.

### 1.1.2. One Belt One Road

Falling under and following the principles of the Chinese Dream ideology and increasingly gaining importance in the Chinese trade and foreign policy framework is the One Belt, One Road (OBOR) initiative. In short, it is a major state-led Chinese initiative to increase the connectivity and investment flows between China and the areas covering the ancient Silk Road ie. South and West Asia to Europe. Since its launch the initiative has widened its scope towards Africa and Oceania. The initiative bases its goals on five principles of multilateral policy communication, road connectivity, unhindered trade, increased currency circulation and understanding between citizens (NDRC, MOFA and MOFCOM 2015). This also included the establishment of the state-backed Asian Infrastructure Investment Bank (AIIB) (*Ibid.*). In the most recent Belt and Road Forum in 2017 President Xi reinforced the main ideology of the initiative by stressing the importance of multilateralism, a stable financing network and following the principle of 'opening up' (Xi 2017). Chinese authorities have also expressed their plans for creating a free trade network with reduced tariffs and other trade barriers with the countries participating in projects as part of the One Belt One Road initiative (WTO 2018, 35).

Despite the Chinese government's ambitious plans for the OBOR initiative and the rhetoric of President Xi, it has sparked criticism and commentary among researchers and analysts. First, some claim that the project is not focusing merely on trade and economic development, but also on using it as a tool to reach China's geopolitical goals. Nordin and Weissmann (2018) claim that the OBOR initiative emphasizes China's pursuit of a Sinocentric world order and the narrative of China as a protector of free-market capitalism (2018, 241). Swaine (2015) illustrates the criticism of the political and security implications of the One Belt One Road initiative. In particular he points out using the initiative as a tool to strengthen Chinese political and economic influence in its surrounding areas and creating new spheres of influence (2015, 1). In essence, the initiative seems to be transformed from an economic policy framework into an integral part of China's foreign and security policy (*Ibid.*).

Second, the plan is seen as having ambiguous and vague claims about its outcomes. For example, the rhetoric of an inclusive framework hasn't been shown in practice. The original document doesn't mention the USA as a target country, and despite being described as a project benefitting all participating countries, some EU countries have for example been reluctant in

taking part in a major key statement promoting the initiative (2018, 248). Finally, the initiative has also been criticised over the financing and the economic effect of various OBOR projects. The government-backed AIIB loans for major infrastructure projects are viewed as having weak terms and raising risks of especially poorer countries' indebtedness and dependency on China as a creditor (Hurley et al. 2018). Economic integration with China may increase competition and add variety on the market, but it includes higher adjustment costs to the exposed countries (Bastos 2018, 39-40).

In the scope of China's main strategy in global trade and politics, the OBOR initiative can be used as an indicator for determining the government's long-term goals and plausible future scenarios. Especially in the current protectionist-oriented political climate in the U.S. the outward-looking OBOR challenges that view. While the U.S. is taking President Trump's 'America First' route and withdrawing from multilateral trade agreements such as the Trans-Pacific Partnership (TPP), China is vocal about the importance of opening up and looking to West to increase cooperation with Central Asia, Africa and Europe with the 16+1 partnership framework consisting of mainly East European countries. In other words, whilst the U.S. is looking inward and taking an isolationist approach, China has the opportunity to extend its sphere of economic influence by bilateral trade agreements. Consequently, this diversification in support of Chinese production and adjustment to lower growth could diminish the economic power of the U.S. in the global status quo.

In addition to the foreign policy implications of the OBOR initiative, it is another projection of China's goal of transforming the model of its national economy and role in international trade. Following the principle of 'opening up' and creating incentives and improved channels for foreign investment and trade flows with China, the framework portrays China as a major infrastructure investor with the ability to boost trade between wealthier Europe and Oceania. Chinese investment is attractive especially to countries in Eastern Europe and Africa, which facilitates the shift in trade policy strategy on a grand scale. In essence, the OBOR initiative shows the materialization of the Chinese Dream rhetoric and goals – from a developing global seller to a global buyer and investor, which creates sustainable domestic growth.

### **1.1.3. Made in China 2025**

Made in China 2025, introduced in 2015, is the Chinese government's 10-year plan to increase investment towards the innovation and the development of high-tech industries to take control of the highest levels of global supply chains. As an economy that has managed to grow rapidly through low value-added industries, this plan can be seen as a way for China to switch its scope towards quality instead of quantity (McBride 2018). The plan also highlights increasing the protection of intellectual property rights and including small and medium sized enterprises (SME) in setting international and company-specific standards for technology (Kennedy 2015). According to McBride, the means to support the initiative cover large governmental subsidies such as low-interest loans and tax breaks, and the government's encouragement for Chinese companies to invest abroad (McBride 2018). The plan is seen not only seeking to develop the domestic production and implementation of innovations, but also aims to serve and increase domestic consumption of Chinese final products and services. While producing domestic policy gains, Chinese government subsidies can be seen as unfair from a foreign perspective.

On the international level China has been accused of providing unfair subsidies to its domestic companies and enabling the exploitation of foreign IP due to the rules for establishing joint ventures with Chinese companies. Establishing joint ventures with Chinese companies has led to China acquiring foreign technology, which has given domestic companies the opportunity to gain access to valuable data and copy the practices in their own operations (*Ibid.*). McBride also describes the common view of the unfairness of Chinese economic policy in regards to foreign investment: Western companies operating in China have to comply with the strict regulations on investments and restricted market access and give up rights to IP, while China gives its domestic enterprises the freedom to invest abroad (*Ibid.*). The WTO review reinforces the issue by stating that China is still struggling with enforcing IPRs even though on the political and judicial level improvements have been made (WTO 2018c).

## **1.2. Chinese trade policy in practice**

The three initiatives described above highlight the major perspective change in the strategy of the Chinese trade policy. In other words, it can be interpreted as an effort to rebalance its



economy and adjusting to lower growth rates by seeking sustainable growth through supporting domestic innovation and demand. Due to its complex, overlapping and multilevel policymaking structure and the lacking capacity to implement the grand strategies in practice, the real effects of this change have been varied. On a practical level the policy follows the Party's vision partially in some sectors. China is a WTO member, and it has committed to various regional trade agreements (RTA), international free trade agreements and launched Pilot Free Trade Zones (PFTZ) to facilitate trade and attract foreign investment to the country (WTO 2018c, 33).

In addition to the policy-making process and the major trade policy goals and plans, it is relevant to bring out the current state of the Chinese economic environment. According to Li and Qiu (2016), membership in the WTO has contributed to the low average tariff rate, the removal of most quotas and licences and the increasing transparency of trade policies (2016, 415-416). When examining the structure of the Chinese market, a major part is taken by state owned enterprises (SOEs), which are contributing to about a third of the Chinese GDP and two thirds in investing abroad (McBride 2018). According to the WTO (2018), the state owns a majority share of 99 publicly listed companies out of the largest 100 in the Chinese economy (WTO 2018c). Thus it can be assumed that the Chinese government has a large control over the economic ecosystem in China and its actions on foreign markets. In addition to domestically owned companies, Hilpert points out that over a half of the income from Chinese exports is received by foreign invested companies (2014, 24).

In the beginning of China's WTO accession it was given a non-market economy status, which has negatively affected the development of China's foreign trade, according to Pan (2015). The status has allowed other WTO members impose discriminatory measures on Chinese imports and made China more vulnerable to anti-dumping lawsuits and high margin rates from other WTO countries. In addition, responding to lawsuits has caused notable costs to Chinese companies (2015, 752-753). Since the US and EU's standards for a market economy are difficult to measure, China is likely to continue holding the status of a non-market economy in the organization, which it should've changed to market economy status in 2016. One of the factors behind China's efforts to rebalance its economy and change its core dynamics could be its stagnant status and the inability to reach its trade goals in the multilateral system. According to Hilpert, it has lead China to actively pursue agreements on the bilateral and regional level, with ASEAN and through the OBOR initiative for example (2014, 18).

Even though China has received discriminative treatment through multilateral channels, it has been accused of taking advantage of the global trading system while not providing equal opportunities on its domestic markets and having weak IPR legislation, most notably by President Trump. For China its trade policy is an integral part to gaining domestic support through maintaining GDP growth. On the other hand, China has to balance between increasing international pressure and its domestic economic interests. According to Weightman (2018), China's efforts to strengthen IPR protection stem from Chinese firms' demand, which fits into one core goal of Chinese trade policy – supporting the domestic industries and national economic interests through protectionist practices (Weightman 2018). Li and Qiu (2016) state that in addition to the influence of WTO membership and regional trade agreements to Chinese trade policy, the practices seem to protect highly productive and profit generating industries and the national and ideological interests of the country (2016, 432). In this light the policy of 'opening up', the One Belt One Road initiative and the 'Made in China 2025' plan can be interpreted as ways for supporting and opening opportunities for Chinese companies to invest abroad instead of committing to actual trade liberalization.

### **1.3. Chinese trade diplomacy**

In addition to the other affecting factors discussed above, there is evidence of the diplomatic relationship with China affecting bilateral trade. In particular, the use of unjustified economic sanctions to China's partner countries can be connected to ongoing diplomatic tensions. The WTO allows the use of trade defence measures – barriers to trade and other discriminatory measures in certain cases related to for example environmental and national security interests, where trade with a specific country would be harmful (Analytical Index..., 599).

The connection between the diplomatic and trade relationship with China has emerged for example in the analysis of Zhang et al. (2011) of the positive link between a diplomatic relationship and trade fluctuations between China and other countries. The main findings showed that political cooperation, China's historical contacts with communist countries and state visits have had an increasing effect on trade flows between China and its partner countries (2011, 41). Based on this notion, Fuchs and Klann (2013) have investigated the impact of meetings between partner countries' government representatives and the Tibetan leader Dalai Lama to trade

relations with China. The researchers show that there is a negative and a short-term impact on receiving the Dalai Lama to exports to China, calling it the 'Dalai Lama effect' (2013, 170). Furthermore, other political factors, such as taking on opposing stance on human rights issues, maritime disputes or the One China policy in regards to China have shown to have an impact on bilateral trade as well.

Reilly (2012) finds the Chinese style of sanctioning being informal in nature, including threats of further repercussions, calling off high-level meetings and selective purchases for example (2012, 123). Another economic tool for China is using consumer boycotts, according to Reilly (2012) and Heilmann (2015). They describe the sanctions often as being paired with high diplomatic pressure while being targeted towards a certain country, which has lead to only short-term effects on the bilateral trade levels (*Ibid.*). China has also used the 'essential security interests' clause in threatening the U.S. over trade in arms with Taiwan for example to avoid consequences in the WTO (2012, 124).

China's informal sanctions on trade seem to be designed carefully to disrupt the partner country's economy or a part of it without drastically affecting the Chinese domestic market. Thus, politically charged sanctions to trade could be seen as a low-cost and highly effective means to reach policy goals in a short period of time. Additionally, targeting a certain sector in foreign trade informally is likely to cause minimal political costs on the domestic level when the partner country is economically less prominent compared to China. However, in the long-term China's use of economic sanctions can lead to companies in target countries diversifying their exports elsewhere, while Chinese companies are losing their gains from trade (Heilmann 2015, 2). Another constraining factor is China's major role in global supply chains. Since China has a major share in globalized production, consumer boycotts can harm Chinese production that depends on foreign imports and market access (Reilly 2012, 130). In light of China's 'Made in China 2025' plan and the ambitions to boost domestic value chains while decreasing dependency on other countries' innovation, this factor might lose importance in the future.

Another effect of this behavior can be predicted in the policymaking in partner countries. Threats of diminishing economic gains from trade with China could lead to companies lobbying for pro-China policies in partner countries, according to Reilly (2012, 124). This is plausible especially in trade with Taiwan, which strongly relies on trade with mainland China. The China-Taiwan trade relationship despite the political situation is a unique counterargument to the hypothesis of

diplomatic relations with China affecting trade, and it can be explained by the impact of internationalist interests. According to Fuchs (2016), the politicization of trade is less likely if the benefits of low trade barriers are high (2016, 6).

## **2. COMPARATIVE ANALYSIS OF CHINESE TRADE DIPLOMACY**

This section of this thesis analyses case examples of China's reaction in terms of trade policy during political tensions. The research focuses on studying China's behavior during a dispute related to trade and diplomatic tensions in which there has been evidence of a spillover to trade. More specifically, the cases in question are the ongoing trade war with the U.S., compared with case studies with the Chinese embargo of rare earth minerals to Japan and a consumer boycott against South Korea. There seems to be a discrepancy in the Chinese reaction depending on the nature of the conflict and the country in question. While tensions derived from the political level are more likely to lead to Chinese informal sanctions with quick and drastic economic outcomes, the Chinese reaction to the highly publicised trade-related conflict has been more calculated and explicit. The purpose of the comparative research is to identify the main reasons behind the differences in Chinese behavior in the case examples.

### **2.1. U.S.-China trade war**

The latest trade dispute between China and the U.S. originates from a series of investigations initiated by the U.S. Trade Representative (USTR) Robert Lightizer, the U.S International Trade Commission (USTIC) and the Department of Commerce about China's alleged unfair practices in the use of IP and technology, washing machine and solar panel imports hurting the U.S. industries and Chinese steel and aluminium imports threatening national security, respectively (USTR 2017; USTIC 2017a; USTIC 2017b). The first imposed tariffs were initiated from the U.S. side in January 2018 to foreign washing machines and solar panels, followed by 25 and 10 per cent tariffs to steel and aluminium respectively in March 2018 (USTR 2018a; The White House 2018a). The tariffs were originally imposed to all trading partners of the U.S. and were made on the grounds of protecting national security. From all affected steel and aluminium

imports Chinese goods accounted for 6 per cent, according to Bown and Kolb (2018). After receiving threats of filing an official WTO dispute and imposing its own tariffs to some U.S. imports from the European Union (EU), the imposed tariffs were changed to exclude the EU, Canada, Mexico, South Korea, Brazil, Australia and Argentina and were set to come into effect on March 23rd and to end in June 2018 (The White House 2018b).

In regards to the USTR's claims of China's unfair exploitation of IP, forced technology transfers and innovation, in March 2018 a Trump administration report was released with recommendations of tariffs, updated rules on investment and starting a WTO dispute. Before China had set retaliatory measures to the first round of U.S. tariffs, the U.S. initiated a dispute in the WTO alleging Chinese violation of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) (WTO 2018d). The U.S. followed by first threatening China specifically with 25 per cent tariffs on 1,333 Chinese products worth 46,2 billion U.S. dollars, which was followed by Chinese threats of tariffs to 106 U.S. goods worth 50 billion including U.S. transportation and soybeans for example, which are among China's largest import product groups (Bown and Kolb 2018).

After the announcement of U.S.-imposed tariffs China continued by imposing wider tariffs on U.S. imports worth 2,4 billion U.S. dollars, which included pork, aluminium scrap, fruits and nuts (Bo 2018). In addition, China imposed anti-dumping measures on American sorghum exports which it began to investigate earlier in the year (China announces..., 2018). Later in May, the Chinese authorities announced the termination of Chinese tariffs to U.S. grain sorghum, which was put under safeguard measures earlier in the year after the U.S.-imposed tariffs on solar panels and washing machines (MOFCOM 2018a).

In June 2018, the U.S. published a list of new 25 per cent tariffs, covering about 50 billion U.S. dollars worth of Chinese goods, to which China responded with its own corresponding document with the same tariff rate. As the lists were planned to be implemented in two phases, the tariffs from both sides went into effect to goods worth 34 billion U.S. dollars at the same time in July. The Chinese tariffs were targeted towards auto, farm and aquatic products, while aircrafts which previously were planned to be subjected under tariffs in April were taken off the list (MOFCOM 2018b).

The latest round of U.S.-imposed tariffs of 10 per cent, increasing to 25 per cent from the beginning of 2019, were issued on September 17th to Chinese imports worth an additional 200 billion dollars. Notable is the imposed tariff rate on both sides; while the U.S. tariffs range between 10 and 25 per cent, the Chinese rates are kept between 5 and 10 per cent (MOFCOM 2018c). During the round the U.S. tariffs covered 5745 product lines, over 500 lines more in comparison to the Chinese response (USTR 2018b).

Compared with the U.S. measures, the Chinese reaction could be interpreted as relatively modest. The tariff percentages from the Chinese side have been on a lower level compared to the U.S., and Chinese authorities haven't been able to set tariffs to the same number of tariff lines as the U.S. due to importing less American goods than vice versa. One of the reasons behind the modest reaction could be the U.S. tariffs' effect on mainly multinational companies and supply-chains, which in the end cause increased costs to U.S. enterprises instead of addressing the Trump administration's allegations of IPR theft by Chinese-owned companies, according to Lovely and Liang (2018, 9). A major part of the Chinese tariffs were also set on American agricultural imports, which in part could be interpreted as a subtle strike towards American areas with a strong Republican support. As of November 2018, U.S. tariffs cover approximately 250 billion U.S. dollars worth of Chinese imports, while Chinese measures cover roughly 110 billion dollars worth of American exports. In 2017, the worth of Chinese exports to the U.S. was roughly 505 billion dollars, while U.S. exports accounted for about 180 billion dollars (USTR 2018a).

In addition to imposing retaliatory tariffs to U.S. imports, China filed a complaint in the WTO concerning the proposed American tariffs and initiated dispute consultations in cases of steel and aluminium imports and the other sectors affected by the additional U.S. tariffs later in August (WTO 2018e; WTO 2018f; WTO 2018g). In response to the retaliatory tariffs from partner countries, the U.S. had filed dispute consultations against China and four other WTO member countries as well in July (WTO 2018h).

As the trade war had had its beginning by the summer of 2018, the Chinese MOFCOM released a statement of the situation at hand addressing six points. In essence, China strongly denied U.S. claims of unfair trade practices within technology, innovation and IPR, the lack of Chinese attention to differences in trade and having no legal basis for their countermeasures. The latter aspect in addition to interests of China and the rest of the world were used to justify the Chinese policy reaction to the U.S.-led trade war. The statement also explicitly accused the U.S. of

endangering the global economy, while emphasizing China's view on its trade policy and principles of opening up (MOFCOM 2018d). In addition, President Xi underlined China's focus on high-quality economic growth through self-reliance in the manufacturing sector, referring to the increased trend of protectionism on the global market after the beginning of the trade war (MOFCOM 2018e). While his notions followed the core goals of the 'Made in China 2025' plan, the increased emphasis on China's self-reliance might signal a decreased political will to negotiate with the U.S. On the other hand, based on the 'Chinese Dream' ideology highlighting international negotiations, the trade war could turn China more willing to negotiate and make concessions to the U.S and third countries. Since the U.S. imports more from China than vice versa, Chinese authorities cannot impose retaliatory measures on the same level as the U.S, which opens an opportunity for negotiations to relax the tariffs or attack the American side in a different way. Parttaking in a trade war using tariffs not only makes Chinese products more expensive on the American markets, but it also threatens the Chinese domestic economy and employment rate. Since China has less leverage to answer to the measures employed by the Trump administration, there are only few alternatives for China to retaliate without hurting its own economy. In the long run the trade war will disrupt both economies, which gives China higher incentive for reconciliation.

Another reason behind China's modest reaction to U.S tariffs could be the uncertainty in American politics. The trade war is causing uncertainty for China in its policy towards the U.S., which makes it difficult for China to create a long-term policy for trade. The continuity of the Trump administration is unclear, which constrains China in making drastic changes to its trade strategy with the U.S. Moreover, China might mitigate the effects of the trade war through decreasing its reliance on the U.S. via promoting diversification to other countries and focusing on negotiating regional trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) and the 16+1 framework in Europe. Alternatively, China can procrastinate its reaction to the short-sighted U.S. measures and wait until the inauguration of a next President with a different approach to the U.S.- China trade relationship.

Currently China's reaction to the situation has been mixed – on the other hand it has followed its commitments to international institutions and law by seeking support from the WTO, but it has also set retaliatory trade measures against the U.S., which could be interpreted as an act against WTO law. Since China has strongly underlined the importance of multilateral institutions and the international world order, offering one-sided concessions to the U.S. would act against its

'Chinese Dream' ideology and consequently would undermine the global rules-based trading system. Thus, future restraint from the Chinese side can be expected.

In addition to the retaliatory and rhetorical reaction from China's authorities, the consequences of the trade war seem to have materialized in the Chinese manufacturing sector, trade flows and GDP growth rate for example. According to the National Bureau of Statistics in China (NBS), the Purchasing Managers' Index (PMI) for large enterprises and SOEs had experienced a fall from 51.9 to 50.2 from May to October 2018 (NBS 2018). Compared to the previous year, the rates were 51.2 and 51.6 for May and October 2017 respectively (NBS 2017). PMI generated by private companies Caixing and IHS Markit, which aims to demonstrate the state of the economy and the manufacturing environment for small and medium sized enterprises (SME), dropped from 51.5 in January 2018 to 50.0 in September the same year (IHS Markit and Caixing 2018a, IHS Markit and Caixing 2018b). During the second half of 2017 the index remained above 50, while in 2018 the index has experienced a gradual fall through the year which could imply the effect of the trade tariffs and rising uncertainty. Additionally, GDP growth experienced a slight drop to 6.5 per cent compared to 6.8 and 6.7. from the year's quarter 1 and 2 respectively (OECD 2018). To possibly prevent other harmful effects of the dispute, China's central bank expanded credit support for SMEs, lowered its reserve requirements and increased liquidity to the financial system to facilitate banks' lending and investment (People's Bank of China 2018). China's exports and production experienced weaker demand for Chinese exports and stagnated production due to the increased costs possibly because of the China-U.S. trade dispute. However, rising uncertainty can constrain actors on the market in fears of additional losses.

With the exception of the cancellation of the sorghum tariff by China, the trade war is most likely to continue in 2019 based on the behavior of the two countries. Thus far China's reaction to U.S. measures has been largely retaliatory and less aggressive compared to the latter. In order to keep its financial stability under control, China will most likely take additional measures to mitigate the effects of the trade dispute by for example extending efforts and investing on a larger scale in the OBOR and 'Made in China 2025' frameworks. The trade war between the two biggest economies in the world is simultaneously a political and an economic dispute, and has highlighted the allegations of China's unfair business practices and regulations regarding foreign enterprises and investors. However, the U.S. hasn't clearly set out its demands for China for ending the trade war, which has made the U.S. goals and demands in the dispute more ambiguous. President Trump has highlighted the U.S. trade deficit, which is difficult to correct



only via tariffs on Chinese goods. On the other hand, impacting Chinese policies on foreign enterprises' market access and IPR on the Chinese market could be possible through negotiation. Whilst taking a defensive stance in imposing tariffs, China has underlined its commitments to the multilateral rules-based free trade system, although it is still a highly protected market in the global context. Moreover, its complicated policymaking structure adds to the disconnect between the rhetoric from the highest political level and the local authorities implementing Chinese trade policy.

## **2.2. Minor case studies**

To demonstrate China's trade behavior in minor political disputes, this section introduces a case relating to exports of rare earth minerals to Japan in 2010 and an example of a recent Chinese boycott of South Korean products in 2017.

### **2.2.1. Japan and rare earth minerals embargo**

In September 2010, a Chinese fishing boat collided with two Japanese coastguard ships in the disputed Senkaku/Diaoyu island area in the East China Sea. The captain of the ship was arrested and detained, while the crew of the ship was freed shortly after questioning. China's state media responded by warning of a threat to the countries' relations in case of an aggressive response from Japan (McCurry 2010). While Japan continued to keep the ship captain detained, traders claimed that shipments of rare earth minerals to Japan were blocked by Chinese customs officers in ports. However, China denied any allegations of an official ban towards Japan (Bradsher 2010a). Later, the unofficial embargo was applied to shipments to Europe and the United States as well, which led to dispute consultations in the WTO requested initially by Japan (March 12), later the European Union, the United States (March 22) and Canada (March 26) in 2012 (Bradsher 2010b). Since China is the world's biggest supplier of rare earth minerals which are crucial for the technology industry, the complainant countries argued that China used its power unfairly by violating the 1994 GATT and various paragraphs from China's Protocol of Accession. China's leading role in the industry also made it possible to affect global demand and pricing of rare earths, thus distorting the market. China blocked the requests for consultations and denied any allegations of discrimination, claiming that China's interest is the protection of

their natural resources and economic development (WTO 2012). The panel for the dispute was formed on September 24 of the same year, and the final report on the dispute was published on March 26, 2014 (WTO 2014a, 21).

The main findings of the report concluded that China imposed restrictive export duties and quotas in addition to limiting enterprises' rights for export. China responded by appealing to the GATT 1994's 'General Exceptions' provision, which allows restrictions if they are needed for the protection of plant life and health. The Panel considered China's counterarguments not strong enough to justify the restrictions and judged China's actions as having the intentions of reaching policy goals (WTO 2014a, 256). Even after China's appeals to the Dispute Settlement Board, it stayed consistent in its decision and recommendations for China (WTO 2014b, 152). China agreed to comply with the rulings and recommendations of the WTO and promised to remove all barriers to trade in rare earth minerals, which according to the WTO were implemented successfully (DS433: China – Measures Related...).

Not only did the incident cause major impact on trade in rare earth minerals, other Japanese companies were affected by the diplomatic clash as well. Fisman et. al (2014) found that Japanese companies that are highly dependent on China and work within sectors which are dominated by SOEs in China experienced a drop in abnormal returns during the incident (2014, 3). While the returns for Japanese companies fell by 3,7 per cent during the 2010 event, Chinese companies experienced an increase of 1,5 per cent (2014, 18). Asset returns on Japanese companies with a high exposure to China declined, when individual investors' expectations about the future became more uncertain.

The Senkaku/Diaoyu case is an example of China's use of economic power to attain foreign policy goals. China is Japan's biggest trading partner, accounting for 19 per cent of Japan's exports in 2010 (UN Comtrade). It is also the most important supplier of rare earth minerals important to Japanese technology industry. The case seems to follow Svedrup-Thygeson's (2015) and Reilly's (2012) claim of Chinese trade behavior depending on how important the target country is to China's economy. As a world leader in the field, China had a great deal of power to distort China-reliant Japanese industry without hurting its own markets, which explains the aggressiveness of the economic sanction in the Senkaku/Diaoyu case. China first imposed trade barriers on an informal level, but in this case it couldn't avoid becoming involved in a WTO dispute as a respondent. The event also brought out the political sensitivity of the trade in

rare earth minerals with China, which lead the Japanese government to invest to the diversification of its sources to other countries (Japan budgets..., 2011).

### **2.2.2. South Korea and consumer boycott**

In March 2017, South Korea swapped land with a Korean conglomerate Lotte in order to deploy a Terminal High Altitude Area Defence (THAAD) system, opposed by China referring to its national security interests. China's response was to quickly report of the incident in its state media channels, encouraging the Chinese to abstain from shopping in Lotte outlets (Ide 2017). After a drastic drop in sales and cancelled partnerships with various Chinese brands, Lotte shut down its outlets in China and finally withdrew from the market (Chae 2017).

The boycott extended to the travel sector after the Chinese authorities were reported to have been banning Chinese travel agencies from selling group tours to South Korea (Tourism industry..., 2017). According to the Korea Tourism Organization, the numbers for incoming Chinese tourists plummeted by 40 per cent soon after the outbreak of the THAAD crisis in March 2017. Despite slightly increasing during the rest of the year, the level of incoming Chinese tourists remained on a notably lower level compared to the previous year, having a significant effect on the overall number of visitors (Figure 2.). The diplomatic dispute didn't have a negative effect on the level on the overall trade flows between the countries. In fact, according to the Korea International Trade Association (KITA), the value of total merchandise exports including in 2017 rose by 18 billion compared to the previous year (KITA).

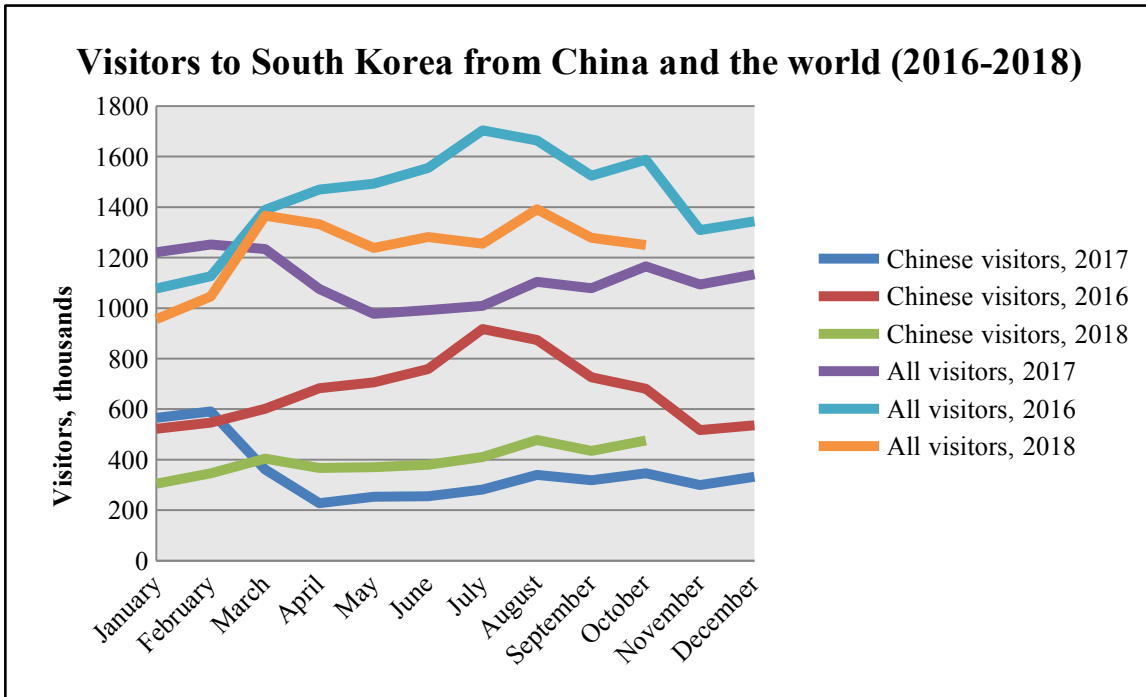


Figure 2. Visitors to South Korea from China and the world (2016-2018).

Source: Korea Tourism Organization, Monthly Statistics of Tourism.  
<http://kto.visitkorea.or.kr/eng/tourismStatics/keyFacts/KoreaMonthlyStatistics/eng/inout/inout.kto>

A formal dispute was not initiated in the WTO, but Korea brought the issue forward by accusing China of a violation of the GATS agreement in a WTO meeting. China responded by denying the allegations and wished the issue not to be addressed on a formal level (WTO 2017). The countries officially announced the restoration of the diplomatic relationship between the two in October 31st in 2017, after which allegedly the travel ban was partially lifted (Ministry of Foreign Affairs, Republic of Korea 2018; 'Travel Ban' to South Korea..., 2017). After the announcement the incoming flows of Chinese tourists to Korea remained low, but on a moderate rise. Since the strong drop in the numbers was evident immediately after the land swap increasing constantly in 2018, the political situation could be connected to the informal Chinese boycott. The Chinese unofficial sanction seemed to only have short-term effects to a narrow sector of the Korean economy.

### **2.3. Analysis and discussion**

The trade-related disputes between China and its partner economies described above demonstrate the different factors that contribute to the Chinese policymaking in trade and how the policy is applied in practice. In the U.S.-China trade war, the dispute was triggered by trade-related issues, whileas in the two latter cases a political issue spilled over to trade. Notable are the differences in the style and the nature of the imposed trade measures in addition to the size and the importance of the partner country to China's economy and vice versa. In particular, the assymetry in China's bilateral trade relations with the U.S., Japan and South Korea is relevant to the analysis as well. Comparing the two different scenarios of disputes connected to trade is relevant to understand how China's trade policy is applied in cases with different countries and situations at hand. Taking into account the background and the dynamics of Chinese trade policy in the analysis consequently can help to explain the Chinese trade behavior in the cases introduced in the previous sections. More specifically, the goals and the factors constraining China are crucial to note in the analysis. Finally, it can offer opportunities for evaluating China's trade policy perspectives and its role in the global trading system in the future.

One of the biggest differences in the two trade-related types of conflicts is the style and the scale of economic sanctioning from the Chinese side. In the trade war, the root of the issue was in trade and it was initiated by the U.S, while in the minor cases the motivation for the issued trade originated from diplomatic tensions. The core difference is the scale of China's reaction – in the trade war China has acted in a relatively constrained way despite publicly addressing the tariffs imposed by the U.S, while the minor diplomatic disputes have had drastic outcomes due to effective and informally imposed sanctions already in the short-run. In the Japanese case, there wasn't an official statement about the imposed measures on the exports in question and during the THAAD dispute with South Korea the measures were imposed indirectly by influencing the public by using state media channels. This might imply that the decisions of trade measures were made on either a lower level possibly without effective coordination with the higher levels of the policymaking structure and the major trade policy strategy. Furthermore, informal sanctions have offered an effective way for China to maintain its face in diplomacy while presenting its power in a short amount of time.

Another important factor in the both cases is the cost of trade sanctions. During diplomatic tensions the sanctions were informal in nature with low costs to the Chinese economy, since the imposed measures were only targeted towards specific services or products and were in effect only for a short period. For the export-led Chinese economy the U.S. is its largest and most influential trade partner, which constrains the Chinese political elite from making quick trade policy decisions. According to estimates half of Chinese exports have foreign content on average (Li et. al 2016, 427). This can restrain China from imposing more aggressive trade measures towards the U.S. The U.S. tariffs have also been highly criticised and stated as being disruptive to American companies. Thus, imposing additional tariffs to Chinese companies would increase costs on also the domestic level and cause political costs to the Party. According to a simulation conducted by Li et al. (2018), trade war with the U.S. most likely has a stronger impact on China than the U.S. by affecting trade, manufacturing production, employment, GDP and welfare. However, they estimate that Chinese economy won't be drastically hurt in the tariff war and the costs of the dispute would be manageable (2018, 1563). Nevertheless, China's interests to engage in a tariff war are significantly lower compared to the U.S., which could explain China's moderate stance in the dispute.

Another difference that can explain the differences in China's trade policy reaction in both cases is the partner country's economy and a certain trade sector's importance to the Chinese economy. Despite the trade deficit between the countries, Chinese and American economies are very interconnected, which implies trade measures having effects on both sides. While in the trade war China has taken a defending stance, in the minor cases China has clearly had a foreign policy goal it has pursued via trade measures. Combined with political pressure, in the minor cases the partner country was more reliant on China than vice versa, which gave the latter leverage to affect the partner economy without distorting its own market. The importance of the partner market to China might thus be a more deciding factor than the size of the other country for example.

China's reaction to the trade war compared to the minor cases differs in its perspective. Despite the informal nature in the minor cases China's effective trade measures have been used to signal China's demands for changes in the partner country's policy in a specific political problem in question. In the case of the trade war, China has acted moderately in imposing barriers to trade and shown initiative to negotiate with the U.S. This seems to align with the major scope of the Party to promote free trade and international cooperation. However, the minor cases suggest

otherwise. China's confidence in its expectation of the other country not retaliating in part explains the severity of the short-term trade barriers due to China's economic and political power. Similar to the Chinese policymaking process, this difference shows that China's trade policy is not coherent with different countries and in different situations.

Taking into account the importance of the U.S. for China, this might suggest that the decisionmakers on the highest level have set the direction of China in its reaction to the trade war. In contrast, the minor cases suggest that the decisions have been made on a more local level, affecting the ports and travel agencies in case with Japan and South Korea respectively. In addition, in the minor cases the sanctions breaking the WTO rules had only a drastic short-term effect, which could be used as a threat to show China's power in the regional status quo. China's role in the relationship with the U.S. is different and it seems like there is uncertainty in the overall strategy in the relationship due to the fragmented Chinese policymaking process, which materializes in its trade policy reaction to the trade war. Additionally, there is also uncertainty about the policy choices from the U.S. side. Since the American presidential administrations change every four years, China might abstain from taking stronger economic measures against the American economy before the next elections in 2020.

In the long run, continuing the tariff war and contributing to increased protectionism doesn't align with the major 'Chinese Dream' framework. Even though its foreign trade policy model has already experienced a shift to strengthening domestic demand, China continues to depend on its access to international markets. However, the trade war can contribute to a deeper commitment to China's OBOR initiative, 'Made in China 2025' plan and the 'Chinese Dream' nationalist ideology in addition to negotiations of other bilateral and regional trade agreements. Since the dispute has underlined the unfairness of Chinese trade policies, it might have also given China the incentive to create trade policy which would be more accommodating to foreign investors and enterprises entering the market.

The effects of China's trade policy reaction in the case studies on a political level vary. While in the minor cases the temporary trade measures were used as a tool to reach specific foreign policy goals and showcasing Chinese power, China's reaction to the trade war can be seen as modest and careful due to major possible economic and political losses. Stieglitz (2017) claims, that China's foreign trade strategy should take a long-term perspective by adhering to norms set by multilateral institutions such as the WTO (2017, 464-465). China benefits from the international

system and not only does its reaction to the imposed sanctions affect its relationship with the U.S., it also determines the integrity of the WTO and the rules-based international system. This can be seen already in China's prior commitment to multilateral institutions via the previously mentioned initiatives, and its immediate official public reaction which has portrayed China as a promoter of globalization and free trade. The major initiatives in the Chinese trade policy context however are planned with a long-term scope, which effects will take longer periods to emerge. In contrast, in the minor cases the Chinese reaction seems to reach short-term goals. The two types of cases showcase the complexity of the forces behind the creation of Chinese trade policy, which makes its analysis difficult as a single entity.

## **CONCLUSION**

The purpose of this thesis was to study the dynamics of China's foreign trade policy and what are the main drivers affecting the scope and the main goals of the policymaking process. After experiencing slower pace of growth, China has recently began the process of rebalancing its economy from a major exporter of low value-added products to maintaining sustainable growth through supporting domestic demand. On a more specific level, the dynamics behind China's policymaking in trade seem to be ambiguous and complex. In practice, China's trade policy seeks to benefit its SOEs and seems to be motivated by personal interests of the persons in power within the Communist Party and the line ministries they lead, which makes the policymaking structure fragmented and weakly coordinated. In addition, evidence suggests a link between political tensions and decreased trade with China, which the case studies with Japan and South Korea showcase. When it comes to the main direction of China's foreign trade policy, it seems to strongly promote multilateralism, free trade and adhering to the rules-based international system. In addition to the aforementioned aspects, initiatives such as the OBOR and 'Made in China 2025' based on the 'Chinese Dream' ideology aim gaining growth through strengthening domestic demand and reaching the highest levels of supply chains. However, on a practical level foreign companies have experienced difficulties in entering the market and IPR abuses due to unfair Chinese subsidies and regulations, favoring domestic companies. Furthermore, the OBOR framework has been criticised as China's way to reach foreign and security policy goals by gaining political influence in the affecting regions.



The main findings of the research show that China's reaction to events on the international stage is determined by what is at stake for China both economically and politically. In a trade-related dispute as the trade war China has thus far reacted in a constrained way with retaliatory trade measures due to the political and economic costs of a drastic policy reaction and possibly uncertainty of the current U.S. administration. China's trade policy is an important channel for gaining domestic political support, and a dramatic response to the trade war could increase domestic costs and contribute to the slowing GDP growth rate. Since the 'Made in China 2025' and the OBOR initiative are implemented with a long-term perspective, their immediate economic gains to China remain to be seen, which creates pressure to China to answer to the actions of the current U.S. administration.

China benefits from the international trade system and has engaged with multilateral frameworks via for example the OBOR initiative, which is both a sign of China changing its scope away from the U.S and its selective commitment to the rules-based global system. In the politically charged trade disputes the imposed trade sanctions have been informal in nature with short-term effects with the intention of reaching specific goals in Chinese foreign policy in a cost-effective way. While the politically influenced and targeted trade tensions seem to be used to showcase China's power towards a specific country, China might seek to keep its position in the global political and economic status quo in the trade war with its modest response.

The aim of this thesis was to present China's trade policy framework and study how it is implemented in practice during international tensions. The ongoing trade war is very likely to continue, and its implications remain to be seen. This opens up opportunities for further research on China's long-term trade policy response towards the U.S and how it seeks to maintain a stable growth rate amid uncertainty on the international markets. Taking into account China's rising status as a world power, continuous research and analysis of the dynamics and the implementation of its trade policy remains crucial in the international relations framework.

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## APPENDICES

### Appendix 1. China's merchandise exports, imports and trade surplus (2001-2017)



Figure 1. China's merchandise export, imports and trade surplus (2001-2017).

Source: WTO Data, <http://data.wto.org/>



## Appendix 2. Visitors to South Korea from China and the world (2016-2018)

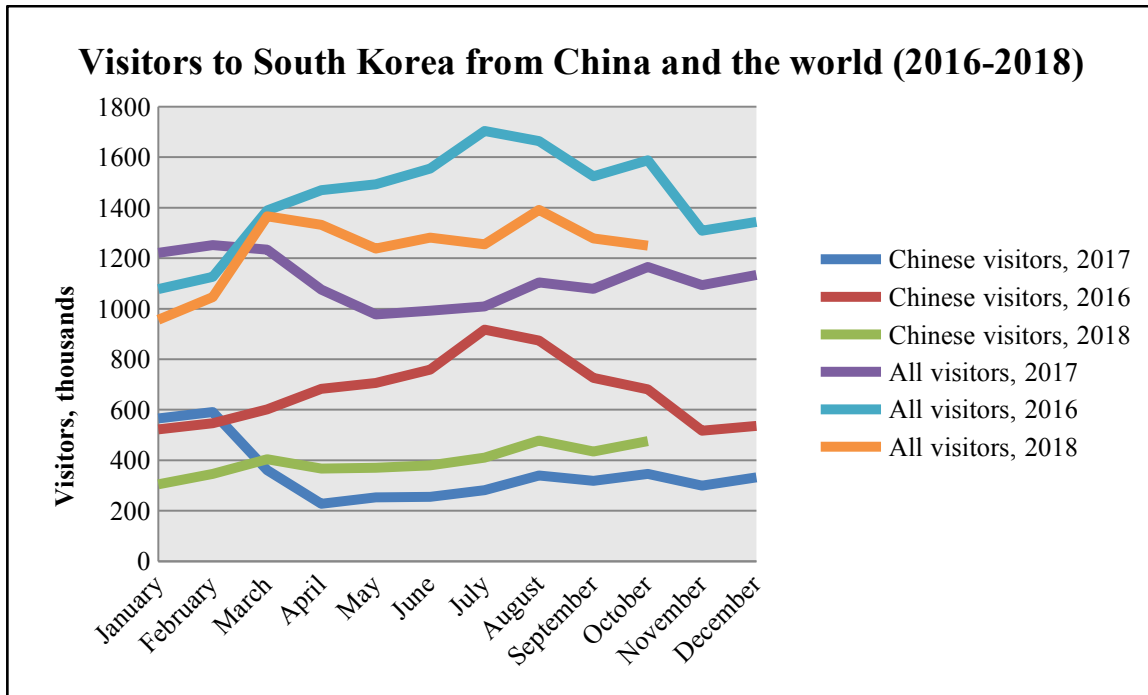


Figure 2. Visitors to South Korea from China and the world (2016-2018).

Source: Korea Tourism Organization, Monthly Statistics of Tourism.

<http://kto.visitkorea.or.kr/eng/tourismStatics/keyFacts/KoreaMonthlyStatistics/eng/inout/inout.kt>

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