

# No to dumping from China

## Too early to grant Market Economy Status to China

**It would seem to be too early today to grant Market Economy Status (MES) to China. Indeed, granting MES to China when it does not meet the technical criteria to be considered a market economy would be devastating for a number of manufacturing sectors in the EU as the possibility to impose anti-dumping measures on cheap Chinese imports will largely disappear. The right to use non-MES methodologies for calculating price differences must therefore be kept in place as the only way to reveal the true level of dumping. The emphasis should be on creating a level playing field between the EU and China where workers do not fall victim to unfair trade practices.**

Although China is a member of the World Trade Organisation (WTO), it is not recognised as a market economy by any of its major trading partners, making it easier for European firms to find it guilty of dumping goods on overseas markets. Indeed, in the case of non-market economies (NMEs), alternative methods for calculating dumping margins (often based on the higher prices of third countries) are allowed. However, at the end of next year an article in its Accession Protocol to the WTO, making it possible to use these non-market methodologies in anti-dumping procedures, will expire. For China it is obvious that the expiry of this article will automatically grant it MES. For the EU to grant China MES, it would need to change its anti-dumping regulations, a procedure which would take almost a year. Such a decision would therefore have to be taken by the end of 2015.

### Dumping

According to Article VI of the General Agreement on Tariffs and Trade (GATT) 1994, which lays down the basic rules on dumping, dumping occurs when products of one country are exported to another country at less than the normal value of the products. The normal value is the domestic market price in the exporting country, or in the absence of such a price, the cost of production in the country of origin. By comparing export prices with home market prices/costs, a margin of dumping can be calculated. This margin of dumping will then be the basis for the imposition of anti-dumping measures on the imported products. However, this applies only if prices/costs are set by market forces. In the case of NMEs, domestic prices/costs are largely determined

by the state and not the market. Therefore a different methodology is allowed to determine the normal value of products originating from NMEs. This alternative methodology is usually based on surrogate prices in a comparable third market economy country characterised by a similar level of development. Often these prices are higher than the prices on the domestic market (e.g. 20% on average in the steel sector), which facilitates anti-dumping procedures.



### China and the WTO

As WTO agreements are concluded by and intended to apply to market economies, the integration of NMEs into the GATT/WTO systems has been a constant source of tension. When China joined the WTO in 2001, it was the only major WTO member with a communist economy and it was widely recognised that China had not completed the transition to becoming a fully-fledged market economy in several important areas. As a result, a number of conditions such as regular progress reports (the Transitional Review Mechanism, which is a WTO term) were imposed on China. Among

those conditions was also the ability of WTO members to apply NME methodologies (a practice that is otherwise banned in the WTO's Anti-Dumping Agreement) in the calculation of anti-dumping duties on imports from China if targeted companies cannot prove that they operate in market economy conditions. It was argued that, because of widespread state influence and market distortions, Chinese prices/costs cannot be considered to be the result of market forces and that, in dumping margin calculations, recourse to surrogate prices and costs in comparable third countries is therefore justified.

The latter was taken up by Section 15 of China's Accession Protocol, which allowed WTO members to continue applying the modified NME methodologies to imports from China until China completed its transition to becoming a market economy. However, two concessions were made to China:

- The automatic expiry on 11/12/2016 of the ability to make use of a 'methodology that is not based on a strict comparison with domestic prices or costs in China' (Section 15 (a)(ii));
- The ability to have MES applied on a sector-wide basis if a sector can clearly show that market economy conditions prevail in the industry (section 15 (a)(i)).

For China, the expiry of Section 15(a)(ii) also means that countries will no longer be able to apply NME methodology on Chinese imports and thus that China will automatically obtain MES for the purpose of anti-dumping investigations. Indeed, the legal basis provided by this article to apply alternative methodologies will have disappeared. As a consequence, in December 2016 China could and will, if WTO member states continue to apply alternative methodologies, take these cases to the WTO for arbitration.

However, many observers are saying that, after the disappearance of Section 15(a)(ii), China will still be an NME. Chinese firms/sectors will still have to provide proof that they are operating according to market rules and, if this is not the case, non-market procedures will still be allowed. These observers also refer to Art. 15 (d) of the Accession Protocol: "Once China has established, under the national law of the importing WTO member, that it is a market

economy, the provisions of subparagraph (a) shall be terminated provided that the importing member's national law contains market economy criteria as of the date of accession." This article clearly states that the use of NME methodologies will only come to an end when China has established a market economy according to the definition of the importing country.

## Market Economy Status

Market Economy Status only matters in trade defence policy when an importing country launches anti-dumping and anti-subsidy procedures that can lead to it temporarily imposing very high import duties on foreign products where foreign firms are selling below normal market prices (whereby the levy on the dumped product is based on the margin of dumping, which is the normal value of the product minus the export price).

In the recent past the EU and China have already clashed over the alleged dumping of products such as solar panels and components (solar glass); steel pipes; table and kitchenware; and flat-rolled stainless steel. China retaliated by launching its own anti-dumping and anti-subsidy probe into European wine. In 2014, the European Commission initiated 16 new anti-dumping and anti-subsidy investigations, of which six targeted Chinese companies. Nine of these cases concerned the steel sector. Of all the new anti-dumping investigations initiated globally between 2010 and 2014, roughly half of them were against China (44%).

It is up to each WTO member to decide whether a partner operates in market economy conditions. A country can thus agree to grant MES to China on the basis of its (subjective) definition of the market economy criteria (according to the Accession Protocol this must be based on the definition prevailing as of the date of accession of China). At the date of its accession China was already eager to be recognised as a market economy, but the US, the EU and Japan did not see China as having MES.

### EU technical criteria for defining a market economy:

1. Limited government influence over the allocation of resources and decisions of businesses (limited state control, no state-fixed prices or discrimination in tax or trade regimes).
2. Absence of state interventions in privatised enterprises (the "carry-over" from the old system: absence

of use of non-market trading or compensation systems). This criterion is considered to have been fulfilled.

3. Transparent and non-discriminatory company law combined with effective business accounting standards, independent boards, accurate and public company information.
4. A full set of bankruptcy, property and intellectual property laws.
5. A well-developed financial sector operating independently from the state and which, in law and practice, is subject to adequate supervision and capital provision.

The underlying idea of these criteria is to determine whether the prices and costs of companies in a transition economy can be relied upon for the purpose of anti-dumping investigations. In this respect it is interesting to note that in the US system for granting MES there is also a requirement that wages are determined by “free bargaining between labour and management”. The EU should also incorporate social criteria such as the right to organise, the right to strike and the right to collective bargaining into its definition of a market economy.

Even 15 years after its accession to the WTO, China can hardly be regarded as a market economy given that its markets are still subject to state intervention. For many reasons China can still be considered as a state-controlled market system with a distortive impact on global markets:

- Detailed five-year government plans supported by a broad array of government programmes;
- Central role of the Communist Party in the organisation of the economy;
- Absence of markets for labour, capital, land and energy;
- Strong political role of industry associations (the regulated are also the regulators);
- Large subsidy programmes, tax breaks, discount loans that are not in line with WTO rules;
- Import and export restrictions;
- State control over inward and outward foreign direct investments;
- Special privileges for state-owned companies;
- No functional intellectual property laws or bankruptcy regime;
- No independent financial sector.

## Arguments in favour of granting China MES

The question is whether the EU is ready to set aside its frequent use of anti-dumping measures based on NME procedures as a convenient policy instrument towards China. An EU refusal to recognise that China is run by market economy principles could have negative consequences. Here are the key arguments in favour of granting China MES:

- The EU and China are currently negotiating a bilateral investment treaty involving liberalisation of China’s investment rules. Refusing MES will endanger these talks and thus prevent EU companies from having fully-owned subsidiaries in China.
- Risk of retaliation (e.g. tariffs and quotas on EU imports, restrictions on Chinese exports of raw materials).
- Ambitious free trade agreements such as TTIP (Transatlantic Trade and Investment Partnership) and TPP (Trans-Pacific Partnership) threaten to sideline China in the global economy, while increasing the relationship between China and the EU is probably politically preferable.
- The EU already granted MES to Russia in 2002 when it was not even a member of the WTO and when it was a moot point whether Russia met the EU’s five key technical criteria for being a market economy. Refusing MES to China on the basis of technical criteria would be perceived by China as applying double standards. Furthermore, countries such as South Africa, Brazil or Australia have already decided to recognise China as a market economy.
- As the EU is currently negotiating an investment deal with China in order to open up the Chinese market for European investors, granting MES to China will probably be the price to pay for that.

## Arguments against granting China MES

- Granting MES to China will probably have a detrimental impact on a number of European manufacturing industries. The steel sector, where China has built up an overcapacity equal to the EU’s full capacity, would be particularly hard hit. Without going into the legalistic MES discussions, it would appear that the disappearance of article 15(a)(ii) does not automatically grant MES to China. Sectors and

companies still have to prove that they are operating in a free market economy and, if this is not the case, the use of anti-dumping procedures based on NME methodologies towards China has to be maintained. The arguments against granting China MES are as follows:

- The EU does not automatically have to grant MES to China when Section 15(a)(ii) expires. It only means that China's trade partners lose a shortcut to using NME anti-dumping determination methods.
- China must honour the commitments that it made when it joined the WTO. Today China has not demonstrated that it meets the technical criteria to be a market economy. It must show that it has MES either for the whole economy or for subsectors of the economy.
- A unilateral EU decision could lead to a flood of cheap imports into the EU as a result of trade deflection. This would have a devastating effect on a large number of manufacturing sectors in the EU. So far the US has shown no sign of wanting to grant MES to China. The issue of China not being an MES is part of the EU anti-dumping regulation, which would need to be changed. If the EU were to decide to change this regulation, it would then take almost a year for China to be granted MES. It should be clear that granting MES to China can only be done in coordination with other major trading partners such as the US.
- The EU should refrain from interpreting the Chinese WTO Accession Protocol and leave it to the WTO to interpret this agreement. It is up to China to initiate WTO dispute settlement proceedings if it wishes to do so.

## Annex

### Excerpts from Section 15, China WTO Accession Protocol: Price Comparability in Determining Subsidies and Dumping

- a) In determining price comparability under Article VI of the GATT 1994 and the Anti-Dumping Agreement, the importing WTO Member shall use either Chinese prices or costs for the industry under investigation or a methodology that is not based on a strict comparison with domestic prices or costs in China based on the following rules:
  - (i) If the producers under investigation can clearly show that market economy conditions prevail in the industry producing the like product with regard to the manufacture, production and sale of that product, the importing WTO Member shall use Chinese prices or costs for the industry under investigation in determining price comparability;
  - (ii) The importing WTO Member may use a methodology that is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product.
- d) Once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of subparagraph (a) shall be terminated provided that the importing Member's national law contains market economy criteria as of the date of accession. In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession. In addition, should China establish, pursuant to the national law of the importing WTO Member, that market economy conditions prevail in a particular industry or sector, the non-market economy provisions of subparagraph (a) shall no longer apply to that industry or sector.