

# EU-CHINA OBSERVER

DEPARTMENT OF EU INTERNATIONAL RELATIONS AND DIPLOMACY STUDIES



"EXCHANGING IDEAS  
ON EU-CHINA RELATIONS:  
AN INTERDISCIPLINARY  
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DEPARTMENT OF EU INTERNATIONAL  
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Baillet Latour Chair of  
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In 2016, the **EU-China Observer** will be published four times. All issues will be dedicated to special themes. The current issue focuses on China's Market Economy Status; the second issue will collect contributions on EU-China Cooperation on Security Issues, whereas the third one will focus on Global Governance.

We hope you will enjoy reading the articles in this issue. If you would like to contribute a paper yourself, please refer to the author's note and the submission deadlines on the website:

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# ECONOMICS, LAW AND POLITICS: THE DEVISIVE QUESTION OF CHINA'S MARKET ECONOMY STATUS

Insa EWERT, Jan Philipp POETER and Maurice FERMONT

## Introduction

China's quest for Market Economy Status (MES) is among the most vigorously debated topics in EU-China relations this year. With the expiration of parts of China's accession protocol to the WTO in December 2016, more and more research is being published arguing possible economic implications, legal interpretations and political positions. Even though China concludes that it will automatically receive MES, its possible actions and influence are hardly examined. This article takes a three-pronged approach. It first looks at the trade and economic strategies of specific EU member states in light of their position on granting China MES, it then examines the relevant legislative procedures in the European Institutions and finally it evaluates China's perspective. It concludes that the question of granting China MES is neither a purely legal nor economic decision for the EU, but a largely political one.

## Background

While a number of countries, including Australia, have granted MES, important economies such as the EU, the United States (US), Canada, Japan, Brazil and India remain undecided for the time being<sup>1</sup>. However, 15 years after China

joined the WTO, the expiration of Article 15 subparagraph (a) (ii) in its accession protocol fuels the debate about the implications of China's possible recognition as a market economy. The importance of this decision for the EU lies in its treatment of China in anti-dumping investigations after December 2016. Currently, the 52 anti-dumping measures in force cover a number of European industries, in particular steel, ceramics and aluminium.<sup>2</sup>

## Impacts of EU Member States' Trade Strategies

Within this debate, various economic and legal studies forecast a range of negative impacts.<sup>3</sup> However, how can one explain the paradox that Germany and the UK – the very countries that the most prominent study by the Economic Policy Institute (EPI) portrays as the biggest economic losers – support granting China MES?<sup>4</sup> In order to examine this paradox of predominant negative economic explanations and yet strong support from Germany and the UK, we will take a closer look at their trade relationships with China and contrast them with the positions of France and Italy.

China has become the EU's second largest trading partner after the US with a trade volume of EUR 467 billion, doubling its share from seven percent in 2002 to 14 percent in 2014.<sup>5</sup>

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<sup>1</sup> L. Puccio, "Granting Market Economy Status to China", European Parliament Research Service, 11/2015, Retrieved 14 December 2015, [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/571325/EPRS\\_IDA\(2015\)571325\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/571325/EPRS_IDA(2015)571325_EN.pdf), p. 9ff. <sup>2</sup> European Commission, "College Orientation Debate on the Treatment of China in Anti-Dumping Investigations", Fact Sheet, 13 January 2016, Retrieved 13 January 2016, [http://europa.eu/rapid/press-release\\_MEMO-16-61\\_en.htm](http://europa.eu/rapid/press-release_MEMO-16-61_en.htm). <sup>3</sup> See for example: R. Scott & X. Jiang, "The Unilateral Grant of Market Economy Status to China Would Put Millions of EU Jobs at Risk", Economic Policy Institute, EPI Briefing Paper #407, 18 September 2015, Retrieved 15. December 2015, <http://www.epi.org/files/pdf/92370.pdf>, European Commission op. cit., or B. Romano, "The Long Read: Market Economy Status for China, Impact on Europe and Italy", Italy 24, 24 September 2015, Retrieved 5 January 2016, <http://www.italy24.ilssole24ore.com/art/business-and-economy/2015-09-23/>. <sup>4</sup> R. Scott & X. Jiang, op. cit. <sup>5</sup> Eurostat, "International Trade in Goods in 2014", News Release 55/2015, 27 March 2015, Retrieved 5 January 2016, <http://ec.europa.eu/eurostat/documents/2995521/6760204/6-27032015-AP-EN.pdf>, p. 1.

However, important differences exist between member states' economies. While understanding individual trade relationships with China helps explain the differing positions on China's MES, the examined country cases demonstrate that focusing solely on economic analysis cannot explain the differing positions. Rather, the importance of Chinese economic diplomacy and positive long-term relationships needs to be considered.

With a strong industrial manufacturing base, Germany enjoys an overall trade surplus. In 2014 bilateral trade with China reached a volume of EUR 150 billion and while the share of German exports increased by 11.3

percent over 2013, almost double the rate of imports from China (6.4 percent), a trade deficit of EUR five billion with China remains.<sup>6</sup> Neither the forecasted negative economic impacts nor this trade deficit with China can explain Germany's position.

As the German economy relies on exports, well-functioning trade regimes have been at the heart of its foreign trade policy. As Germany's fourth largest export destination, China plays a vital role for German manufacturing, foremost in cars, car parts, machinery and pharmaceutical products.<sup>7</sup> Over decades, the German government has built a preferential relationship with China on economic cooperation. In the most recent confirmation of this relationship Chancellor Merkel publicly positioned herself, in principle, in favour of China's MES last October – despite fears of Chinese retaliation, appealing to China's leadership.<sup>8</sup> The long-term benefits of this relationship – due to the remaining influence of politics steering the Chinese economy – seem to outweigh any predicted negative impacts of granting China MES.

The case of the UK – with a significantly larger bilateral trade deficit than Germany – supports this argument. Trade with China plays a significant role in the UK, as China's sec-

ond largest trading partner in the EU. However, in contrast to Germany, its trade deficit of EUR 20 billion with China is considerably larger and its strategy aims at attracting Chinese outgoing investments.<sup>9</sup> The UK's efforts resulted in "[t]he UK [being] the most popular European destination for Chinese investment, benefitting from over £ 8 billion in 2013/14 alone".<sup>10</sup> In June 2014, trade and investment deals worth £14 billion were signed and China is even investing in the construction of strategic infrastructure such as nuclear

power plants in the UK.<sup>11</sup> Xi Jinping's latest visit to the UK, and Cameron's rhetoric, proclaiming the UK as China's "best partner in the West" and forecasting a "golden age" for the relations of the two countries are far

## CHINA PLAYS A VITAL ROLE FOR GERMAN MANUFACTURING, FOREMOST IN CARS, CAR PARTS, MACHINERY AND PHARMACEUTICAL PRODUCTS.

stronger symbols of the UK's strategic approach.<sup>12</sup> Additionally, the UK is a strong advocate for free trade regimes.<sup>13</sup> Overall however, incoming investments seem to be the main driving force behind Cameron's focus on China and the UK's position towards granting China MES.

Germany and the UK have, despite their negative predicted outcomes, positioned themselves in favour of granting China MES. France and Italy, also cited as losers in the EPI study and running comparable trade, deficits with China in absolute terms as the UK come to different conclusions. France, with a trade deficit with China of over EUR 25 billion (five times that of Germany), yet exporting only about a third of Germany's volume, has so far refrained from taking a public position on China's MES.<sup>14</sup> Finally, Italy, running a trade deficit with China of around EUR 18 billion, strongly opposes granting China MES. A plain relationship between cumulative trade relationships is therefore not a sufficient variable.

As the trade relationships between EU member states with China differ in detail, the combination of bilateral trade, investments and long-term positive economic relations seems to be decisive for Germany and the UK as the largest

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<sup>6</sup> Federal Foreign Office, "China", Retrieved 5 January 2016, [http://www.auswaertiges-amt.de/sid\\_178A8FDDA49F2430FAA0C0A2180672C7/EN/Aussenpolitik/Laender/Laender-infos/01-Nodes/China\\_node.html#doc474918bodyText3](http://www.auswaertiges-amt.de/sid_178A8FDDA49F2430FAA0C0A2180672C7/EN/Aussenpolitik/Laender/Laender-infos/01-Nodes/China_node.html#doc474918bodyText3). <sup>7</sup> Federal Foreign Office, op. cit. <sup>8</sup> Reuters, "Merkel Backs China's Market Status, But Homework Required", 30 October 2015, Retrieved 10 December 2015, <http://www.reuters.com/article/us-china-germany-idUSKCN0S00I220151030>. <sup>9</sup> Office for National Statistics, "How Important is China to the UK Economy?", 9 June 2015, Retrieved 5 January 2016, <http://www.ons.gov.uk/ons/rel/international-transactions/outward-foreign-affiliates-statistics/how-important-is-china-to-the-uk-economy-/sty-china.html>. <sup>10</sup> Enviro Estates, "The Statistics on Chinese Buying Property", Retrieved 13 January 2016, <http://www.enviroestates.co.uk/china-desk/the-stats>. <sup>11</sup> Ibid. <sup>12</sup> Tweed, David, "U.K. Throws Lavish Welcome for Xi in Hopes of 'Golden Era' in China Trade", 19 October 2015, Retrieved 12 January 2016, <http://www.bloomberg.com/news/articles/2015-10-18/u-k-in-economic-kowtow-to-xi-seeks-golden-era-of-china-trade>. <sup>13</sup> UK Government, "2010 to 2015 Government Policy: Free Trade", Policy Paper, 8 May 2015, Retrieved 12 January 2016, <https://www.gov.uk/government/publications/2010-to-2015-government-policy-free-trade/2010-to-2015-government-policy-free-trade>. <sup>14</sup> France Diplomatie,

trading partners of China within the EU. Furthermore, the fact that bilateral relationships play a significant role allows China to 'divide and conquer' on this issue. To what extent the legislative process within the Institutions manages these different positions, and what challenges the process faces, will be analysed in the following section.

### The legislative process in the EU

The differences in bilateral economic relations impede the finding of a common position and the legislative process within the Institutions. In order to grant China MES, the EU has to amend the basic anti-dumping Regulation (Regulation No 1225/2009) – a community competence – through ordinary legislative procedure (OLP).

OLP is outlined in Article 294 TFEU<sup>15</sup>, which stipulates Co-Decision between the European Parliament (EP) and the Council following a Commission proposal. Most legislation is passed in first reading and, in effect, dissent between the Institutions is resolved at an early stage, thereby securing consent during formal votes. This however increases the influence of the Council presidency during the time of negotiations, i.e. the Netherlands and Slovakia in 2016.

### Difficulties in the decision-making process

However, in the case of whether to grant China MES, interests are spread widely. Not only are Council members divided due to their bilateral relationship with China, but frictions are also present in the Commission and the EP.

Even though voting behaviour in the EP depends largely on the individual MEP, party affiliation and constituency, first debates on the subject indicate cross-party consensus that China does not fulfil relevant MES criteria. The EP legal service explained that the presently used pricing methodology based on China's WTO accession protocol would no longer be available after 11 December 2016. China would thereafter not automatically acquire MES and the EU may continue to apply alternative pricing methodology under

certain conditions, but must in any case adapt its legal and administrative framework.<sup>16</sup>

In contrast, the legal service of the Commission concludes that China should be granted MES automatically and that a decision to the contrary would be "unwise". However, these decisions are not legally binding and Trade Commissioner Malmström has voiced her objections about the automaticity of granting MES.<sup>17</sup>

Ordinarily, MES can be granted if the criteria set out by the EU are fulfilled. In the EU's last review in 2011, China fulfilled only one out of five criteria, hence China is not a market economy according to EU criteria.<sup>18</sup> This supports the argument that, despite the frequent framing as such, this is not a technical question and the legal grounds are debatable.<sup>19</sup> The case of Russia's recognition as a market economy in 2002 confirms this assessment. Yet, at that time Russia was not a member of the WTO and the EU, in parallel to formal recognition as market economy, put in place legal mechanisms to be able to disregard domestic prices and construct the normal value "in particular market situations", thereby preserving its abilities in trade defence.<sup>20</sup> In addition, the economic consequences would be direr in the case of China – in 2015 only one anti-dumping investigation was launched against Russia, whereas six have been launched against China.<sup>21</sup> While manufactures make up 96 percent of EU imports from China, they only amount to 9 percent of imports from Russia.<sup>22</sup> This demonstrates that in the case of China additional fears in economic terms – but also in the form of political or legal retaliation – are at play. The following section will therefore examine China's position on the issue and possible future scenarios.

### The Chinese position

China has been pursuing MES predominantly on a legal basis and has relied almost exclusively on its WTO accession protocol when claiming MES recognition by December 2016. China appeals to international law because the criteria

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"Economic Relations", 7 October 2015, Retrieved 20 February, <http://www.diplomatie.gouv.fr/en/country-files/china/france-and-china/economic-relations/>. <sup>15</sup> Treaty on the Functioning of the European Union. <sup>16</sup> European Parliament, Legal Service, "Legal Opinion", 25 June 2015, Retrieved 8 January 2016, <http://www.vieews.eu/eutradeinsights/wp-content/uploads/2015/10/Extract-of-EP-legal-opinion-on-market-economy-status-for-China.pdf>. <sup>17</sup> M. Dalton, "EU Lawyers Favor Market-Economy Status for China Next Year", The Wall Street Journal, 9 June 2015, Retrieved 4 January 2016, <http://www.wsj.com/articles/eu-lawyers-favor-market-economy-status-for-china-next-year-1433873355>. <sup>18</sup> R. Bendini & B. Barone, "Trade and Economic Relations with China 2015", In-Depth Analysis, European Parliament, Directorate General for External Policies, April 2013, Retrieved 15 December 2015, [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/549062/EXPO\\_IDA%282015%29549062\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/549062/EXPO_IDA%282015%29549062_EN.pdf), p. 24. <sup>19</sup> J. Men & G. Balducci, Prospects and Challenges for EU-China Relations in the 21st Century, "College of Europe Studies No. 12", Brussels, P.I.E. Peter Lang, 2010, p. 126. <sup>20</sup> F. Di Gianni, Targeting Russia?, Brussels, Van Bael & Bellis, 2005, p. 22. <sup>21</sup> European Commission, "Anti-Dumping, Anti-Subsidy, Safeguards, Statistics covering the first 11 Months of 2015", 8 December 2015, Retrieved 10 January 2016, [http://trade.ec.europa.eu/doclib/docs/2015/june/tradoc\\_153518.pdf](http://trade.ec.europa.eu/doclib/docs/2015/june/tradoc_153518.pdf). <sup>22</sup> European Commission, "European Union, Trade with China", Retrieved 15 February 2016, [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113366.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113366.pdf), European Commission, "European Union, Trade with Russia", Retrieved 15 February 2016, [http://europa.eu/rapid/press-release\\_MEMO-16-61\\_en.htm](http://europa.eu/rapid/press-release_MEMO-16-61_en.htm).

applied by the EU do not support China's claim to MES.<sup>23</sup> Since EU member states are divided over the legal interpretation of China's accession protocol, the 2016 deadline raises the question of what strategies China might pursue.

To date China has pursued three approaches to obtain MES from the EU. Under EU law, China cooperated in investigations that assessed its progress toward obtaining MES in 2004, 2008, 2010 and 2011, after which China ceased to cooperate with these investigations. Second, Premier Wen Jiabao publicly mentioned in September 2011 that the EU could grant China early MES in exchange for further support from China in bailing out the European economy.<sup>24</sup> Third, at a WTO meeting in late 2015, China warned that it would take WTO action against countries that refuse to acknowledge China as a market economy after December 2016.

One could argue that China should do nothing until the deadline has passed. Doing anything more than reiterating arguments as to why the accession protocol stipulates that China should receive MES is a concession to those who, like Commissioner Malmström, argue that MES is not automatic, or that, like the EP's legal service, the expiry of Article 15's subparagraph (a) (ii) is separate from recognition of MES. Exerting pressure on countries to adopt China's position namely acknowledges there is no self-evident truth to start with.

## 'ECONOMIC DIPLOMACY' IS CHINA'S TRADEMARK FOR ENGAGING WITH THE INTERNATIONAL COMMUNITY, APPLYING A LONG-TERM PERSPECTIVE.

Some Europeans fear that China will, however, retaliate if it does not get what it believes it deserves. There are three ways in which China might exert pressure. First, China pledged to contribute to the European Fund for Strategic Investments (EFSI) and is currently deliberating the size of

its contribution. It could use this as leverage to pressure the Commission to propose granting MES. Second, China could close further parts of its domestic market to foreign competition or enact anti-competitive measures to the same effect. Third, China could employ selective pressure – either against specific industries, by appeals to individual governments, or by using its investments in European companies to force them to speak out to their governments in favour of granting MES. Although these are only options, the second and third approaches are in contradiction of WTO law and go against the spirit of international economic cooperation.

It is not in China's interest to retaliate or exert pressure on Europe, however. Contrary to the infamous solar panels case in 2012 in which China launched investigation against European products, MES concerns many industries and involves the entire EU.<sup>26</sup> Where would it begin or end? Given that 1.38 percent of EU imports from China are subject to anti-dumping, the potential costs of employing economic pressure across the continent would far outstrip the gains MES would bring and damage EU-China relations in the process.<sup>27</sup> Second, since joining the WTO China's overall trade has soared despite its non-market economy (NME) status, indicating that while MES is an important economic issue for Europe, it is not an acute issue for China. Third, retaliatory moves by China would further undermine European investors' confidence in China in the midst of its economic slowdown.<sup>28</sup> Lastly, the question of MES does not just concern the EU, but all other WTO members, including most of the major developed economies. It is unlikely that China would retaliate against or pressure all of them. China's options are hence limited and its best option might be to pursue its assumed rights through the WTO and not through economic and political pressure in case China is not granted MES. This approach would raise China's international standing, boost its soft power, show that China takes WTO law seriously, and potentially result in the outcome it desires: MES granted by all WTO members without costly economic pressure or damaged political relations.

### Conclusion

The analysis has shown that neither economic nor legal arguments give a clear indication of whether China should

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<sup>23</sup> R. Bendini & B. Barone, *op.cit.* <sup>24</sup> N. Casarini "For China, the Euro is a Safer Bet than the Dollar", European Union Institute for Security Studies Analysis Paper, EUISS, Paris, June 2012. <sup>25</sup> J. Valero, "China uses Juncker Plan to Boost Involvement in Europe", EurActiv.com, 6 October 2015, Retrieved 10 January 2016, <http://www.euractiv.com/sections/euro-finance/china-uses-juncker-plan-strengthen-investment-europe-318232>. <sup>26</sup> ECFR, "EU-China Solar Panel Case", European Foreign Policy Scorecard 2014, Retrieved 6 January 2016, <http://www.ecfr.eu/scorecard/2014/china/4>. <sup>27</sup> European Commission, *op.cit.* <sup>28</sup> The European Chamber of Commerce in China, "Business Confidence Survey 2015", June 2015, Retrieved 4 January 2016, <http://www.eurochamber.com.cn/documents/confirm/56995c81d6284/en/pdf/334>.

be granted MES in December 2016 and that the probability of China retaliating – resulting in a ‘trade war’ – remains low. Hence, the decision is in particular political when it comes to weighing the possible consequences of the overall economic and political relationship of the member states with China and other important partners. After all, ‘economic diplomacy’ is China’s trademark for engaging with the international community, applying a long-term perspective. To what extent the EU understands the importance of this Chinese character trait and factors it into its decision-making process remains to be seen.

There are however several aspects that weigh into the EU’s decision. Firstly, the indecisiveness of the EU Institutions

might have grave consequences for the outcome of the decision. Making use of the existing cleavages, China’s lobbying of individual member states is much more effective if there is no clear position from Brussels. Secondly, it reflects more general difficulties in EU decision-making, especially regarding community competences. Thirdly, the decision taken by the EU will send a message about its reliability and legal compliance in international regimes. All of this will inform and impact the relationship of the EU with its partners. While not granting China MES might negatively impact the negotiations for the EU China Bilateral Investment Treaty, granting China MES might provoke discontent among other trading partners with whom the EU is currently negotiating agreements such as the US or Japan. ☹



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## BIO

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# MARKET ECONOMY STATUS AND EU-CHINA RELATIONS

Richard HERD

## Introduction

The issue of whether the EU should grant market economy status to China has come to the fore in 2016. The resurgence in interest is due to the Chinese view that 15 years after the signing of their accession agreement, they will automatically obtain such status. Not granting market economy status to China is important to the EU because it allows a derogation from the normal anti-dumping rules of the WTO and results in much higher duties being placed on companies in the non-market status country. This article puts this issue into a framework of both economics and political economy but only deals with legal issues in passing.

## A short history of anti-dumping

Anti-dumping legislation has its origins in the laws dealing with price discrimination in domestic markets. These laws aimed to prevent predatory pricing whereby a company that dominates the market for a given product sells that product at below cost in order to drive competitors out of the market, so increasing its market share and making it eventually possible to raise prices on consumers and users of that product through its enhanced monopoly power. In general, price discrimination between different markets is legal but is generally restrained by the possibility of arbitrage between different markets.

From its origin in 1948, international trade law has incorporated rules that limit the sale of the goods in an export market at prices that are lower than prices in the domestic market of the exporter.<sup>1</sup> The respective article of the GATT allows an exception to the rules and general spirit of the GATT which do not allow for discrimination.<sup>2</sup> In practice the focus is not on the domestic price but on the normal value of the product, which is interpreted as its cost of production in its home market.

From its inception, the legal framework – set out in the GATT Treaty – recognised that in certain cases domestic costs were not relevant for such comparisons because of government intervention in markets. The two cases where derogation from the normal rules was allowed was first where a government controlled all prices; second, where it exerted monopoly control over foreign trade. These criteria were established in the context of the existence of centrally planned economies, even though the main centrally planned economies were not signatories of the GATT.

The first time that the problem of how these rules should be interpreted was posed was when Czechoslovakia applied to sign the GATT in 1955. It argued then that its domestic prices and costs were not market determined and therefore should not be compared to its export prices.

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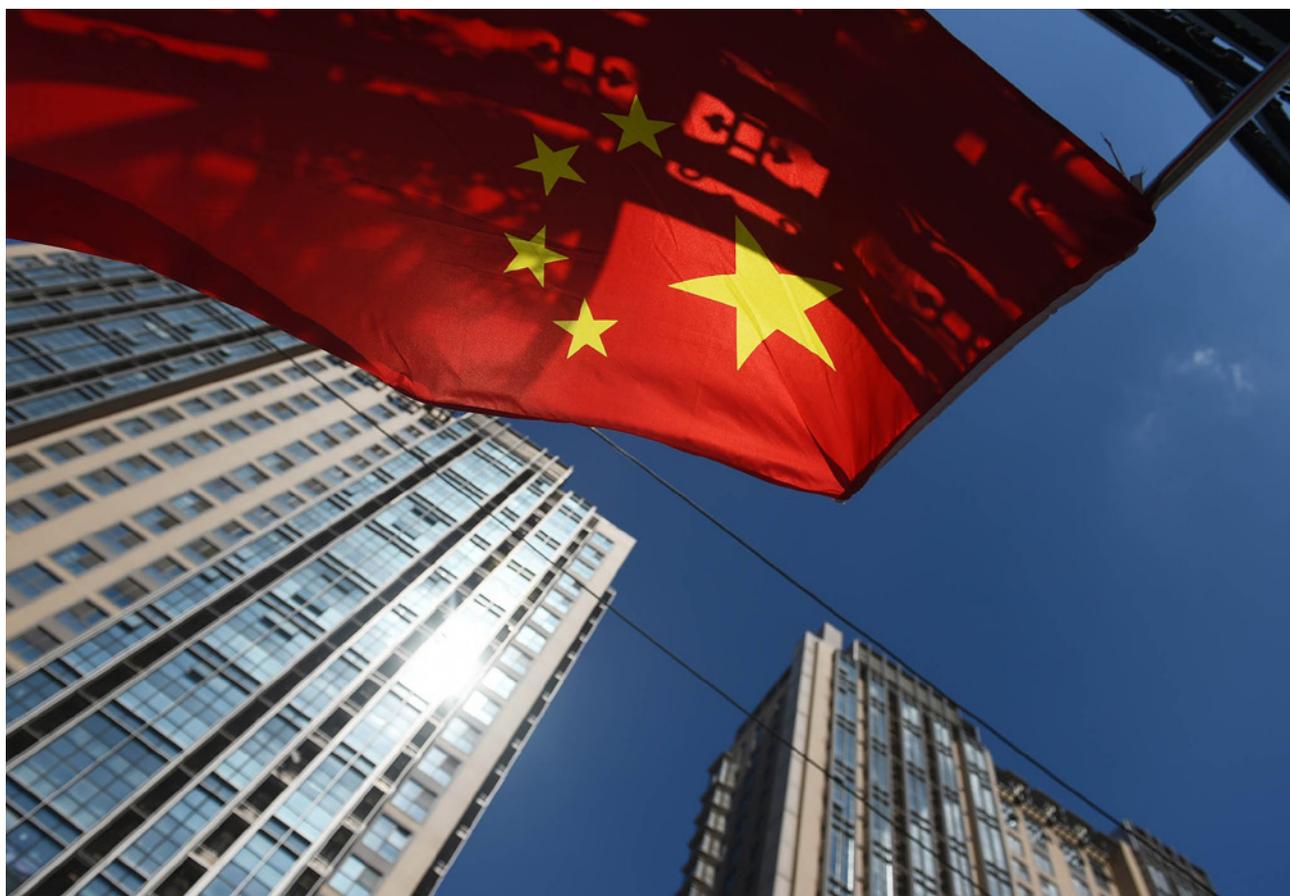
<sup>1</sup> K.D. Raju, World Trade Organization Agreement on Anti-dumping: A GATT/WTO perspective, Netherlands, Wolters Kluwer, 2008, p. 14.

Rather, it argued, its export prices should be compared to costs in an analogue third party country.<sup>3</sup> The other signatories of the GATT did not accept this argument and the issue lay dormant until the accession of Poland when the analogue country method of determining was allowed for measuring the normal value of Polish exports but only to the extent the Polish economy fulfilled the 1948 definitions of exceptions allowed under Article VI.

However, when China applied to join the GATT, the issue became live once again. China failed to be accepted into the GATT before the organisation changed to the WTO. Negotiations for it to join the new organisation continue. In the 1980s and early 1990s, China was recognisably a centrally-planned economy even though it was beginning to reform. The scale of the eventual reform of the economy was still uncertain when the negotiations were underway.

The EU first introduced the phrase non-market economy into its anti-dumping regulations in 1979.<sup>4</sup> The regulation had no definition of such an economy. Rather such economies were named in another regulation that listed countries considered as state-trading economies.<sup>5</sup> At this point in time, a non-market economy was synonymous with the concept of a state-trading economy which in turn referred back to the 1948 definitions of when a deviation from normal anti-dumping laws was allowed. This definition persisted in the 1996 EU implementation of the Anti-Dumping Agreement.<sup>6</sup>

However, by the time China was close to entering the WTO, the negotiators (principally the United States but also the EU), realising that the 1948 concepts of state-trading would no longer apply to China, defined the concept of a non-market economy much more broadly. The EU intro-



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<sup>2</sup> J. H. Jackson, *World Trade and the Law of GATT*, Indianapolis, Bobbs-Merrill, 1969, p. 411. <sup>3</sup> World Trade Organization, *GATT Analytical Index: Article VI anti-dumping and countervailing duties*, 2016, p. 228. <sup>4</sup> Council Regulation (EEC) No 3017/79, *Official Journal of the European Communities*, No L 339/1, 20 December 1979. <sup>5</sup> Council Regulation (EEC) No 925/79, *Official Journal of the European Communities*, No L 131 / 1, 8 May 1979. <sup>6</sup> Once again the phrase non-market economy is used in Council Regulation (EC) No 384/96 of 22 December 1995, but the regulation defines the countries as falling into the state-trading category in Council Regulation (EC) No 519/94.

duced a definition of a non-market economy with five very broad criteria to define whether a company operates in such an economy.<sup>7</sup> During the negotiations for China's entry, there was no consensus on the precise definition of a market economy. The agreement that China signed specified that for 15 years if a WTO member had a definition of market economy in its legislation prior to 2001, and if China did not match this definition the 1955 proposal of the Czechoslovak government could be used to calculate normal costs, so introducing the concept of an analogue country. Earlier papers in this issue have touched on whether this right of substitution expires on 11th December 2016, as was believed for many years.

### The impact of the using analogue country costs

At its origin the objective of using the analogue country approach was justified by the absence of market prices and distortions in the economy. In reality, the analogue country system is based on replacing Chinese labour costs by the much higher labour costs in advanced countries. This can be seen by the choice of companies that are used for comparison with Chinese companies: almost 60 percent of the comparisons have been with companies in high income countries, with 38 percent coming from the United States alone.<sup>8</sup> Direct and indirect labour costs are much higher in the US than in China and so it is to be expected that a large difference would be found in the costs of producing in China and the analogue country.

## DIRECT AND INDIRECT LABOUR COSTS ARE MUCH HIGHER IN THE US THAN IN CHINA.

The language used to describe the anti-dumping in the EU is evocative of the underlying attitude to competition. They are generally known as Trade Defence Instruments. It is as if

trade was a war and the anti-dumping unit of the EU was the shock battalion of the EU army. By contrast, the World Bank classes an anti-dumping duty as a Temporary Trade Barrier.<sup>9</sup>

The ease with which significant anti-dumping margins can be found has led to an upsurge of these cases. In the EU, at the end of 2013, out of a total of 66 AD cases, 41 were against China.<sup>10</sup> The average anti-dumping margin against market economies (15 cases) was 26 percent but was 66 percent against Chinese companies.<sup>11</sup>

Anti-dumping duties do not appear to have a significant impact on production or employment in the EU, according to a Swedish government study.<sup>12</sup> EU users turn to imports from the countries with labour costs somewhat above those of China rather than buying from EU producers. In addition, when China is forced out of the market, prices for the product rise, both for the remaining exporters to the EU and domestic producers. Even Chinese producers raise their prices, enabling them to argue that their prices no longer justify the imposition of an anti-dumping duty when the duty is reviewed.

The overall cost to the EU is measured by the significant increase in import prices (and hence a terms of trade deterioration) that occurs when the anti-dumping duty is imposed on a given product. There is also a transfer of income within the EU as the producers obtain windfall profits at the expense either of the profits of other companies or the disposable income of consumers.

It is noticeable that the EU anti-dumping decisions make little attempt to weigh the costs to the EU economy against the benefit to the EU producers of the affected item. A typical case involved aluminium car wheels imported from China.<sup>13</sup> Two large car manufacturers (BMW and Renault) argued that the proposed duty would hurt the consumer. The EU decision found no adverse impact as the increased cost of wheels was less than 0.23 percent of the value of car and so could easily be absorbed.<sup>14</sup> It would

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<sup>7</sup> Official Journal of the European Communities L 128/18 COUNCIL REGULATION (EC) No 905/98 of 27 April 1998. <sup>8</sup> United Kingdom Government (2012), Anti-dumping: Selected Economic Issues, Trade and Investment Analytical Papers No 18, Department for Business Innovation and Skills, Department for International Development, May 2012. <sup>9</sup> C. P. Bown (2014), 'Trade policy through 2013: Signs of improvement but new policy concerns', available at <http://www.voxeu.org/article/trade-policy-through-2013-signs-improvement-new-policy-concerns>. <sup>10</sup> European Commission (2015), Commission Staff Working Document accompanying the document: 33rd Annual Report from the Commission to the Council and the European Parliament on the EU's Anti-Dumping, Anti-Subsidy and Safeguard activities SWD(2015) 149 final, Brussels. <sup>11</sup> This figure is based on the unweighted average of measures in force in the EU in 2014 according to Chad P. (2015) 'Global Antidumping Database', The World Bank, June, available at <http://econ.worldbank.org/ttbd/gad/> <sup>12</sup> C. Prawitz (2013), 'Do EU Producers and the EU Economy Really Benefit from Anti-Dumping Policy?', National Board of Trade, Sweden. <sup>13</sup> Council Implementing Regulation (EU) No. 964/2010 of 25 October 2010 Imposing a Definitive Anti-Dumping Duty On Imports of Certain Aluminium Road Wheels Originating In The People's Republic Of China, Official Journal of the European Union, No L 282/1, 28 October 2010. <sup>14</sup> Ibid. <sup>15</sup> Lucy Davis (2009), 'Ten Years of Anti-dumping in the EU: Economic and Political Targeting' (2009) 4 Global Trade and Customs Journal, Issue 7/8, pp. 213–232 <sup>16</sup> As footnote 9. <sup>17</sup> European Union (2011) Council Implementing Regulation (EU) No 452/2011 of 6 May 2011 imposing a definitive anti-subsidy duty on imports

appear that the Trade Directorate ignores the reality of calculus: that the sum of the product of a large number of AD cases and an infinitesimal increase in costs is not in itself infinitesimal, but could be a large number. Moreover, there seems little concern about the competition policy consequences of anti-dumping actions, even when the imposed duties will create a monopoly in the EU market.<sup>15</sup>

### Alternative policies

There is an alternative to using the analogue country method for determining an anti-dumping duty. The WTO treaty allows the imposition of countervailing duties if the foreign company has been subsidised either directly or indirectly through trade restrictions. The oft-cited reasons showing subsidisation include: land being provided at a non-market price, credit being priced at below market rates, electricity being sold at non-market rates and, finally, selective VAT rebates on exports used to ensure that domestic prices for raw materials are lower than world prices.

However, the EU only had five anti-subsidy duties in force against China at the end of 2014 against 52 anti-dumping cases.<sup>16</sup> Indeed it was not until 2011 that the EU opened its first anti-subsidy case. The reason for the lack of anti-subsidy cases against China is that when subsidies are investigated and measured, the benefit to price charged by a Chinese exporter is generally found to be small relative to the difference between the cost of producing the item in an analogue country and the Chinese export price. Indeed, in the 2011 coated paper case the EU found an average subsidy of 8 percent<sup>17</sup> but a dumping margin of 53 percent as Chinese export prices were compared with US costs.<sup>18</sup>

The significant impact of abandoning the analogue country methodology can be seen by comparing the results of decisions on the same product (aluminium road wheels) by Australia and the EU. The EU found a dumping margin of 49 percent.<sup>19</sup> By contrast, Australia, which does not use the analogue country methodology, found a subsidy of 6.7 percent and dumping margin of 6.2 percent.<sup>20</sup>

### What should be the EU policy on granting market economy status to China?

The EU can no longer keep the anti-dumping policy as practised in 2015 and earlier. Two legal cases mean that in the future, the EU (and other WTO members) must make considerable changes to its anti-dumping regime.

The first case dealt with imports by two European footwear companies from their subsidiaries in China and Vietnam. The consequence of this ruling is that the Commission must undertake investigations into all importers rather than just the usual three or four companies.

## THE EU HAD FIVE ANTI-SUBSIDY DUTIES IN FORCE AGAINST CHINA AT THE END OF 2014 AGAINST 52 ANTI-DUMPING CASES.

Moreover, the scope of industry-wide duties must be limited and duties calculated depending on the circumstances of each company, if they are found to be operating under market conditions or eligible for individual treatment. This could impose a very substantial cost burden on the Commission.

The second case was decided before the Appellate Body of the World Trade Organisation and was decided in favour of China.<sup>21</sup> The EU will now have to withdraw the disputed anti-dumping measures. This ruling confirms that the approach taken by the EU against China is non-transparent and biased. Notably, it found normal value calculations must make adjustments for productivity differences affecting cost comparability. These decisions are bound to change the way in which future anti-dumping cases are conducted and in a way that is favourable to China.

A further change could occur before December 2016. By that date, the EU must decide whether to treat China as

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of coated fine paper originating in the People's Republic of China. <sup>18</sup> European Union (2011), Council Implementing Regulation (EU) No 451/2011 of 6 May 2011 imposing a definitive anti-dumping duty on imports of coated fine paper originating in the People's Republic of China <sup>19</sup> European Union (2010) Council Implementing Regulation (EU) No 964/2010 imposing A Definitive Anti-Dumping Duty on Imports of Certain Aluminium Road Wheels Originating in The People's Republic of China. Official Journal of the European Union L 282/1, Brussels. <sup>20</sup> Australian Government Anti-Dumping Commission, Review Into Anti-Dumping Measures Aluminium Road Wheels Exported from the People's Republic of China, Canberra, Report 263, 2015. <sup>21</sup> World Trade Organization, Report of the Appellate Body on the Recourse to Article 21.5 of the DSU by China concerning the European Communities – Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China, Geneva, WT/DS397/AB/RW, 2016.

any other member of the WTO or whether to continue with its existing regime once brought into compliance with the above two decisions. The outcomes from this decision are asymmetric.

The EU is able to grant market economy status before December 2016, using its sovereign powers. This bargaining power, however, is a decaying asset. After December 2016, the EU no longer has the sovereign right to withhold normal treatment (the so called market economy status) from China. It can still refuse to grant market economy status to China but the sovereign decision rests with the World Trade Organisation.

## CONTINUING TO TREAT CHINA AS A NON-MARKET ECONOMY WOULD ALMOST CERTAINLY RESULT IN CHINA LAUNCHING A DISPUTE PROCEDURE AGAINST THE EU.

The EU, though, can mount a defence of its case through the various levels of decision making in the WTO and eventually make an appeal to the highest court. Such a process will take many years.

Given the time taken to terminate any post-December 2016 appeal process, the possibility of a bargain between the EU and China remains open. The problem arises with what China would be prepared to offer the EU in exchange for granting MES. There are three possible avenues that could be explored: a bilateral investment treaty (BIT), a free trade agreement (FTA), or voluntary restrictions on certain Chinese products.

### **A possible Bilateral Investment Treaty**

The EU has considerable interest in consolidating the 27 existing country-specific BITs with China into a new wide ranging EU bilateral investment treaty (BIT) which it now has competence to negotiate. There are many issues concerning the effective granting of national treatment to

EU companies investing in China that could be improved through a new BIT.

China, on the other hand, showed little interest in a Bilateral Investment Treaty with the EU until it agreed to open negotiations in 2013. Even now the bargaining positions are tilted against the EU as it is the EU that wants to increase market access and lessen the scope for arbitrary decisions in investment areas. China already has access to EU markets.

### **A Free Trade Agreement**

A free trade agreement between the EU and China would be another area where China could make concessions. However, free trade agreements take a long time to negotiate. For example, the Comprehensive Economic and Trade Agreement between Canada and the EU has still not been approved by the European Parliament six years after the opening of talks.

Thus the scope for using either a new BIT or FTA with China as a bargaining tool are limited. There is a further problem in that both of these arrangements now have to be approved by the European Parliament which dislikes the arbitration method of settling investment disputes.<sup>22</sup> The Parliament is also very active in efforts to link human rights performance to trade agreements.<sup>23</sup> Thus the agreement between the Parliament and the Commission to draft agreements might be difficult to reach.

### **Voluntary export restrictions are a possible route to minimise conflict**

The third and most likely avenue for negotiations would be for China to accept a number of time limited voluntary price agreements or voluntary export restraints on the key items that are subject to anti-dumping duties.

The objective of the voluntary restraints would be to secure agreement to the granting of market economy status from those countries that traditionally have been in favour of the imposition of anti-dumping duties. The priority areas for agreements would be steel, ceramics, wood and paper, non-ferrous metals and, finally, chemicals.

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<sup>22</sup> European Parliament (2015), Committee on International Trade, Working Document in View of Preparing the Draft Report on Parliament's Recommendations to the Commission on the Negotiations for the Transatlantic Trade and Investment Partnership (TTIP), PE546.593v01-00 <sup>23</sup> European Parliament (2016), EU-Vietnam Framework Agreement on Comprehensive Partnership and Cooperation (resolution), P8\_TA (2015) 0468, Strasbourg.

## Conclusion

Much of the discussion on whether to grant China market economy status has centred on whether China is or is not a market economy. There is clearly no absolute answer to this question as the question has no binary answer. There is a continuum of states between centrally-planned economies, on the one hand, to one in which there is scarcely any intervention by the government. Every country in the world has some form of government intervention that moves the economy away from a free market.

The EU has five criteria for judging China but the criteria are sufficiently vague to give considerable leeway to officials in making any judgement about whether the criteria are met. For example, in the coated paper case the EC argued that as all land was owned by the government the market could not be free and yet the supply of development land in nearly all advanced countries is also controlled by governments through the issue of planning permissions or zoning controls.<sup>24</sup>

The EU, with its usual tendency to leave decisions to the last minute, has now almost run out of bargaining power. It can certainly continue to treat China as non-market economy and so use the analogue country methodology to raise anti-dumping duties above their justifiable level, though it will have to modify past practices to conform to recent WTO judgements. However continuing to treat China as a non-market economy would almost certainly result in China launching a dispute procedure against the EU after 11 December 2016.

Such a confrontational policy should be avoided since, as outlined above, anti-dumping harms the overall EU economy by raising import prices. A compromise needs to be found that would reassure those EU countries with policy preference for the imposition of high anti-dumping duties about the future of producers benefitting from existing duties such as in the industrial sectors covering ceramics, wood and paper, non-ferrous metals, bicycles and finally parts of the chemical sector. At the time of writing, an agreement for limiting steel prices might also be attractive to the EU. The solar panels agreement could form the basis for such agreements with a combination of price agreements and voluntary restraint on exports. The policies would need to be strictly limited in time. While such policies represent a transfer of income to China from the EU, they would be a price worth paying to end the likelihood of the future growth of anti-dumping actions against China, which hurt the interests of the overall EU economy.©

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<sup>24</sup> Official Journal of the European Union (L 128/18), Council Implementing Regulation (EU) No 452/2011 of 6 May 2011 imposing a definitive anti-subsidy duty on imports of coated fine paper originating in the People's Republic of China



Richard Herd

## BIO

For more than decade, **Richard Herd** was responsible for economic analysis of the China at the OECD. During this period, he produced the first three OECD Economic Surveys of China as well as contributing background papers for the 12th and 13th Five Year Plans, documents for the annual China Development Forum and the China chapter in the bi-annual Economic Outlook. Since retiring in 2014, Herd has become a consultant for the Guangdong Development Research Centre and a visiting professor at the University of Shenzhen.

CALL FOR CONTRIBUTIONS



EU-CHINA OBSERVER ISSUE #2.16

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- A way forward for EU-China security cooperation, building on successful examples such as the Iran nuclear deal, anti-piracy operations in the Gulf of Aden
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- The arms embargo – slowing down cooperation?

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# YES OR NO? IT IS TIME FOR AN ANSWER - ANALYSIS OF THE EU'S POSITION ON CHINA'S ACCESSION PROTOCOL TO THE WTO (ART. 15)

Jing MEN

## Introduction

2016 will be a very busy year for the Europeans. As well as the heavy domestic agenda and dedicated negotiations with the US for the TTIP, they are being pressed for an answer to the Chinese as to what they are going to do after December 2016, that is, when anti-dumping investigations against Chinese imports begin, which analogue country and which price (price from China or third countries) they will use.

China is undoubtedly important to the EU, due to the fact that it has been its second largest trading partner for more than a decade. But often, China's presence in the media is more troublesome, and in particular, in recent months, the debate over whether to say 'yes' or 'no' to China (or probably to find a third way) with regards to Article 15 of the latter's Accession Protocol to the WTO has notoriously divided the EU, to the extent that reaching a consensus before the deadline (11 December 2016) looks increasingly difficult. We all know that the EU is more easily divided than it is able to have one voice. Particularly for this case, the interests involved on both sides are so conflictual and complicated that until now it has been impossible to say what the optimal solution would be. Yet, taking a step back from the ongoing and heated debate, one may say that China's presence serves as a wake-up call to the EU that the world changes fast and we must all be ready to face and meet the challenges.

This paper will first look at the EU-China trade history and examine the changes in bilateral trade relations. It will then examine the debate between the Europeans and analyse the difficulties the EU faces in handling the issue. As a conclusion, the paper will point out that the EU does not have a clearly defined strategy in its relations with China. The high probability of being unable to reach consensus before the deadline in the EU would mean a de facto 'no', or a 'soft decline' to say 'yes' to China.

## EU-China trade relations

A review of the past four decades of China's economic growth and EU-China trade relations reveals that the EU has been an important witness of the Chinese trading system reform and a catalyst for rapid Chinese trade growth. Before the European Community (EC) and the PRC established diplomatic relations in 1975, the two sides conducted a very limited amount of trade. As a result of the successful negotiation of a bilateral trade agreement in 1978, which was the first ever agreement between the EC and the PRC, trade deals gradually increased.<sup>1</sup> Together with the trade agreement, China also received most-favoured-nation (MFN) treatment from the European Community. At that time, China was a planned economy and only public ownership was allowed to exist. From the beginning of 1979, the Chinese government implemented the reform and opening-up policy, which led to great transformation of the overall Chinese economic system.

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<sup>1</sup> For the content of the agreement, please see F. Snyder (ed.), *The European Union and China, 1949-2008: Basic Documents and Commentary*, Oxford, Hart Publishing, 2009.

In 1980, the European Community and China reached a textile agreement, which increased China's quotas of its export to Europe market from 20,000 tonnes to 40,000 tonnes.<sup>2</sup> In the same year, China was included in the General System of Preferences (GSP) by the EC. In 1985, the EC and China reached one of the most important agreements in their history – the Agreement on Trade and Economic Cooperation – which is, by far, still the legal basis of bilateral commercial relations. Chinese Customs Statistics showed that between 1975 and 1984, the value of trade in goods between the EC and China increased by 10.5 percent per year, but by 31.9 percent annually between 1985 and 1989.<sup>3</sup> China's dynamic exports growth to the EU was, to a certain degree, attributed to the Community's GSP system. As the Commission's paper stated, "It should be noted that China has been, by far, the biggest beneficiary of the EU GSP in recent years".<sup>4</sup>

In 1986 China formally submitted its application for the membership of the General Agreement on Tariffs and Trade (GATT), but failed to conclude the negotiations before 1994 and lost the opportunity to be a founding member of the newly founded World Trade Organization (WTO). Another five years passed before China finally concluded its negotiations with the United States – and, based on the bilateral agreement with the United States and with further revision, China reached the agreement with all the other members including the EU and became the 143rd member of the WTO at the end of 2001.

Before 1995, although the EC/EU was active in responding to China's need of economic and trade cooperation, it had no clearly formulated policy on how to push forward commercial relations with China. The first policy paper A Long-Term Policy for China-Europe Relations published in 1995 "for the first time articulated a coherent strategy towards China".<sup>5</sup> In bilateral trade relations, China had continued to have trade deficit with the EC up until 1995. Since 1996, China has started to generate trade surplus and has continued to increase the surplus in the 21st century. Between 1995 and 2006, the European Commission published a series of policy papers on China. Apart from the

evaluation on the changing global and bilateral situation, each paper sets out clearly defined objectives in developing relations with China. Yet, in just a decade, the Commission's understanding of the nature of the relationship had changed a lot.

In the 1995 policy paper, the Commission sounded rather optimistic about the role that the EU could play in supporting China's transformation and integration into the international community, as well as the opportunities brought by China's economic reform to the European economy. In the 31-page-long document, the word 'opportunity/opportunities' appeared 16 times. Although the word 'challenge/challenges' was also used, it appeared only four times. Among them, the word 'challenges' was mentioned together with opportunities on two occasions, and the two sentences were quite repetitive: "The rise of China represents enormous opportunities and challenges to the international system" on page 3; "The rise of China presents China and the world with new challenges and opportunities" on page 19. The real challenge pointed out in the paper was that "China still falls well short of having a full market economy, with adequate social protection including freedom of association for employees. Reform of state-owned industry, and the creation of a social security system to cope with its consequences, remain as key challenges for the future"<sup>6</sup> and "Given China's strong cultural identity and language, and given the shortcomings of its communication system and its sheer size, China presents a particular challenge"<sup>7</sup> to the EU's efforts of raising its profile in China.

In comparison, in the 15-page-long 2006 EU policy paper "Closer Partners, Growing Responsibilities A policy paper on EU-China trade and investment: Competition and Partnership", the EU's understanding of the nature of EU-China trade relations seemed to have changed. Instead of commenting positively on Chinese development and the opportunities created for European growth as it had in the previous paper of 1995, the Commission in the very first sentence stated that "China is the single most important challenge for EU trade policy".<sup>8</sup> As a matter of fact, the paper indicated clearly that China was regarded

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<sup>2</sup> Ibid. <sup>3</sup> Quoted in R. Ash, "Europe's Commercial Relations with China", in David Shambaugh, Eberhard Sandschneider and Zhou Hong (eds.), *China-Europe Relations*, London and New York, Routledge, p. 190. <sup>4</sup> European Commission, "A Long-Term Policy for China-Europe Relations", Brussels, 2005, COM(1995) 279/final. <sup>5</sup> R. Ash, "Europe's Commercial Relations with China", p. 192. <sup>6</sup> European Commission, "A Long-Term Policy for China-Europe Relations", p. 9. <sup>7</sup> Ibid., p. 17. <sup>8</sup> European Commission, *Closer Partners, Growing Responsibilities A policy paper on EU-China trade and investment: Competition and Partnership*, Brussels, 24.10.2006, COM(2006) 632 final. <sup>9</sup> Ibid., p. 13. <sup>10</sup> European Commission - Press release, "Commission launches new anti-dumping investigations into several steel products", Brussels, 12 February 2016, retrieved 15 February 2016, [http://europa.eu/rapid/press-release\\_IP-](http://europa.eu/rapid/press-release_IP-)

more as a challenge than as an opportunity. Interestingly enough, throughout the relatively short paper, the word “challenge/challenges” was used 13 times whereas “opportunity/opportunities” was used only four times.

Noticeably, when discussing the issue of Market Economy Status, the two papers are quite coherent in understanding the problem in China. As confirmed again by the Commission in the 2006 paper, “At present, the conditions for granting Market Economy Status (MES) to China for anti-dumping investigations are not fulfilled. The EU is actively working with China with a view to creating the conditions permitting an early granting of MES”.<sup>9</sup>

Along with the deepening of EU-China trade relations, the number of trade disputes have also been increasing rapidly. The ‘Bra War’ broke out between the EU and China due to the abolition of the textile quota system in 2005; in 2012-2013, the solar panel dispute involved 7 percent of bilateral trade; most recently, the Commission launched new anti-dumping investigations into several steel products originating in China.<sup>10</sup> Currently, China accounts for 80 percent of all the cases of anti-dumping and anti-subsidy investigations by the Commission.<sup>11</sup>

### How to deal with Art. 15 of China’s Accession Protocol to the WTO

Since joining the WTO in 2001, China has reached bilateral agreements with around 80 members of the WTO in order to get Market Economy treatment from these countries. China has also tried to get the Market Economy Status from the EU, but failed. Now that the 15-year transitional period is coming to an end, Yang Yanyi, Chinese Ambassador to the EU, stated that “Whether or not it recognizes China’s market economy status, the EU and all other members of the WTO are under the obligation to apply the rules of the WTO, namely Section 15 of the Protocol on the Accession of China to the WTO, which sets out Members should stop using the ‘analogue country method’ in anti-dumping investigations against China as of December 11, 2016”.<sup>12</sup>

For the EU, how to deal with Art. 15 of China’s Accession Protocol to the WTO is not an easy question. At first

glance, it seems to be simply a legal question. Theoretically, one should follow the Art. 15 and act according to what it says. However, due to the existing ambiguity in the article, lawyers on behalf of different interests are able to interpret it in different ways. Those in favour of free trade argue that the EU should treat China as a normal country after 11 December 2016, that the EU should follow the WTO rule without any hesitation.<sup>13</sup> In contrast, those in favour of manufacturing producers, lobby that the expiration of part of Art. 15 does not change anything but allows the EU to continue to use the trade defence tools it has at hand against Chinese imports.<sup>14</sup> The conflicting points of view from the lawyers make the issue very complicated. If lawyers cannot agree with each other, it only indicates that, first of all, Article 15 is not well articulated; and, secondly, that the interests involved are so crucial that no party is willing to give in.

The EU and China used to talk about a relationship of mutual benefit: both the EU and China benefit from bilateral commercial relations. This liberal approach, supported by a set of institutional arrangements between Brussels and Beijing, promoted a positive-sum game – both parties in the cooperation win, although one party may win more than the other. Yet, the increasing deficit in the EU’s trade with China in the 21st century has somehow gradually changed the EU’s understanding of the nature of the game. Despite the win-win situation – both parties develop a huge amount of trade in goods with each other; the bilateral trade value exceeds one billion per day; China is one of the fastest growing export markets for the EU – the EU pays more attention to what it loses in bilateral trade than what it gains. The EU is more irritated by its deficit and tends to understand the trade with China as a zero-sum game – China’s imports directly leads to job losses and bankruptcy of some enterprises, which jeopardises the interests of certain industrial sectors and member states.

Therefore, the issue of how to deal with Art. 15 is not as simple as a legal issue, it is more an economic issue. In the trade with the EU, China enjoys the advantage of low prices in many sectors of products. If the EU does not resort to trade defence measures including anti-dumping, anti-sub-

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16-287\_en.htm. <sup>11</sup> This information was provided by the presentation of Inès Van Lierde, Secretary General of Aegis Europe, on March 17, at the conference organised by DG Trade of the European Commission. <sup>12</sup> Y. Yanyi, “Market economy status not a bilateral negotiation”, China Daily, 18 February 2016. <sup>13</sup> This group of lawyers are represented by Jean-Francois Bellis, Edwin Vermulst, and Folkert Graafsma. <sup>14</sup> This group of lawyers are represented by Bernard O’Connor and Laurent Ruessmann.

sidy or safeguarding, Chinese products will pour into the European market and squeeze out many small- and medium-sized European enterprises which produce similar products. However, on the other hand, if punitive taxes are added to Chinese imports, the interests of wholesalers, retailers and consumers will be affected negatively. Inside the EU, it is rather difficult to coordinate those interests on behalf of different sectors.

Moreover, the political wrestling cannot be underestimated. The member states that are in favour of free trade take a different position from those in which manufacturing still plays an important role in the national economy. It is obvious that the decision-making on whether or not to make legislative change in EU law will be difficult on this issue at the Council. Due to the fact that the European Parliament has joined the co-decision-making process, this will only make the debate on the issue more complicated. As a matter of fact, the Commission has made several attempts to reform the trade policy in recent years, but failed to do so because of lack of consensus.

In the Commission's current proposal of three options, many people, particularly steel producers, are in favour of option one, which is to do nothing – "leaving the EU legislation unchanged".<sup>15</sup> While this option seems to save the EU and its member states a lot of hassle, in reality, if the EU does nothing then China will certainly take revenge after the deadline has passed. In such a case, it is very possible that at least in the short term, EU-China relations will become troublesome, which will not only affect bilateral trade and economic cooperation, but also slow down bi-

lateral exchanges on crucial international affairs including anti-terrorism, climate change, and energy security.

### Concluding remarks

The ongoing heated debate inside the EU somehow demonstrates that the EU does not have a clearly defined strategy in its relations with China. Since 2006, the EU has not published any policy papers on China. In view of the rapidly changing international situation and bilateral relations, it really is necessary for the EU to make a clear evaluation of the new strategic necessity of the EU-China relationship; and based on such clearly defined strategic objectives, the EU can make relevant and appropriate policy.

The current problem is that the EU is too divided to produce a single voice. It is very likely that the deadline will be missed due to protracted discussions in the EU institutions. In such a situation, on the one hand, the EU would signal a de facto 'no' to China, despite its efforts to deal with the issue. On the other hand, it would put itself in a very uncomfortable position: the EU always attaches great importance to the rule of law, but this time it would itself defy the WTO rule. In spite of the ambiguity of Art. 15, its section a(ii) will definitely expire. Accordingly, the EU is obliged to revise its own legislation. If it fails to do so, it will most probably be singled out by China to the WTO dispute mechanism. As a result, if China is supported by the WTO, the EU would have to pay a big price. In order to avoid that scenario, the EU must hurry up! No matter how complicated the issue is, the EU should be able to provide an answer before 11 December 2016. ©

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<sup>15</sup> DG Trade of European Commission, "Change in the methodology for anti-dumping investigations concerning China", 3 February 2016, retrieved 10 February 2016, [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154241.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf).



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## BIO

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# THE EUROPEAN UNION'S POSITION CONCERNING CHINA'S MARKET ECONOMY STATUS

Eva MONARD <sup>1</sup>

## Introduction

The current hot-topic in international trade law and policy is whether China will be granted Market Economy Status (MES) by the European Union (EU) and several of its other trading partners by the end of 2016. Until recently, this controversial topic was a debate reserved for trade lawyers and policymakers. However, it has now come to the forefront, and has even sparked unseen protests of thousands of steelworkers and employers in Brussels mid-February 2016.

In this paper, the author will address the legal interpretation that lies at the origin of the ongoing debate and will elaborate on the possible ways in which the European Union could address the current impasse.

## The interpretation of paragraphs 15(a) and 15(d) of China's protocol of accession

The origin of this debate lies in China's negotiations to join the World Trade Organization (WTO), and in particular a deal it struck primarily with the United States (US) and the EU. In its protocol of accession to the WTO, China allowed other WTO Members to consider it a non-market economy country for the purpose of anti-dumping investigations.

In particular, paragraph 15(a) of China's protocol of accession provides that:

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.

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<sup>1</sup> The author is an associate at the Brussels office of the law firm Jones Day, working on international trade law matters. The views reflected in the present article represent solely the opinion of the author. <sup>2</sup> See also for instance, Barbara Barone, One year to go: the debate over China's market economy status (MES) heats up, In-Depth Analysis. Brussels: European Parliament Policy Department (December 2015), p. 11, available at [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/570453/EXPO\\_IDA\(2015\)570453\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/570453/EXPO_IDA(2015)570453_EN.pdf). <sup>3</sup> See, for instance, European Commission, Change in the methodology for anti-dumping investigations concerning China, (2016), p. 3, available at [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154241.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf); European Commission, Inception Impact Assessment – Possible change in the methodology to establish dumping in trade defence investigations con-

The practical result of China being a non-market economy country is that anti-dumping duties on its exports are usually significantly higher than those that would be imposed if it were to be treated as a market economy country. This is for instance evident from a comparison of the duties imposed on Chinese exporters who received market economy treatment (when the Commission still granted this to Chinese exporters) and those imposed on other Chinese exporters.<sup>2</sup> The non-market economy provision of the protocol also contains a (poorly drafted?) expiry clause. Indeed, paragraph 15(d) of the protocol of accession provides:

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.

## THE NON-MARKET ECONOMY PROVISION OF THE PROTOCOL CONTAINS A EXPIRY CLAUSE.

The only crystal clear element in this provision is that something should change as of 15 years following China's accession to the WTO (thus, 11 December 2016). The crucial question is what should change.

China's interpretation is that, according to the expiry clause, the right of other WTO Members to consider China a non-market economy country will expire on 11 December

2016. China is not alone in its interpretation, as several commentators and even the European Commission's internal Legal Service agree with China.<sup>3</sup>

This position follows from the exceptional nature of the use of a methodology that is not based on a strict comparison with domestic prices or costs in China, which derogates from the principles laid down in the WTO Anti-Dumping Agreement. This exception is laid down in subparagraph (a)(ii) and cedes to exist 15 years after the date of accession, thereby subjecting Chinese exports to the general rules applicable under the WTO Anti-dumping Agreement. This position seems to be supported by the Appellate Body's findings in EC – Fasteners (China), where it stated that “paragraph 15(a) contains special rules for the determination of normal value in antidumping investigations involving China” and that “[p]aragraph 15(d) in turn establishes that these special rules will expire in 2016 and sets out certain conditions that may lead to the early termination of these special rules before 2016”.<sup>4</sup>

Only a few years ago, this position was undisputed, to the extent that the previous European Commissioner for Trade, Karel De Gucht, had no qualms about openly declaring, in the presence of the European Parliament, that “in 2016 China will receive market-economy status”.<sup>5</sup>

However, the US, supported by other commentators and by several EU Member States, consider that the WTO Members' right to keep considering China a non-market economy will not automatically lapse.<sup>6</sup> WTO Members would retain the right to grant market economy status to China only if and when they consider that China meets the relevant conditions. According to this interpretation, the expiry clause would only concern certain aspects of the non-market economy methodology applicable to China, and not China's non-market economy status itself.

Such opinions are primarily based on the argument that, even though subparagraph (a)(ii) of paragraph 15 will lapse, the chapeau of paragraph 15 will remain in force. These commentators are of the opinion that, as the cha-

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cerning the People's Republic of China (January 2016), p. 5, available at [http://ec.europa.eu/smart-regulation/roadmaps/docs/2016\\_trade\\_002\\_dumping\\_investigations\\_china\\_en.pdf](http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_trade_002_dumping_investigations_china_en.pdf); Ryan Heath, Secret legal opinion inflames China trade fight, POLITICO, (13 January 2016), available at <http://www.politico.eu/article/secret-legal-opinion-inflames-china-trade-fight-market-economy-wto/>; Matthew Daltom, EU Lawyers Favor Market- Economy Status for China Next Year, The Wall Street Journal, (9 June 2015), available at <http://www.wsj.com/articles/eu-lawyers-favor-market-economy-status-for-china-next-year-1433873355>. <sup>4</sup> Appellate Body Report, EC – Fasteners (China), para. 289. <sup>5</sup> Karel De Gucht, European Trade Commissioner, Modernisation of Trade Defence – Getting the Job Done, Speech made to the European Parliament, Workshop on Trade Defence Instruments (TDI) Modernization, Brussels (7 November 2013), available at [http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc\\_151873.pdf](http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151873.pdf). <sup>6</sup> See, for instance, Bryce Baschuk, USTR Official Says Chinese Market Economy Status 'Not Automatic' after Dec. 11, Bloomberg BNA, (8 February 2016); Christian Oliver, Shawn Donnan and Tom Mitchell, US warns Europe over granting market economy

peau will still provide that WTO Members may “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”, China does not automatically have to be granted MES. According to those commentators, the chapeau in itself would provide a legal basis to derogate from the ordinary rules on how to determine the normal value, even if subparagraph (a)(ii) would expire.<sup>7</sup>

### The way forward for the European Union

Reportedly, around 80-90 countries have granted China MES.<sup>8</sup> These include WTO Members such as Australia, Brazil, New Zealand, Russia, Singapore and Switzerland.<sup>9</sup> As regards the European Union, there seem to be only two ways to break the current impasse: either China and the European Union work together to find a mutually satisfactory solution, or they will end up with a WTO dispute, the outcome of which will provide a definitive answer.

If the European Union does not grant market economy status, China is likely to bring the matter before the WTO. Thus, if the European Union denies market economy status, the final answer as to whether this approach complies with WTO law will come from the WTO dispute settlement mechanism. The European Union could try to avoid a decision on this matter by the WTO by granting market economy status to China, accompanied with negotiated solutions concerning trade defence for key industries, such as steel or chemicals. There are valid examples of negotiated solutions, such as the 2014 deal, where the EU and China reached an agreement that led the EU to drop a possible trade defence investigation against Chinese telecom

equipment.<sup>10</sup> But is a negotiated solution on this issue still possible at this stage?

In deciding whether to grant market economy status to China, the Commission will not be the only player. The European Union will have to amend its anti-dumping legislation and this will require the approval of the European Parliament and of the Council. It is well known that southern EU countries and several EU industries, such as the metals and chemicals industries, are strongly against granting market economy status to China.<sup>11</sup>

With respect to the European Parliament, its Legal Service concluded that “[t]he general possibility for WTO members to apply an alternative methodology not based on Chinese prices for determining the normal price in anti-dumping proceedings against enterprises based in China on the basis of Section 15, paragraph (a)(ii) will no longer be available after 11 December 2016.” However, it also added that “[i]t cannot be excluded that the opening clause of paragraph (a) could be interpreted as allowing for an alternative method if it can be shown that market economy conditions still do not prevail in the relevant industry and the instruments available under the general regime under GATT and the Anti-Dumping Agreement do not allow to take this situation sufficiently into account in the determination of the price comparability.”<sup>12</sup> This position appears to suggest that China would not necessarily have to be treated as a market economy, but that some alternative approach exists between the current situation and granting China MES. Finally, while most political groups in the European Parliament agree that a decision on Chinese MES has to be taken this year and that the EU should stick

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to its WTO obligations, they also mostly seem to agree that this should not merely be automatic and that the ability of the EU to impose effective trade defence measures on imports from China should be safeguarded.<sup>13</sup> Even if the Commission decides to propose market economy status for China, the final outcome remains uncertain.

At this stage, the Commission as well as the European Parliament and the Member States have not been able to reach a common position and will further assess the impact of granting market economy status to China. Indeed, on 10 February 2016, the Commission opened a public consultation on “whether, and if so, how, the EU should change the treatment of China in its anti-dumping investigations after December 2016.”<sup>14</sup> Together with the consultation, the Commission published an analytical information note as well as an inception impact assessment.<sup>15</sup> Both of these outline what the Commission considers the three possible options to be, namely i) leaving the EU legislation unchanged; ii) changing the anti-dumping methodology for trade defence investigations against China with no mitigating measures; and iii) changing the anti-dumping methodology for China as part of a package including mitigating measures.

It is clear that the Commission is leaning towards the third option. Indeed, with respect to the first option, the Commission itself states that “[t]here is a clear risk that this option could put the EU in breach of WTO obligations and may be challenged leading to compensation.”<sup>16</sup> With respect to the second option, the Commission states that “[t]he total employment effect in the long term, if no mitigating measures are taken, is therefore a possible employment loss, including indirect upstream and downstream effects, ranging between 63,600 and 211,000 jobs.”<sup>17</sup> Clearly, neither of these two options appear very appealing. With respect to the third option, the mitigating measures

suggested by the Commission include i) grandfathering the existing anti-dumping measures in force against China, whereby the revised rules would not apply to these measures until they qualify for an expiry review; ii) rejecting domestic and/or export sales prices in situations where there are significant distortions affecting prices and/or costs of the exporters; iii) limiting the use of the “lesser duty rule”, by not applying it in cases where significant distortions are found; and iv) allowing for the automatic investigation of new subsidies discovered in the context of an ongoing anti-subsidy investigation.<sup>18</sup>

Some of these mitigating measures, in particular with respect to the “lesser duty rule”, had already been proposed by the Commission in April 2013 in the context of the modernization of the EU trade defence instruments.<sup>19</sup>

There are certain concerns regarding the WTO compatibility of these proposed mitigating measures, in particular with respect to certain WTO non-discrimination provisions, such as Article 9.2 of the Anti-Dumping Agreement and the MFN-principle laid down in Article I:1 of the GATT 1994. Article 9.2 of the Anti-Dumping Agreement provides that anti-dumping duties must be collected on a non-discriminatory basis on imports of a particular product from all sources found to be dumped and causing injury. In *US – Anti-Dumping and Countervailing Duties (China)* the Appellate Body explicitly linked Article 9.2 with the “imposition” stage, and that duties may not be imposed on a discriminatory basis.

The proposal also met strong opposition from certain Member States, such as the United Kingdom (UK) and Sweden, and has resulted in a deadlock in the Council of the European Union. As recently as 10 February 2016, the UK government spoke out against the proposed amendments to the lesser duty rule. As one of the representatives

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Commission, Public online consultation concerning a possible change in the methodology to establish dumping in trade defence investigations concerning the People's Republic of China, available at [http://trade.ec.europa.eu/consultations/index.cfm?consul\\_id=191](http://trade.ec.europa.eu/consultations/index.cfm?consul_id=191). <sup>15</sup> European Commission, Change in the methodology for anti-dumping investigations concerning China, (2016), available at [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154241.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf); European Commission, Inception Impact Assessment – Possible change in the methodology to establish dumping in trade defence investigations concerning the People's Republic of China (January 2016), available at [http://ec.europa.eu/smart-regulation/roadmaps/docs/2016\\_trade\\_002\\_dumping\\_investigations\\_china\\_en.pdf](http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_trade_002_dumping_investigations_china_en.pdf). <sup>16</sup> European Commission, Change in the methodology for anti-dumping investigations concerning China, (2016), p. 3, available at [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154241.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf); European Commission, Inception Impact Assessment – Possible change in the methodology to establish dumping in trade defence investigations concerning the People's Republic of China (January 2016), p. 5, available at [http://ec.europa.eu/smart-regulation/roadmaps/docs/2016\\_trade\\_002\\_dumping\\_investigations\\_china\\_en.pdf](http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_trade_002_dumping_investigations_china_en.pdf). <sup>17</sup> European Commission, Change in the methodology for anti-dumping investigations concerning China, (2016), p. 5, available at [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154241.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf). <sup>18</sup> European Commission, Inception Impact Assessment – Possible change in the methodology to establish dumping in trade defence investigations concerning the People's Republic of China (January 2016), pp. 3-4, available at [http://ec.europa.eu/smart-regulation/roadmaps/docs/2016\\_trade\\_002\\_dumping\\_investigations\\_china\\_en.pdf](http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_trade_002_dumping_investigations_china_en.pdf). <sup>19</sup> Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Council Regulation (EC) No 1225/2009 on protection against dumped imports from countries not members of the European Community and Council Regulation (EC) No 597/2009 on protection against subsidised imports from countries not members of the European Community /\* COM/2013/0192 final - 2013/0103 (COD) \*/, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013PC0192&qid=1457713266219&from=EN>.

of one of the free-trade oriented EU Member States put it,<sup>20</sup> “we rather see a situation whereby China is not granted MES, even if this is contrary to WTO law, if the alternative would be to mess up the entire instrument”.

### Conclusion

The issue is likely to be debated heavily between European Institutions and between the different EU Member States in the coming months and maybe even longer. The best solution would be to reach a mutually satisfactory agreement, a win-win solution according to which the European Union grants market economy status to China, but secures adequate long-term protection for its key industries. The alternative, very likely at the moment, is that the European

Union will not be able to reach a common position internally and will not grant market economy status to China. China will then resort to the WTO, which will put an end to this dispute. If so, nobody in the European Union will have to take responsibility for having granted market economy status to China. There will be one party that officially wins and the other that officially loses. In reality both parties will have wasted their precious time and resources, which could have instead been used to reach a constructive mutually satisfactory agreement. ☹

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<sup>20</sup> On an anonymous basis.



Eva Monard

## BIO

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Eva has assisted governments during all stages of WTO dispute settlement proceedings before the Panel and the Appellate Body. In addition, she has advised clients on the compatibility of legislation between WTO members and on implementation of WTO agreements, assisted governments in drafting their legislation implementing their WTO commitments, and provided support to governments in Doha Round trade negotiations and in negotiations of free trade agreements.

Eva has advised clients on obligations under EU export controls law and has assisted clients in complying with obligations relating to dual-use goods and restrictive measures (so-called sanctions) taken by the EU. She has also assisted clients with EU customs law matters.

Eva also advises clients on competition law matters, in particular cartels and merger control.

# CHINA'S MARKET ECONOMY STATUS UNDER WTO LAW: A EUROPEAN PERSPECTIVE

Alessandro SPANO

## Introduction

Section 15 of China's Accession Protocol to the World Trade Organization (WTO) introduces a transitional arrangement which allows importing WTO members to treat China as a non-market economy (NME) in anti-dumping proceedings.<sup>1</sup> The main implication of NME status is that a specific methodology, not based on a strict comparison with domestic prices or costs in China, can be applied in order to determine the values of goods if Chinese producers cannot prove that market economy conditions prevail in the industry concerned. Since NME methodology normally leads to higher anti-dumping duties, one of the priorities of China's political agenda since 2003 has been to obtain Market Economy Status (MES) recognition by as many trading partners as possible. In many cases, China's efforts have yielded success since WTO rules do not prevent countries from recognising MES under domestic law even when the criteria for MES are not met. In any case, the Chinese government considers that Section 15(d) of China's Accession Protocol entails that NME methodology is intended to expire after 15 years from the date of China's WTO membership, resulting in the legal obligation to automatically grant MES to China after 11 December 2016. However, much controversy has surrounded this interpretation of Section 15(d) in the EU. In the attempt to protect several Euro-

pean industries from unfair trading practices, over the years, EU authorities have initiated various high profile anti-dumping investigations against China by making use of alternative methodologies to calculate dumping. The situation is now at a turning point and the European Commission has been contemplating the implications of the expiry of China's transitional arrangement on EU anti-dumping legislation. From a European perspective, three main options are under consideration: to maintain the status quo; to grant China full MES; or to grant China MES but in combination with alternative trade defence measures.<sup>2</sup> In taking a decision, the European Commission will not only have to achieve balance between the conflicting views which emerged from various parts in relation to anti-dumping policy in the EU but also to consider carefully the repercussions over EU-China future trade relations in light of, inter alia, the ongoing negotiations for a comprehensive Bilateral Investment Agreement (BIT) and of the efforts for a potential Free Trade Agreement (FTA).<sup>3</sup>

## China's WTO Accession Protocol and Non-Market Economy Status

The issue of whether the EU should recognise MES to China in anti-dumping investigations has been the subject of heated debate over the last few years in the EU. The

<sup>1</sup> See Section 15 of China's Accession Protocol to the WTO on "Price Comparability in Determining Subsidies and Dumping". World Trade Organization, "Protocol on the Accession of the People's Republic of China", WTO.doc, WT/L/432, 23 November 2001. <sup>2</sup> European Commission, "Change in the methodology for anti-dumping investigations concerning China.", 3 February, 2016, retrieved 23 April 2016. [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154241.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf) <sup>3</sup> The first round of negotiations for an EU-China investment agreement took place in Beijing on 21-23 January 2014.

European Commission intends to decide by December 2016 whether to grant China MES, having postponed its decision in order to conduct supplementary analysis on the potential implications of this choice and to hold a public consultation to gather the opinions of industry representatives and trade unions on the relaxing of trade barriers against China.<sup>4</sup>

It is worth remembering that various countries have already granted recognition of MES to China. A 2015 research paper from the European Parliamentary Research Service (EPRS) indicates that the main reasons behind this decision include: granting China MES as a pre-condition for the negotiation of FTA (e.g. South Africa and Australia); the fact that some countries are or have also been subject to NME status (e.g. Vietnam or Russia); the conclusion of memoranda of understanding to encourage Chinese investment (e.g. Brazil and Argentina); and the possibility to attract investments, loans and Chinese foreign aid (e.g. African countries).<sup>5</sup> Thus, also by looking at the approach adopted by other WTO members, the EU is now weighing the consequences of granting full or partial MES to China against leaving the situation unaltered.<sup>6</sup>

### Legal issues surrounding China's transitional arrangement on Non-Market Economy status

To complicate matters, the question of how to interpret the terms of the transitional arrangement introduced by Section 15 of China's WTO Accession Protocol remains. When China joined the WTO in December 2001<sup>7</sup>, the Chinese government agreed, *inter alia*, to apply a specific methodology for calculating dumping. Delineated in Section 15 of the Protocol, the agreed terms allow for WTO members to consider China as a NME in anti-dumping proceedings.

Although Article 15(a)(i) states that if the producers under investigation can clearly show that market economy conditions prevail in the industry, the importing WTO Member shall use Chinese prices or costs for the industry under

investigation in determining price comparability, sub-paragraph 15(a)(ii) adds that a methodology, not based on a strict comparison with domestic prices or costs in China can be applied if the producers under investigation cannot clearly show that market economy conditions prevail in the industry. Thus, the introduction of these specific terms produces a presumption that NME status is applicable to China.

However, Article 15 (d) specifies that once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of sub-paragraph (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 sub-paragraph (a)(ii) shall expire 15 years after the date of accession that is after 11 December 2016.

The wording of Section 15 sub-paragraph (a)(ii) has sparked debate among policy makers, legal scholars and practitioners about its correct interpretation.<sup>8</sup> China advocates that after the deadline will elapse, the country should automatically be granted MES. Instead, some other countries believe that MES can only be recognised by the domestic law of the importing country.<sup>9</sup>

The devil is in the detail. It appears evident that the decision to opt for an interpretation or its opposite assumes huge political relevance and it may have serious repercussions over the future of trade relations with China.

### China's Market Economy Status from a European perspective

From a European viewpoint, three options are on the table. These include: refusing China MES and, thus, leaving EU anti-dumping legislation in its current form; granting China full MES and amending EU norms; or adopting a mixed

<sup>4</sup> On 10 February 2016, the European Commission opened a 'public online consultation concerning a possible change in the methodology to establish dumping in trade defence investigations concerning the People's Republic of China'. The consultation ran until 20 April 2016 and was available on the European Commission website. <sup>5</sup> L. Puccio, "Granting Market Economy Status to China - An analysis of WTO law and of selected WTO members' policy", EPRS - European Parliamentary Research Service, November 2015 – PE 571. 325.

<sup>6</sup> In addition to the EU, the main countries which still consider China a NME include the US, Canada, Japan, Mexico and India. *Ibid.* <sup>7</sup> China's accession process to the WTO was subject to intense scholarly interest. For an insightful discussion on this issue see, *inter alia*, R. Bhala, "Enter the Dragon: An Essay on China's WTO Accession Saga", *American University International Law Review*, Vol. 15, Issue 6, (2000), 1470 – 1537; and D. C. Clarke, "China's Legal System and the WTO: Prospects for Compliance", *Washington University Global Studies Law Review*, Vol. 2, Issue 97, (2003), 97 – 120. <sup>8</sup> See, for instance, B. O'Connor, "Market-economy status for China is not automatic", *VOX – CEPR's Policy Portal*, 27 November 2011, retrieved 23 April 2016, <http://voxeu.org/article/china-market-economy>. C. Tietje and K. Nowrot, "Myth or Reality? China's Market Economy Status under the WTO Anti-dumping Law after 2016", *Policy Papers on Transnational Economic Law*, N. 34, *Transnational Economic Law Research Center*, (December 2011). For a discussion on China's MES see also F. Urdinez and G. Masiero, "China and the WTO: Will the Market Economy Status Make Any Difference after 2016?", *The Chinese Economy*, Vol. 48, N. 2, (2015), 155-172. <sup>9</sup> The US, Canada, Japan, Mexico and India still maintain legal discretion in deciding whether to grant China MES after the expiry of the transitional arrangement. <sup>10</sup> European Commission, "Change in the methodology for anti-dumping investigations concerning China", 3 February, 2016, retrieved 23 April 2016, [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154241.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf) <sup>11</sup> Cecilia Malmström, Commissioner for Trade, "Trade Defence and China: Taking a Careful Decision", *European Commission Trade defence Conference*, Brussels, 17 March 2016.

<sup>12</sup> The legal basis of the EU trade defence system is Arts VI and XVI of the WTO General Agreement on Tariffs and Trade (GATT) and the respective implementing agreements (i.e.

approach by granting China MES but in combination with complementary trade defence measures.<sup>10</sup>

As the EU Trade Commissioner, Cecilia Malmström, recently said none of the options available is "cost-free".<sup>11</sup> Under the first scenario, the EU would continue to consider China a NME for the purpose of anti-dumping proceedings. However, the application of NME methodology to China on the basis of existing EU anti-dumping legislation may raise issues of compliance of EU rules and practice with international trade norms.<sup>12</sup> In this regard, China would be encouraged to file a complaint under the WTO's dispute settlement mechanism.<sup>13</sup> This option seems to represent a costly strategy. In case of success, China would be entitled to claim compensation and, in any event, it is likely that the Chinese government would implement ad hoc policy measures to restrict market access for EU exporters.<sup>14</sup>

The second scenario would entail granting China full MES. EU anti-dumping rules and methodology should also be amended to reflect this change. The implications of recognising MES to China would certainly increase competitive pressure from Chinese firms in those European industries which have benefitted so far from anti-dumping protection including steel, chemicals, solar panels and footwear.

The steel industry is a case at point. In recognition of the strategic role of the steel industry, over the years the Chinese government has invested substantial financial resources to promote the development of the steel sector and the capacity of Chinese firms to compete globally.<sup>15</sup> As a result of these policies, China's steel industry has emerged as the largest in the world and China is now the leading player exercising significant influence on prices and cost

parameters worldwide.<sup>16</sup>

It should be noted that over the years the European Commission has imposed numerous measures to offset the harmful effect of dumping in the steel sector from China.<sup>17</sup> Furthermore, in March 2016, it issued a communication setting a strategy for the European steel sector in order to overcome the challenges fuelled by global overcapacity, a dramatic increase of exports and unfair trading practices.<sup>18</sup> More specifically, the European Commission announced the implementation of a series of defence mechanisms to strengthen the EU's defence against China's unfair trading practices, as well as longer-term action to guarantee the competitiveness and sustainability of the steel industry.<sup>19</sup>

Axel Eggert, EUROFER Director General, recently stated that: "In the steel sector, the massive Chinese excess capacities and exports fuelled by pervasive government support and subsidisation are a case in point illustrating the distorting impact of China's planned economy on a global scale."<sup>20</sup> Within this context, the representatives of European industries in general and of the steel sector in particular fear that MES would enhance China's ability to successfully adopt unfair trading practices resulting in a reduced possibility for European firms to develop and to innovate, and in the loss of millions of jobs in the EU member states.

The third scenario envisages the removal of China from the list of NME countries and the amendment of the EU's current anti-dumping legislation while, at the same time, sees the implementation of alternative trade defence measures. The European Commission suggests that these measures may include, for example, safeguarding definitive anti-dumping measures already in place ('grandfathering')

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Anti-Dumping Agreement (ADA) and the Agreement on Subsidies and Countervailing Measures (ASCM)). Trade defence instruments fall under the scope of Article 207 of the Treaty on the Functioning of the European Union (TFEU) which confers to the EU exclusive competence in matters of common commercial policy. Regulation 1225/2009 (the Basic Anti-Dumping Regulation), and Regulation 597/2009, (the Basic Anti-Subsidy Regulation) implement the ADA and the ASCM into the EU legal system. See Council Regulation (EC) No 1225/2009 of 30 November 2009 on protection against dumped imports from countries not members of the European Community, OJ 2009 L 343/51; and Council Regulation (EC) No 597/2009 of 11 June 2009 on protection against subsidised imports from countries not members of the European Community, OJ 2009 L188/93. <sup>13</sup> It was noted that, after a cautious approach during the first years of its accession to the WTO, China has progressively started to make more use of the dispute settlement mechanism. Since 2009, ten cases were filed by China as main complainant. Six cases concerned the US and four cases concerned the EU. As far as anti-dumping disputes with the EU are concerned, so far China has only challenged specific EU measures but not the general methodology of the EU's anti-dumping rules. P. Wruuck and H. Levinger, "Ending China's differential treatment - What's at stake for EU trade defence?", Research Briefing – European Integration, Deutsche Bank Research, 18 March 2016, p. 4. <sup>14</sup> European Commission (2016), op. cit. See also article 22 of the WTO Understanding on Settlement of Disputes (DSU). <sup>15</sup> P. In Der Heide and M. Taube, "China's Iron and Steel Industry at the Global Markets Interface: Structural Developments and Industrial Policy Interventions", *Copenhagen Journal of Asian Studies*, Vol. 29, N.2, (2011), 110-142. <sup>16</sup> *Ibid.* See also P. T. in der Heiden, "China's trade in steel products: Evolution of policy goals and instruments", *The Copenhagen Journal of Asian Studies*, Vol. 31, N. 1, (2013), 29-61; and Gh. H. Popescu, E. Nica, E. Nicolăescu, G. Lăzăroiu, "China's steel industry as a driving force for economic growth and international competitiveness", *Metallurgy*, Vol.55, No.1, (January 2016), 123-126. <sup>17</sup> European Commission, "Commission launches new anti-dumping investigations into several steel products", Press Release, Brussels, 12 February 2016. <sup>18</sup> European Commission, "Steel – Preserving sustainable jobs and growth in Europe, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee of the Regions and the European Investment Bank", COM (2016), 155 final, 16 Mar 2016. <sup>19</sup> *Ibid.* <sup>20</sup> Axel Eggert, EUROFER Director General, "China is not a market economy, confirms new In-depth Study", Press Release, EUROFER – The European Steel Association, Press Release, 29 June 2015, retrieved 23 April 2016, <http://www.eurofer.org/News%26Media/Press%20releases/China%20is%20not%20a%20market%20economy.fhtml>.

as well as strengthening other trade defence instruments (i.e. anti-dumping and anti-subsidies) to guarantee their effectiveness in future proceedings.<sup>21</sup> This third option may result in a satisfactory compromise between more extreme positions. However, these new trade defence measures “should be objective, easy to administer, and effective in terms of ensuring a level playing field.”<sup>22</sup> Thus, their precise design would assume primary importance in determining the success of the European Commission’s anti-dumping policy.

### Conclusion

The expiry date of China’s transitional arrangement for the calculation of dumping contained in Section 15 of its Protocol of Accession to the WTO is approaching. However, the question of whether China should be automatically granted MES after 11 December 2016 has yet to receive a univocal answer. From a European perspective, the EU relies extensively on anti-dumping measures and therefore a modification of the methodology for calculating dumping against China might have a significant impact on the European economy.

The issue is complex for various reasons. Legally, the design of EU anti-dumping measures has to comply with WTO requirements while at the same time provide effective defence for European industries from unfair trading practices. Politically, this contentious issue may have serious repercussions

on future EU-China relations. So far the European Commission has been very skilful in not politicising the matter and avoiding the situation, as is brilliantly depicted by the Anglo-Japanese novelist Kazuo Ishiguro: “when you make a move in chess and just as you take your finger off the piece, you see the mistake you’ve made, and there’s this panic because you don’t know yet the scale of disaster you’ve left yourself open to.”<sup>23</sup> However, the clock is ticking and, further delay in action may affect bilateral trade relationships and investments. It is true that China is not quite at the point where it is ready to fully embrace market economic principles but it is a lot closer now than it was fifteen years ago.

The progress of the negotiations for a comprehensive BIT and the renewed interest in initiating the negotiations of a FTA represent positive steps towards a more market-oriented approach in trade relations. Indeed, whatever solution should the EU adopt in relation to China’s MES, few would dissent with EU Trade Commissioner Cecilia Malmström who recently emphasised that the EU should, in any case, “maintain solid trade defense instruments towards China and others, now and after December.”<sup>24</sup> ©

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<sup>21</sup> European Commission (2016), op. cit., p. 5. <sup>22</sup> Wruuck and Levinger, op. cit., p. 5. <sup>23</sup> K. Ishiguro, *Never let me go*, Faber and Faber Limited, (2005), p.122 <sup>24</sup> Cecilia Malmström, Commissioner for Trade, quoted by D. Lawder, “EU to keep strong trade defenses even with China shift: official”, Reuters, Washington, 10 March 2016.



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# WHAT HINDERS THE EU IN DETERMINING TO FULFIL ITS WTO OBLIGATION ON CHINA'S MES ISSUE?

Xiaohong ZHOU

## Introduction

The EU and China have spent a lot of time and energy on the issue of China's market economy status (MES). In September 2003, China submitted a report on China's market economy development to the European Commission as part of its effort to be granted MES. This for China will mean an earlier end of the usage of the so-called 'analogue country' price as the basis for calculating dumping margins in the anti-dumping investigation against export products originating in China before its expiry (on 11 December 2016) according to Section 15 of China's Protocol of Accession to the WTO.<sup>1</sup> Since 2003 China has consulted with the EU on this issue regularly. The EU had made several assessments in 2004, 2008, 2010 and 2011 and the same conclusion was always reached: China did not meet all five criteria of a market economy.<sup>2</sup>

At the end of 2015, when the expiry date of certain provisions of Article 15 of China's Protocol of Accession to the WTO on "Price Comparability in Determining Subsidies and Dumping" was approaching, some statements such as "market-economy status for China is not automatic" were voiced and the Commission declared that "it is studying the implications of the expiry of these provisions

on the EU anti-dumping and anti-subsidy legislation" and initiated the online public consultation.<sup>3</sup>

Given the fact that the EU recognised Russia's MES under the circumstance that Russia still kept its protective laws and granted Ukraine MES with political conditions provisos attached,<sup>4</sup> it does beg questions: Is the MES issue a purely legal one or one that highly correlates with political economy? Why has the EU been so hesitant to grant China MES? To date, what fetters the European Commission from proposing to fulfil its obligation under the WTO law?

This paper aims to explore the potential factors affecting the EU's decision-making process. Part I will demonstrate the triggers for filing anti-dumping (AD) cases by reviewing the existing research, which reveals that anti-dumping measures may not only be used for punishing unfair trade practices and creating a level playing field, as claimed, but could also be distorted and abused as instruments of trade protectionism. The next two parts will focus on why the opposition to granting China's MES is unfounded and finally it will conclude that the EU should remove the stumbling block to fulfil its WTO obligation of treating China as a market economy country.

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<sup>1</sup> "Zhongguo minlin shichang jingji diwei zhibian, zhuanjia cheng zhongzai shenhua gaige" ["China is facing the debate of market economy status, experts claim that the focus is to deepen reform"], Xinlang Net 30 June 2004, retrieved 25 February 2016, <http://news.sina.com.cn/c/2004-06-30/14302951097s.shtml>. <sup>2</sup> BUSINESSEUROPE, "China's Market Economy Status", position paper, December 2015, p. 3, retrieved 25 February 2016, [https://www.busesseurope.eu/sites/buseur/files/media/position\\_papers/rex/2015-12-11\\_chinas\\_market\\_economy\\_status.pdf](https://www.busesseurope.eu/sites/buseur/files/media/position_papers/rex/2015-12-11_chinas_market_economy_status.pdf). <sup>3</sup> European Commission, "Change in the Methodology for Anti-Dumping Investigations Concerning China", 3 February 2016, p. 1, retrieved 5 February 2016, [http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc\\_154241.pdf](http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf). <sup>4</sup> "US calls Russia a market economy", BBC News, 7 June 2002, retrieved 10 March 2016, <http://news.bbc.co.uk/2/hi/business/2032498.stm>; "EU to grant Ukraine market economy status", Kyivpost, 9 November 2005, retrieved 10 March 2016, <http://www.kyivpost.com/article/content/business/eu-to-grant-ukraine-market-economy-status-23456.html?flavour=full>.

### Triggers for Filing AD Cases: Secrets Hidden behind the 'Fair Trade'

Anti-dumping (AD) is a measure that was originally conceived as a way to counteract predatory foreign cartels. It has since evolved into a complicated mechanism whereby a 'threatened' domestic industry can initiate an anti-dumping petition against specific foreign competitors, regardless of how competitive the industry might be. Many studies have revealed the economic and political factors that help to explain the more intensive use of AD remedies. A brief review of this literature will help us understand the economic and political roots of the current debate in the EU on whether or

## INDUSTRIES APPEAR TO USE THE ANTI-DUMPING PROCESS AS A RESPONSE TO GROWTH IN IMPORTS FROM PARTICULAR COUNTRIES.

not to automatically grant China market economy status. The economic studies have shown the influence of macroeconomic conditions on the intensiveness of AD filing. On the macro level, the proximate determinants that encouraged the filing of AD petitions are the unemployment rate, the exchange rate and import penetration.<sup>5</sup> Staiger and Wolak provided evidence that the import penetration ratio, capacity utilisation rate, employment and the extent of vertical integration are all statistically and economically important determinants of the number of AD petitions filed by an industry within a year.<sup>6</sup>

As an example, Knetter and Prusa illustrated how the real currency appreciation (or depreciation) increases (or decreases) the likelihood of injury and decreases (or increases) the likelihood of less than normal value. They found that "a real appreciation of the filing country's currency will lead to a significant increase in AD filings". According to their study, a one (two)-standard deviation real appreciation of the

filing country's currency leads to a 33 percent (77 percent) increase in AD filings in the specification that constrains the response to be common across filing countries. The link between real exchange rates and filings suggests that either foreign firms are being held responsible for factors beyond their control or that foreign firms behave in a "predatory" manner when conditions favour them the most.<sup>7</sup>

Another example is the analysis of the impact of GDP on the number of anti-dumping charges. Based on the data on AD filings from Australia, Canada, the European Union, and the United States, the researchers found that a one-standard deviation fall in domestic (import country's) real GDP growth leads to a 23 percent increase in AD filings.<sup>8</sup> The decline of an export country's GDP can also have a similar effect, because a country in a recession may cut its export price in order to stabilise its excess domestic supply. In this case, the likelihood of the export country facing anti-dumping charges with a less than fair value determination is generally increased.<sup>9</sup>

In some cases, industries appear to use the anti-dumping process as a response to growth in imports from particular countries, rather than as a form of broad-based protection. Apparently, substantial re-allocation of market share can be viewed as threatening and/or injurious, even when total imports of a commodity are flat or falling.<sup>10</sup>

The use of the AD measure is also easily affected by the economic and business cycle and it functions differently in different countries. As Aggarwal explained, when on the upturn of business cycles firms in developed countries are not significantly concerned with import competition; however when on the downswing they strive for anti-dumping protection from import competition. In developing countries, anti-dumping appears to serve as a tool enabling governments to open up their economies and as an expression of retaliation, for it allows them to counter such actions targeted against them.<sup>11</sup>

The empirical evidence presented in these studies demonstrates that anti-dumping measures "have gone beyond

<sup>5</sup> D. A. Irwin, *The Rise of US Anti-dumping Activity in Historical Perspective*, Oxford, Blackwell Publishing, 2005, p. 651, retrieved 25 February 2016, <http://www.dartmouth.edu/~dirwin/docs/AD.pdf>. <sup>6</sup> R. W. Staiger & F. A. Wolak, "Measuring industry-specific protection: Antidumping in the United States", *Brookings Papers on Economic Activity*, 1994, pp. 51–118.

<sup>7</sup> M. M. Knetter & T. J. Prusa, "Macroeconomic Factors and Antidumping Filings: Evidence from Four Countries", National Bureau of Economic Research working paper 8010, November 2000, retrieved 26 February 2016, <http://www.nber.org/papers/w8010.pdf>. <sup>8</sup> Ibid. <sup>9</sup> S. Sudsawasd, "Which Countries Are the Targets for Anti-Dumping Filings?", *The International Journal of Business and Finance Research*, vol. 5, no.1, 2011, p. 69, retrieved 28 February 2016, <http://ssrn.com/abstract=1876063>. <sup>10</sup> R. Hillberry & P. McCalman, "What Triggers an Anti-Dumping Petition? Finding the Devil in the Detail", October 2009, retrieved 28 February 2016, [https://www.usitc.gov/research\\_and\\_analysis/economics\\_seminars/2009/Hillberry-2009abstract.pdf](https://www.usitc.gov/research_and_analysis/economics_seminars/2009/Hillberry-2009abstract.pdf). <sup>11</sup> A. Aggarwal, "Patterns and Determinants of Anti-dumping: A Worldwide Perspective", *Indian Council For Research On International Economic Relations Working paper*, no. 113, October 2003, pp. 37-39, retrieved 28 February 2016, <http://www.icrier.org/pdf/wp113.pdf>.

punishing unfair trade practices and creating a level playing field as claimed by the national anti-dumping authorities"<sup>12</sup> and are protective in nature, for "[o]nce the anti-dumping case is filed the decision to grant protection is subject to substantial discretion and hence can be influenced by the involved parties".<sup>13</sup>

The above studies will help us to analyse the reasons for the increase of AD cases initiated by the EU against Chinese exports involving iron and steel products last year, which will be discussed in detail in the next section.

### **Worrying about Weakening the Effectiveness of EU Trade Defence Instruments**

The strongest opposition to automatically granting China MES comes from some EU industries like iron and steel, chemical and allied, and ceramics, which are the sectors with the most AD measures in force. They worry that the effectiveness of the EU's trade defence instruments against potentially increased Chinese exports caused by overcapacity might be weakened if China is granted MES. We will take the steel industry as an example to illustrate the protective pressures faced by EU decision makers and why such concerns are exaggerated.

On 18 September 2015, AEGIS Europe, quoted in the study of the Economic Policy Institute (EPI), claimed that "if the EU grants Market Economy Status (MES) to China, MES for China would directly put at risk up to 1 million European jobs in affected industries, with knock-on losses of 1 million additional indirect jobs in related sectors. Subsequent negative income effects could lead to as many as 3.5 million job losses over the next three to five years, the hardest hit countries would be Germany, Italy, UK, France and Poland".<sup>14</sup>

The opposition has won the responses from the policymakers. In November's house debate, a MEP suggested that "the trade defence instruments should be used in an active way" and that "measures should be taken immediately".<sup>15</sup> MEPs considered that "the Commission should use all available anti-dumping and trade-defence instruments in order to pro-

tect European industry" and expressed their concerns about the impact that granting free market economy status to China might have on industry in the EU.<sup>16</sup> In its recent press release, the Commission states that it "is already imposing a record number of measures to offset the detrimental effect of dumping, with 37 anti-dumping and anti-subsidy measures in place on steel products (16 of which on steel imports from China)".<sup>17</sup> "The Commission will further accelerate the adoption of anti-dumping measures and stands ready to make additional proposals to speed up the overall procedure and improve the efficiency of the current system".<sup>18</sup>

It seems that the above statements have implied a causal link between the injury of the EU steel industry and China's steel overcapacity, but after we analyse the macro variables of the global steel industry mentioned in the previous section, it is hard to find the solid foundation for such a causal link.

## **THE STEEL INDUSTRY IS NOW ENTERING A PERIOD OF PAUSE BEFORE UNDOUBTEDLY PICKING UP AGAIN WHEN MARKETS OTHER THAN CHINA DRIVE NEW DEMAND.**

Firstly, overcapacity is an issue that is common to the global steel industry and the situation of the steel industry has deteriorated further by the recessionary and subdued world economy. As the OECD described in its report, "the outlook for the steel industry has weakened significantly, due to cyclical factors associated with sluggish global economic activity and industry-specific structural problems such as overcapacity".<sup>19</sup> The World Steel Association also pointed out that "the steel industry is now entering a period of pause before undoubtedly picking up again when markets other

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<sup>12</sup> Ibid, p. 38. <sup>13</sup> Ibid, p. 39. <sup>14</sup> "Unilateral Grant of Market Economy Status to China Would Put Millions of EU Jobs at Risk", AEGIS Europe press release, 18 September 2015 retrieved 3 December 2015, [http://static1.squarespace.com/static/5537b2f6e4b0e49a1e30c01c/t/55fc08d1e4b04c74c505ebc4/1442580689708/ENGLISH\\_FINAL\\_Press+Release+AE-GIS+Europe\\_MD%5B1%5D.pdf](http://static1.squarespace.com/static/5537b2f6e4b0e49a1e30c01c/t/55fc08d1e4b04c74c505ebc4/1442580689708/ENGLISH_FINAL_Press+Release+AE-GIS+Europe_MD%5B1%5D.pdf). <sup>15</sup> European Parliament, "EU Needs to Boost Its Steel Industry", plenary session press release, 25 November 2015, retrieved 3 December 2015, <http://www.europarl.europa.eu/news/en/news-room/20151120IPR03669>. <sup>16</sup> Ibid. <sup>17</sup> European Commission, "Steel Industry: Commission Takes Action to Preserve Sustainable Jobs and Growth in Europe", press release, 16 March 2016, retrieved 17 March 2016, [http://europa.eu/rapid/press-release\\_IP-16-804\\_en.htm](http://europa.eu/rapid/press-release_IP-16-804_en.htm). <sup>18</sup> Ibid. <sup>19</sup> A. D. Carvalho, Steel Market Developments – Q4 2015, OECD Publishing, Paris, p. 4, retrieved 3 February 2016, <http://www.oecd.org/sti/ind/Steel-market-developments-2015Q4.pdf>.

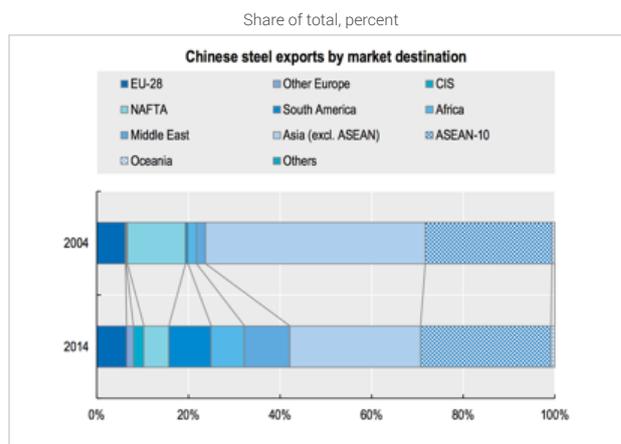
than China drive new demand. Nobody can predict exactly when or where."<sup>20</sup> Growth in world crude steel production has decelerated significantly in the past three years. Following growth of 5.8 percent in 2013 (to 1.65 billion tonnes), production growth slowed to 1.2 percent in 2014 and has turned negative in 2015. In the first 10 months of 2015, crude steel production declined by 2.5 percent compared to the corresponding time period one year earlier. The world production decline appears to have been gathering some momentum during the course of this year, with the rate of contraction reaching 3.1 percent in October 2015.<sup>21</sup>

Secondly, the Chinese government, steel industry and enterprises have taken effective measures to curb overcapacity in recent years and achieved some results.<sup>22</sup> The "cuts made in outdated production capacity over the past three years have included over 90 million metric tons of steel and iron", China's production has declined 2.2 percent in 2015.<sup>23</sup> During the period from 2016 to 2020, China will continue its efforts to address the overcapacity in the steel, coal, and other industries facing difficulties. The Chinese government will use economic, legal, technological, environmental, quality inspection, and safety-related means to strictly control the expansion of production capacity, shut down outdated production facilities, and eliminate overcapacity in a planned way. It will address the issue of 'zombie enterprises' proactively yet prudently by using measures such as mergers, reorganisations, debt restructurings, and bankruptcy liquidations. 100 billion Yuan in rewards and subsidies will be provided by the central government, which will be mainly used to resettle employees laid off from these enterprises. The government will also improve its fiscal, financial, and other policies to support this work and take a full range of measures to reduce the costs of enterprises.<sup>24</sup> This shows that it is less likely that China will rely on export to curb its overcapacity in steel industry.

Lastly, the analysis on the world steel trade does not support the blaming of Chinese steel export. On the export side, the OECD study shows that Chinese steel exporters compete intensively with steelmakers based in Japan, Korea and Chinese Taipei for markets located within the Association

of Southeast Asian Nations (ASEAN) region. China's export share to ASEAN has gradually increased and its export shares to Africa, the Middle East and South America have risen considerably. Each of these regions now import slightly less than a tenth of China's exports. China's export share to the EU has not increased significantly.<sup>25</sup> Although China's steel exports increased in 2015 (until September), they were distributed to different geographic regions such as the ASEAN region, Korea, the EU, India, and the Middle East. It's hard to conclude that its market share in the EU has increased significantly.

**Figure 1. Chinese steel exports by market destination and product, 2004 and 2014**<sup>26</sup>



On the price side, the combined effect of weakening global steel demand, growing imports in many economies, and decreases in steelmaking costs has led to a very sharp decline in world steel prices.<sup>27</sup> Together with the complementarity of the export product structure, it is hard to conclude that Chinese steel export products constitute "dumping" and injure or will injure the EU steel producers.

### How to read the Chinese Economy

Neither the legal text of GATT 1994 nor China's Protocol of Accession to the WTO provides the definition of the term of 'market economy'. In practice, half of the WTO Members have granted China MES. China characterises its own economy as a 'socialist market economy', but the EU refuse

<sup>20</sup> World Steel Association, World Steel In Figures 2015, retrieved 3 February 2016, <http://www.worldsteel.org/publications/bookshop/product-details.-World-Steel-in-Figures-2015-PRODUCT-World-Steel-in-Figures-2015-.html>. <sup>21</sup> Ibid., p. 12. <sup>22</sup> European Chamber, "Overcapacity in China: An Impediment to the Party's Reform Agenda" 22 February 2016, retrieved 25 February 2016, <http://www.eurochamber.com.cn/documents/confirm/56163a75c914c/en/pdf/406>. <sup>23</sup> Ibid., p. 13. <sup>24</sup> The 13th Five-Year Plan for National Economic and Social Development of People's Republic of China, Xinhua Net, 17 March 2016, retrieved 18 March 2016, [http://news.xinhuanet.com/politics/2016lh/2016-03/17/c\\_1118366322\\_6.htm](http://news.xinhuanet.com/politics/2016lh/2016-03/17/c_1118366322_6.htm). <sup>25</sup> A. D. Carvalho & N. Sekiguchi, "The Structure of Steel Exports: Changes in Specialisation and the Role of Innovation", OECD Science, Technology and Industry Working Papers, July 2015, OECD Publishing, Paris, p. 8, retrieved 1 March 2016, <http://dx.doi.org/10.1787/5jrxfmstf0xt-en>. <sup>26</sup> Ibid., p. 8. <sup>27</sup> Carvalho, op. cit., pp. 15-16. <sup>28</sup> European Commission, "Change in the Methodology for Anti-Dumping Investigations Concerning China", p. 1. <sup>29</sup> BUSINESSEUROPE, "China's Market Economy Status", p. 3. <sup>30</sup> "The 2016 Report on the Work of the Government", delivered by Premier Li Keqiang at the Fourth Session of the Twelfth National People's Congress, retrieved 17 March 2016, <http://english.gov.cn/premier/>

to recognise it as a 'market economy' with the argument that "[a]s a result of the many distortions in the Chinese economy, prices and costs do not reflect normal market forces",<sup>28</sup> "in particular in relation to the important role of the Government in setting prices in key sectors of the economy like energy".<sup>29</sup>

The EU's argument touches on the intellectual puzzle about how to interpret the success of the Chinese economy. Although the significant state intervention may bring problems of undisciplined growth of state bureaucracy and the cost of policy-induced price distortions, the state-led mobilization of investment and state-directed industrial development has led to the high performance of the Chinese economy during past decades. Here is not the place to go into the details of the discussion, but one thing that does need to be mentioned is that one of initiating conditions of the economic reform of China is lack of an efficient market, so the government has played the substitutive function, and it is a logical and reasonable choice for the government to avoid the chaos and turmoil of its economy.

In recent years the Chinese government has implemented many reforms and will continue to take measures to adjust to all kinds of distortions of policy and systemic arrangement after the third Plenary Session of the 18th CPC Central Committee proposed to make the market play a decisive role in the allocation of resources in November 2013, which include but are not limited to the following measures:<sup>30</sup> Unnecessary government regulation was removed. The number of items which require government approval for new businesses prior to registration was cut by 85 percent; the number of restrictions on overseas investment in China was cut by 50 percent, and over 95 percent of overseas-funded projects may now be undertaken on a simple reporting basis.

Pricing reform was intensified. The guidelines for moving ahead with price reform were published and implemented. Pricing controls over nearly 40 goods and services were either lifted or delegated to lower-level governments. The

number of central government set prices was reduced by 80 percent and the number of local government set prices was cut by more than 50 percent. The government will further improve the price formation mechanism over competitive areas in the power, petroleum, natural gas, and transportation industries during the period of the 13th Five Year Plan. The playing field for all kinds of enterprises will be levelled. The government will significantly relax restrictions on entry into markets such as electricity, telecommunications, transport, petroleum, natural gas, and municipal public utilities, remove hidden barriers, and encourage private companies to increase investment in these areas and participate in SOE reform. In these fields, private companies will enjoy the same treatment afforded to SOEs in terms of project verification and approval, financing, fiscal and tax policies, and land availability. The government will, in accordance with the law, provide equal protection to the property rights of entities under all forms of ownership and will ensure that infringements on the legitimate rights and interests of non-public sector enterprises and individuals are investigated and prosecuted.

In a word, China's economic development has its own path dependence. An analysis of the institutional innovation process of China's economic reform reveals that many aspects of China's economic reform cannot be verified and interpreted by classical western political and economic theories and practices. The adaptive rationality, the division of powers between the central government and the local governments, the encompassing government and the practical pragmatism contributes to the uniqueness and success of Chinese model.<sup>31</sup> As Professor ZHENG Yongnian commented, "[t]he most profound significance of China's reform and opening up lies in the exploration of the road of national development".<sup>32</sup> Therefore, the EU should respect China's independent development approach and abandon the political bias on the MES issue.

## Conclusion

By the end of 2015, the share of imports from China to the EU affected by AD measures is 1.38% in terms of value.<sup>33</sup> As

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news/2016/03/17/content\_281475309417987.htm; xx The 13th Five Year Plan for National Economic and Social Development of the People's Republic of China, retrieved 18 March 2016, [http://news.xinhuanet.com/politics/2016lh/2016-03/17/c\\_1118366322\\_6.htm](http://news.xinhuanet.com/politics/2016lh/2016-03/17/c_1118366322_6.htm). <sup>31</sup> Yao Yang, *Zuowei zhidu chuangxi guocheng de jingji gaige* [The economic reform as a process of institutional innovation], Gezhi chubanshe, Shanghai renmin chubanshe, 2008, pp. 1-15, pp. 238-245. <sup>32</sup> Zheng Yongnian, *Zhongguo moshi: Jingyan yu kunju* [Chinese model: experience and dilemma], Zhejiang chubanshe, Zhejiang renmin chubanshe, 2010, p. 3. <sup>33</sup> European Commission, "Change in the Methodology for Anti-Dumping Investigations Concerning China", p. 2.

one lawyer said, “[a]lthough it (anti-dumping) is an important factor for those companies involved in international trade investigations, we shouldn’t view our bilateral trade relationship only in respect of anti-dumping. 98 percent, 99 percent of the trade is never subject to anti-dumping.”<sup>34</sup> Given this, the proportion and the probability of exporters engaged in malpractices in international trade should not be exaggerated, and the role of trade defence instruments should not be over weighted.

In the jointly adopted China-EU 2020 Strategic Agenda for Cooperation, the EU had recognised that “it is critical to follow WTO rules when undertaking trade remedy investigations or imposing trade remedy measures to prevent their abuse,”<sup>35</sup> and in its new trade strategy, the EU also proposed that it “should do everything possible to restore the centrality of the WTO as a trade negotiation forum”.<sup>36</sup> Therefore, the EU should take practical action to convince its major trade partner of its support for the multilateral trade system. Rather than delaying the expiration of current method or exploiting the new alternative measures, the EU should make full use of the existing bilateral mechanisms to strengthen communication with China to find ways to avoid unfair trade, like building up the credit system for importers and exporters, enhancing the capacity of SMEs on fiscal management, and prevent the MES issue from becoming the stumbling block to EU-China trade and investment. ©

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<sup>34</sup> “China’s market economy status ‘political’: attorney”, China Daily, 23 January 2015, retrieved 6 March 2016, [http://usa.chinadaily.com.cn/world/2015-01/23/content\\_19386984\\_2.htm](http://usa.chinadaily.com.cn/world/2015-01/23/content_19386984_2.htm). <sup>35</sup> The China–EU 2020 Strategic Agenda For Cooperation, retrieved 3 March 2016, <http://ozs.mofcom.gov.cn/article/hzcg/201601/20160101233963.shtml>. <sup>36</sup> European Commission, Trade for All: Towards a More responsible Trade and Investment Policy, October 2015, retrieved 3 January 2016, [http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc\\_153846.pdf](http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf).



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