

The EU on granting China market economy status: a compromise or a dodge?

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China joined the World Trade Organisation (WTO) in 2001 as an economy which was undergoing transformation and did not yet have market economy status (MES). This enabled other WTO members, including the European Union, to be more flexible in imposing anti-dumping tariffs on Chinese exporters. China's accession protocol provides for the elimination of one of the anti-dumping procedures after 15 years, i.e. in December 2016. The upcoming changes have fuelled a dispute in Europe regarding the interpretation of the conditions of China's accession to the WTO and the future of trade relations between the EU and China.

For years, Beijing has opted for 'hard automatism'. In their official statements, Chinese leaders have pointed to the fact that the EU "needs to fulfil its promises" and emphasised the commitment to grant China market economy status, which they say was contained in the accession protocol. China has reacted negatively to the European Commission's stance (announced in July 2016) which provides for a comprehensive reconstruction of the procedures for imposing anti-dumping and anti-subsidy tariffs. The European Commission's activities were interpreted as a tactical dodge and an attempt to refuse to take the Chinese position into account. The announced change in the methodology of imposing tariffs was seen as a tool to maintain the *status quo* and as continued action to discriminate against Chinese producers on the EU market. Further actions by China depend on how quickly the changes announced by the Commission are to be implemented. If these are not approved by the European Parliament and the member states by December 2016, and the EU continues to apply the present regulations, China will likely take legal action at the WTO. At the same time, Beijing will try to influence the final shape of the new procedure for imposing anti-dumping tariffs by taking advantage of its contacts with EU institutions and specific member states.

The legal dispute: what does China's WTO accession protocol provide for?

When the conditions of China's accession to the WTO were being negotiated, China – as an economy undergoing transformation – was covered by modified rules for imposing anti-dumping tariffs for a period of 15 years. Article 15a of China's WTO accession protocol signed in 2001 provides for two types of procedure for setting the so-called normal price, which is the

basis for calculating the scale of dumping. According to the first type, prices used at the Chinese domestic market are considered the normal price, provided that the specific Chinese producer is able to prove that market economy conditions prevail in their industry. In this way, anti-dumping proceedings focused on a specific company are *de facto* carried out according to principles applicable to economies which have been granted MES. According to the second type, the importer may use the methodology in-

volving comparing the prices offered with prices used in third-country markets; this is possible when the producer is unable to prove that market economy conditions prevail in their industry.

The dispute over the interpretation of the provisions of China's WTO accession protocol concerns the legal basis for the EU's customs policy towards China.

Article 15d of the accession protocol states that on 11 December 2016 the second type of procedure, involving comparison with third countries, is to be automatically and unconditionally revoked. However, Article 15d does not refer directly to the issue of granting market economy status on that day. This is to be done when a specific WTO member state establishes that China meets its definition of a market economy¹. If MES is granted, Article 15a will cease to apply, the special treatment of China will be discontinued, and China's position will become equal to that of the remaining WTO members.

The potential automatism in granting China market economy status, associated with the provisions of Article 15d, has become a bone of contention among the participants in the debate. According to some lawyers, no commitment to treat Chinese entrepreneurs after December 2016 as equal partners, similar to entities from any market economy, has been formulated. The only effect of the expiration of the disputed provision would involve offering the importing country an opportunity to freely choose one of the methodologies: either the domestic price methodology or the methodology of third-country prices, in case Chinese producers fail to prove that market economy conditions prevail in their industry.

¹ In light of the definitions adopted by the European Union during the recent verification procedure carried out in 2011, China failed to meet four out of the five main EU's criteria of a market economy.

On the other hand, supporters of automatism point to the fact that even if Article 15d does not contain any commitment to grant MES to China *de iure* in December 2016, it fully revokes the procedure based on methodologies applied to non-market economies. As a consequence, the importing country can only take advantage of the methodology based on Chinese prices, which in turn would be tantamount to *de facto* granting MES to China regardless of whether it meets the criterion of a market economy as defined according to local standards.

The economic consequences of granting MES to China

If the provisions of China's WTO accession protocol were implemented in line with China's expectations, this would be tantamount to abandoning the main tool used to protect European producers operating in those industries which are unable to compete with Chinese producers due to the Chinese state's control of the prices of land, capital and energy. The main argument put forward by European opponents of granting MES to China involves the potential weakening of the competitiveness of producers from EU countries resulting from the potential lowering of prices of Chinese goods, which in turn would raise the unemployment rate. The level of damage depends on the economic models used to prepare the forecasts, and on the estimates regarding those industry sectors which are potentially at risk. Due to major difficulties in forecasting the structural changes to trade which would result from the fact of granting MES to China, the adopted assumptions and the final calculations frequently depend on the views of the institution which prepares them. Figures quoted by industry associations, trade unions and states which oppose the plan to grant MES to China are usually several times higher than the figures provided by the European Commission.

According to the report by the Economic Policy Institute (EPI), an organisation associated with American trade unions, which has most frequently been quoted by the media and in parliamentary debates, the granting of MES to China could directly cause 1.7-3.5 million jobs in the EU to be lost². These calculations seem to significantly overestimate the potential losses that the EU economy may suffer.

A change in the method of imposing anti-dumping tariffs on Chinese companies would reduce the competitiveness of those sectors of the EU economy which in previous years had taken advantage of protective instruments.

The key drawback is that they do not take into account the historical trends regarding anti-dumping procedures which the EU has used towards Chinese producers over the last 15 years. In particular, these overestimates concern those sectors which the EPI has defined as the most risky, i.e. the clothing and textile industry, and the production of furniture and electronics, which were subject to anti-dumping proceedings only occasionally³.

It should be expected that the change in the procedure for imposing anti-dumping tariffs scheduled for 11 December 2016 will mostly affect those sectors which have applied this tool so far. The repetitive nature of these cases over the last 15 years and the dominance of

the chemical and metallurgical industries suggest that if China is granted MES, this would put certain sectors at risk, which in turn would limit the scope of potential losses for specific EU economies⁴.

Even though the risk involved in granting China MES is of a sector-specific nature, it will significantly affect the situation of those sectors in the EU which have been covered by protective tariffs. According to estimates by the European Commission, at present around 1.38% of imports from China are subject to anti-dumping procedure; however, when the solar panel sector is excluded, the figure is a mere 0.68%. In the long term, abolition of the present rules for imposing anti-dumping tariffs may cause around 63,000 to 211,000 jobs in the 52 goods categories covered by this tariff to disappear⁵. The possible consequences will be borne by specific EU member states in different proportions, depending on the geographical distribution of industry sectors at risk. According to the European Commission, 79% of the jobs which potentially are at risk of being closed down are in Italy, Germany, Spain, France, Portugal and Poland⁶. These states operate those EU industry sectors which are covered by the widest scope of anti-dumping tariffs, namely the metallurgical, ceramic and textile industries. It cannot be excluded that in the future Chinese companies operating in new industries which the Chinese leadership defines as industries of key importance will offer excessively low prices for

² The figures are based on the assumption that granting China MES will cause a 30% drop in the prices of Chinese products in all sectors of imports from China, which will dramatically boost the competitiveness of these imports, thereby increasing their volume and value. This is expected to cause around 800,000-1,500,000 jobs to disappear in the EU's production sectors, with the textile, electronic, furniture and metallurgical sectors being hardest hit. Multiplier effects are then added to these figures.

³ At present, anti-dumping tariffs have been imposed on synthetic fibres, which belong to the category of textiles and account for a mere fraction of total imports from China in this goods category.

⁴ In 2001-2016, 103 anti-dumping procedures were carried out against Chinese producers (around 45% of all proceedings by the European Commission), of which 80 resulted in additional tariffs being imposed. What is important, over half of the tariffs concerned the metallurgical (24 cases) and chemical sectors (20 cases). The remaining proceedings concerned selected categories of goods including photovoltaic panels and glass, ceramics, bicycles, glass and polyester fibres, strawberries and saddles.

⁵ The research was conducted in February 2016. The estimated number of jobs lost has been calculated taking into account that no other protective measures have been taken and that certain intra-sector flows have taken place.

⁶ Italy – 66,200, Germany – 55,800, Spain – 27,100, France – 12,900, Poland – 11,000. Source: http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154241.pdf

goods sold on the EU market, resulting from a privileged access to resources granted by the government⁷. The significant dumping risk also concerns those sectors in China which at present are struggling with excess production capacity, for example the steel production sector.

China's stance

For years, Chinese leaders have emphasised the need to recognise China *de iure* as a market economy in their contacts with the EU. This was particularly evident during the rule of President Hu Jintao (2002-2012). However, after four failed verification procedures launched pursuant to EU law in 2004-2011, China has abandoned its attempts to obtain this status under a formal procedure.

The Chinese tactic involves abandoning attempts to obtain the formal status of a market economy, and instead emphasising the real dimension of the dispute over the abolition of the disputed methodology of imposing tariffs.

In 2011, Prime Minister Wen Jiabao presented the EU with a proposed political solution: MES was to be granted to China in exchange for China's assistance to Europe as it became affected by the debt crisis. Under the rule of Xi Jinping, China has toughened its stance, and announced in 2015 that it would take legal action at the WTO aimed against members which refuse to offer equal treatment to Chinese exporters after December 2016. At the same time, the Chinese media has maintained its narrative calling for "promises to be kept", and for China's positive role in the development of the global economy to be acknowledged by granting it MES.

Over 2016, China's official stance has evolved. China began to separate the issues of granting it *de iure* MES and enforcing Article 15d of China's WTO accession protocol. At present, Chinese leaders are expressing a 'hard automatism' concerning the heart of the matter, which involves revoking the methodology based on comparing Chinese export prices with third-country prices and treating Chinese entrepreneurs on equal terms to those from market economies. The Chinese leadership seem to be aware that in its present shape the Chinese economy does not meet the basic market economy criteria as defined by the EU. This is indirectly confirmed by the Chinese reform agenda, which gives priority to reducing the excessive influence of the state on the economy.

The change in China's stance should be treated as a response to the dynamics of the debate within the EU. The toughest opponents of the idea to abolish limitations regarding Chinese imports have begun to challenge not only the automatism of granting China MES *de iure*, but also the very commitment to abolish the disputed anti-dumping methodology scheduled in Article 15d of China's WTO accession protocol. For example, this stance was included in the European Parliament's resolution of May 2016, which China heavily criticised. The Chinese foreign minister Wang Yi said that abolishing the methodology based on third-country price comparison is an unconditionally valid commitment by the EU contained in the treaty and resulting from WTO rules. In his opinion, it is also fully independent of the EU's internal standards regarding the granting of MES⁸. In his view, *de iure* granting MES would merely be a significant gesture intended to symbolise mutual trust and the fact the EU recognises China's positive role in global trade⁹. A similar stance was adopted during the EU-China summit in Beijing in July 2016; according to the European Commission

⁷ This has happened in the past, for example in 2012 as regards photovoltaic panels. This resulted in duties being imposed, which in turn triggered political tension between the EU and China.

⁸ http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1364322.shtml

⁹ http://news.xinhuanet.com/english/2016-07/20/c_135527339.htm

Vice-President Jyrka Katainen, China did not emphasise the issue of granting it MES itself, and instead focused on revoking the disputed methodology¹⁰.

As regards the issue of China's production surplus and its intention to sell the excess goods on foreign markets, which is nowadays the main cause of trade disputes between the EU and China, Beijing does not currently seem ready to make concessions. In its official statements China's trade ministry has deemed the accusations made towards China concerning government-induced overcapacity, for example in the steel market, to be false and identified the problems this sector faces as a consequence of the global supply slump¹¹. According to the ministry, these issues should in no way be associated with granting China MES¹².

Some Chinese experts seem aware of the potential tensions within the EU concerning excess production, and have become more inclined to compromise. According to Shi Zhiqin, an expert at the Carnegie Center at Tsinghua University, in China the problem of excess steel production, which poses a threat to European producers, is important albeit temporary. He proposes to cover the sectors which are particularly threatened with a temporary agreement to protect the EU market¹³. Usually, however, concessions which Chinese experts propose towards the EU relate to a more comprehensive process of making the Chinese economy a market economy (which is anyway the aim of the internal reforms), which involves increasing the access to the internal market of public procurement, protecting intellectual property and reducing subsidies, with no sectors specified¹⁴.

¹⁰ <http://ec.europa.eu/avservices/video/player.cfm?ref=1124948>

¹¹ http://www.chinadaily.com.cn/business/2016-07/18/content_26122977.htm

¹² http://news.xinhuanet.com/fortune/2016-07/23/c_129171831.htm

¹³ <http://carnegietsinghua.org/2016/03/15/china-eu-relations-crisis-and-opportunity/iv8f>

¹⁴ http://www.ecfr.eu/article/commentary_chinas_coming_battle_for_market_economy_status_7052

The European Commission's gambit

The EU's official stance on granting MES to China, as presented by the European Commission on 20 July 2016, reflects Europe's intention to avoid open conflict with China by way of reconstructing the instruments the EU applies to impose anti-dumping tariffs. At the same time, it satisfies the demands voiced by the main stakeholders within the EU who oppose the abolition of limitations on imports from China.

The European metallurgical industry has been the strongest opponent of liberalising trade with China. However, Chinese leaders are not inclined to compromise and do not intend to limit the export of steel products.

The Commission has announced that it is closing the debate on granting MES to China by removing the very term of market economy status from EU legislation¹⁵. This is tantamount to eliminating the division into states which have MES and those which do not. China has repeatedly referred to this division as discriminatory. The new system, which Cecilia Malmström, the European Trade Commissioner, referred to as "neutral", is intended to contain a brand new mechanism to protect the EU market which would comprise all WTO member states. The new anti-dumping rules are intended to guarantee at least the same level of protection as the one offered so far, and in addition the anti-subsidy tariff mechanism is to be improved. A new methodology will be devised, based on comparisons with international prices, to be used against those entrepreneurs who take advantage of state assistance. All the present protective tariffs are to be maintained, and the procedures

¹⁵ Press conference by European Commission representatives on 20 July 2016, <http://ec.europa.eu/avservices/video/player.cfm?ref=1124948>

which have been launched are to be completed according to the old rules. The final shape of the new regulations needs to be approved by the governments of the 28 member states, including tariff procedures liberalization's strongest opponent Italy, and by the European Parliament.

Statements by members of the Chinese government indicate that if the EU decides to maintain the status quo, this would likely lead to China taking legal action in the WTO forum.

The approach proposed by the European Commission is intended to remove the source of the symbolic conflict with China – *de iure* MES. At the same time, recognition of Article 15d and the announcement of 'neutral' methodologies are intended as a response to China's demands to meet international legal commitments and its announcement regarding the legal action at the WTO¹⁶. However, the question of the real dimension of the dispute, i.e. the level of tariffs to be imposed on Chinese products in the future, remains open, and depends on the specific legislative proposals which the European Commission is to present in the upcoming months.

China's possible response

Reactions in the Chinese media to the EU's plan involving the reform of procedure for imposing protective tariffs suggest that the proposal put forward by the European Commission is being seen as a tactical dodge which will not lead to China achieving its goals. Admittedly, the first official press release by the Xinhua agency did contain a passage that the removal of the debate over MES, which is "of no particular

¹⁶ Representatives of the European Commission did not specify the details of how the disputed provision will be interpreted after 11 December. This was criticised by Chinese experts.

importance", from the China-EU agenda was a positive step, but the announced creation of a new, "non-standard" methodology for tariff calculation has sparked controversy. If this will involve the calculation of the normal price based on international prices, as the announcement suggests, the planned reform may involve a mere change of the name or the scope of the instrument used against China. Some experts highlight that the new regulations may be inconsistent with WTO rules, which in turn may encourage China to take legal action against the EU despite the announced reform of protective instruments¹⁷.

Most publications contained an accusation towards the European Commission regarding its vague presentation of its stance towards the subject matter, that is, the abolition of the methodology of third-country price comparison. The publications emphasised that the Commission's announced obligation to meet "international commitments" does not guarantee that a stance favourable to China as regards Article 15d of the accession protocol will be adopted¹⁸. The EU has identified its "real commitment" not as formal amendments, but as real and equal treatment of Chinese exporters according to the rules applicable to entrepreneurs from other WTO member states. According to an expert quoted by the *Renmin Ribao* daily, the proposal put forward by the European Commission contains several unclear passages regarding the future status of Chinese entrepreneurs in the new anti-dumping procedure, whereas the plan to maintain the present tariff level would be tantamount to a continuation of protectionist practices¹⁹.

The Chinese authorities' reaction to the EU's actions largely depends on the pace at which the

¹⁷ http://news.xinhuanet.com/fortune/2016-07/23/c_129171831.htm

¹⁸ <http://world.people.com.cn/n1/2016/0723/c1002-28579254.html>

¹⁹ <http://world.people.com.cn/n1/2016/0725/c1002-28583427.html>

announced changes in the procedures for imposing tariffs are introduced. Chinese experts highlight the fact that the remaining months may prove insufficient to convince the European Parliament and the member states to approve the new regulations. In this context, the decision by the United Kingdom (the strongest supporter of free trade) to leave the EU has been considered a factor which will facilitate the Commission's task. However, if the EU does not manage to reform its anti-dumping instruments by December 2016 and continues to apply the methodology described in Article 15a, China will take legal action against the EU under a WTO²⁰ procedure.

The very process of formulating the final wording of the EU regulations regarding protective tariffs will undoubtedly take up China's attention in the upcoming months. Chinese diplomats will most likely try to influence the EU's decision-making process by lobbying EU institutions and using bilateral contacts with specific states. The stance adopted by the Chinese government and Chinese experts suggests that they are determined to gain significant concessions in the field of the economy. Their tough stance as regards limiting the volume of exports in those Chinese sectors which have a production overcapacity indicates that the potential for compromise in this field is limited.

²⁰ Due to the complexity of the procedures and to the importance of the negotiations between the parties, the potential results of the arbitration may become evident only several years after the case has been filed. The issue of the European Commission using the wrong methodology to calculate the tariffs for the import of metal goods from China has been the subject of WTO arbitration before; in 2015, six years after filing the case, China won, which forced the EU to lift the tariffs.

APPENDIX

Market economy status (MES)

Market economy status determines the procedure of introducing anti-dumping tariffs targeting exporters from World Trade Organisation (WTO) member states. In the context of WTO regulations, dumping involves the producer setting the prices of exported products at a level which is lower than that of the prices of goods sold on the domestic market. For an anti-dumping procedure to be carried out, a so-called normal price needs to be set. Then, the price of a product which is to be imported is compared with this normal price. If the price of the imported product is lower than the normal price, a so-called dumping margin arises, which causes a relevant anti-dumping tariff to be imposed on the exporter.

In the case of states which have MES, the basis for comparison is the prices applied on their domestic markets. For non-market economies (NME), it is assumed that domestic prices are administratively regulated, which makes it impossible to use them as a credible basis for calculating the scale of dumping. This means that if an anti-dumping procedure is launched against an NME, then the normal price is set not on the basis of the prices used on the domestic market, but according to other methodologies, for example by comparing the prices with prices applied on third-country markets.

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