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Legal issues related to the recognition of market economy status of China

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Section 15 of Protocol for the China's accession to World Trade Organization (WTO) leaves to each member of the organization to decide whether or not China's economy can be regarded as a market economy. This choice must be made according to the legislation of each WTO's member (since, in the regulation of WTO, there is not a precise definition of "non market economy").

The European Union has included in its anti-dumping regulation (Regulation (CE) n. 1225/2009) the five criteria on the basis of which the EU evaluates whether a third country may be granted the status of market economy.

- *Low degree of government influence over the allocation of resources and decisions of enterprises, whether directly or indirectly (e.g. public*

bodies), for example through the use of state-fixed prices, or discrimination in the tax, trade or currency regimes.

- *Absence of state-induced distortions in the operation of enterprises linked to privatization and the use of non-market trading or compensation system.*
- *Existence and implementation of a transparent and non-discriminatory company law (application of international accounting standards, protection of shareholders, public availability of accurate company information).*
- *Existence and implementation of a coherent, effective, and transparent set of laws, which ensure the respect of property rights and the operation of a functioning bankruptcy regime.*
- *Existence of a genuine financial sector, which operates independently from the state and which in law and practice, is subject to sufficient guarantee provisions and adequate supervision.*

Since 2003, China has asked the European Union for recognition of the status of market economy. In response to this request, the European Commission has published an assessment report about the Chinese economy, in which the only criteria satisfied is the criteria in paragraph 2 related to the absence of state-induced distortions in the operation of enterprises linked to privatization and the use of non-market trading or compensation system. With regards to the satisfaction of the other criteria, the European Commission expressed a negative opinion, although European Commission admitted that China made progress in the processes of economy liberalization.

This assessment was confirmed by subsequent reports of the European Commission, which have consistently ruled out the possibility of granting China the status of market economy, since it has not yet satisfied the five criteria of European Union (the last evaluation report about Chinese economy by the European Union was published in 2008).

The recognition of market economy status would have a direct impact on the anti-dumping procedures practiced by the European Union towards China (dumping occurs when a product is exported at a price lower than price normally applied in the internal market, i.e. its “normal value”, causing damage – because of unfair competition – to the businesses in the importing Country).

In fact, the WTO members that have not recognized China’s market economy status, instead of using the Chinese domestic prices or costs to assess the dumping margin, may use other methods to determine the price comparability.

In particular, Article 2 of European Regulation (CE) n. 1225/2009, states that *“in the case of products imported from countries that are not governed by a market economy, the normal value is determined on the basis of the price or value built in a third country having market economy or the price for export from that third country to other countries”.*

The so-called method of “analogue country” (or “reference country”) adopted by the European Union allows the present European Union’s

anti-dumping procedures related to products imported from China, to use the prices of a third analogue country, that are usually higher than Chinese prices, and therefore allows European Union to apply anti-dumping correction tariff margins higher than those would be charged if domestic Chinese prices were considered.

The Chinese government supports the argument that Section 15 of the Protocol provides for a deadline (11th December 2016, i.e. 15 years after China entered in WTO), beyond which the WTO members are obliged to abandon the analogue country method, adopted in anti-dumping procedures related to products imported from China.

The different positions regarding the automatic abolition of this method in anti-dumping procedures are related to the interpretation of Section 15 of the Protocol that is provided below:

Section 15 – Comparability of prices in the determination of dumping and subsidy

- *a) In determining price comparability under Art. 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*

(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 the manufacture, production, and sale of that product.
(B) In proceedings under Parts II, III, and V of the SC In proceedings under Parts II, III and V of the SCM Agreement, when addressing subsidies described in Art. 14(a), 14(b), 14(c) and 14(d), relevant provisions of the SCM Agreement shall apply; however, if there are special difficulties in that application, the importing WTO Member may then use methodologies for identifying and measuring the subsidy benefit which take into account the possibility that prevailing terms and conditions in China may not always be available as appropriate benchmarks. In applying such methodologies, where practicable, the importing WTO Member should adjust such prevailing terms and conditions before considering the use of terms and conditions prevailing outside China.

(C) The importing WTO Member shall notify methodologies used in accordance with subparagraph (a) to the Committee on Anti-Dumping Practices and shall notify methodologies used in accordance with subparagraph (b) to the Committee on Subsidies and Countervailing Measures.

(D) Once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of subparagraph (a) shall be terminated provided that the importing Member's national law contains market economy criteria as of the date of accession. In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession. In addition, should China establish, pursuant to the national law of the importing WTO Member, that market economy conditions prevail in a particular industry or sector, the non-market economy provisions of subparagraph (a) shall no longer apply to that industry or sector.

Therefore, in accordance with paragraph (d), after 15 years from the date of accession of China, the provisions of sub-paragraph (a) (ii) authorizing the WTO members to use alternative methods for determining price comparability (i.e. methods not based on strict comparison with Chinese domestic prices or costs) will no longer be valid in the event that the Chinese producers under anti-dumping investigation can not clearly prove the prevalence of market conditions.

The argument of those who support the possibility of continuing to use the same method for the country even after 11th December, 2016 is based on the assumption that, first, paragraph (d) only provides for the forfeiture of sub-paragraph (a) (ii) and, second, the residual provisions of paragraph (a) allow WTO members to continue using alternative methodologies related to price comparability, even after the expiration of 15 years from the date of China's accession to WTO .

In fact, the introductory part of paragraph (a) provides for the possibility of using a methodology for comparability of prices that are not based on a strict comparison with domestic prices or costs in China, on the basis of the rules written in the two sub paragraphs, while in sub paragraph (a) (the) – for which there is not explicit expiration after 11 December, 2016 – excludes this possibility only in the case where producers under anti-dumping investigation can clearly show that market economy conditions prevail in their industry.

So, according to this opinion, the expiration of sub-paragraph (a) (ii) alone would not remove the burden on Chinese enterprises to demonstrate that market economy conditions prevail in their sector.

Another possible interpretation is that the expiration of sub paragraph (a) (ii) would lead to a reversal of the burden of proof: while the Chinese companies currently have to prove the prevailing of market economy conditions in their sector, after 11th December, 2016 the authorities of the importing countries will need to prove that the Chinese companies do not operate under market conditions.

The European Commission has not yet taken an official position on the so-called automatic abolition of alternative methods in anti-dumping procedures and there are different orientations between the member states of the European Union and specialized doctrine.

The authorities of the European Union have commissioned an

assessment about the impact of its decision on the European Union's economy in order to decide between different options, including the possibility of changing its regulations related to anti dumping in order to minimize the impact on European companies, even if the analogous country's method will be abandoned. The European Commission has already taken the first step in this direction with the introduction of faster and more effective procedures in the adoption of anti-dumping measures in the steel sector.

There are, therefore, the following possible scenarios depending on the different possible decisions of the European Commission.

- *a. The European Union denies the automatic abolition of alternative methodologies in anti-dumping procedures*

In this case, China would continue to be treated as a non market economy, even after 11th December, 2016 and the European Union would continue to apply alternative methods in anti-dumping procedures (in particular, the method of "analogous country").
This scenario certainly would see the opposition of China who could appeal to the WTO, requesting a decision about this. In any case, it is a solution that could generate tension in the political relations between China and the European Union, and could push China to review its investment projects in Europe.

- *The European Union continues to apply alternative methodologies in anti-dumping procedures, but only for particular sectors*

According to this interpretation, paragraph (d) of Section 15 of the Protocol entails, after 15 years from the date of China's accession to the WTO, the expiration of sub-paragraph (a) (ii), but the residual provisions of paragraph (a) would allow WTO members to use alternative methods in anti-dumping procedures in some industries that have a clear distortion of prices compared to the market prices (for example, steel, bicycles, solar panels).

The European Union could adopt for China, and with regard to these particular industries, a methodology of "costs adjustment" similar to that used for the calculation of dumping margins on certain products imported from Russia, Argentina and Indonesia (these countries, however, criticize the use of this methodology).

This would involve the need for the European Union to change its regulations on anti-dumping, but would allow European Union to continue to apply alternative methodologies for the assessment of the dumping margin for the most critical industries.

- *The European Union accepts the automatic abolition of alternative methodologies in anti-dumping procedures*

This is the perspective advocated by China and is based on the assumption that, under Section 15 of the Protocol, after 11th December, 2016, the WTO members are automatically forced to abandon alternative

methodologies in anti-dumping procedures.

This scenario would entail that it will be impossible for the European Union to derogate from the normal methods contained in Article VI of the GATT in order to determine the comparability of prices, and therefore the European Union will need to consider Chinese domestic prices and costs in anti-dumping procedures (abandoning the method of analogue country).

According to important studies, if China is treated like any other WTO member with a market economy, there will be a drop of around 30% of anti-dumping duties applied to China, resulting in a higher competitiveness of its products in the European market.

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