

China, the EU and ‘market economy status’: what happens now?

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Summary

Yesterday marked the deadline to solve the issue of China’s market economy status (MES) and yet nothing has changed in the EU rulebook. However, a reform package is on its way and will probably be agreed at some point in 2017. In the meantime, the EU will likely carry on as usual in anti-dumping investigations. The main takeaway from the MES debate is not the new methodology put forward by the European Commission though, since it is already expected to result in a similar treatment of Chinese imports. It is the revival of the long-delayed reform of the broader trade defence system. This reform, which could not have been possible without the sense of urgency created by the MES debate nor without diminishing UK influence in Brussels due to Brexit, could chart a new course for the EU trade defence system.

Yesterday marked the 15th anniversary of China’s accession to the World Trade Organisation (WTO). The date matters, because of an often-overlooked commitment in China’s WTO accession agreement. This is the apparent commitment by WTO members, such as the EU and the US, to cease treating China as a non-market economy in certain technical but important ways at the latest fifteen years after its accession. What exactly that commitment should mean has been the subject of a bitter debate in the EU over the last year. As the deadline passes, how will the EU interpret its obligations? How will China? And why do the answers matter to anyone who imports goods from China?

Sidestepping the MES issue

When China joined the WTO in 2001, other WTO members argued that its economy and markets remained irremediably distorted by state intervention and unreliable accounting practices. For this reason, they required that it accept that until such time as they judged individually that it had moved beyond this ‘non-market economy’ status, WTO members would be able to discriminate against its exports in the narrow area of ‘trade defence’. What this means in practice is that when WTO states such as the EU and the US conduct investigations into whether Chinese firms are exporting goods below their true cost of production, either via predatory pricing or as a result of distorted costs of production, they reserve the right not to use actual data from China in modelling costs

and prices. However, Beijing insisted on a backstop to this right: that it would lapse after fifteen years.

Over the last year, this has provoked particular debate in the EU, which is the only one of China’s large trading partners that has seriously entertained the idea of declaring China a market economy. This is in part because of a feature of EU rules, which set out how it might use data from other sources and other “analogue” countries when conducting anti-dumping investigations against ‘non-market’ economies. The current rules require that it must cease doing this once the EU has granted a state ‘Market Economy Status’ (MES). Ergo, Beijing argues, to meet its WTO obligations the EU must now do this.

This puts Brussels in a methodological and political bind. It awards MES on the basis of five tests of the basic transparency of prices in a market economy. It has never suggested China has even come close to passing those tests. MES judgements have been fudged in the past - think Russia in 2004 - but there is no political will among EU member states or in the Commission to fudge this one. More importantly, MES only matters in terms of the EU’s WTO commitment to the extent that it forces the EU to change the way it conducts anti-dumping cases and to scrap the use of analogue country data for China, which is what Beijing really wants. But there is strong political resistance among less liberal-minded states and exposed sectors in the EU to doing this, as it will almost certainly mean lower duties on dumped Chinese imports.

The European Commission's answer is to side-step the issue and put forward a proposal for a new anti-dumping methodology on 9th November. The proposal suggests deleting references to market and non-market economies in EU law altogether. Instead it proposes a methodology that would apply to imports of any WTO country where significant market distortions such as state intervention in prices are observed, regardless of how that country's economy is run. (see Table 1)

Where such features are found, the proposal argues that the EU investigators should be able to discard price data from the exporting country's market and instead resort to using international prices or costs, or even data from a "representative" country with a similar level of economic development (under the current 'analogue country' methodology, any market economy third country can be chosen). An impact assessment conducted by the Commission on the potential effect of its new methodology has been prepared to reassure EU producers that the new system would - in principle - produce outcomes on Chinese goods broadly similar to the status quo. (Figure 1)

Beijing can be expected to challenge any such revised system in the WTO, and the EU has been criticised and successfully challenged in the WTO for using similar approaches over recent years. But it does remove any explicit suggestion of discrimination against China, or any sense in which the EU defines China as 'not a market economy'. In theory, it will leave the EU broadly able to carry on using non-Chinese data on Chinese exports, at least for now, but one should not underestimate the influence that China will bring to bear informally to limit this, or the possibility that the whole approach does not survive a WTO challenge. Nevertheless, there is a real sense in which these

Table 1: Market distortion criteria

Criteria to use, inter alia, to identify market distortions:
<ul style="list-style-type: none"> ▪ Reported prices or costs, including the costs of raw materials, are not the result of free market forces as they are affected by government intervention. ▪ State presence in firms allowing the state to interfere with respect to prices or costs. ▪ Public policies or measures discriminating in favour of domestic suppliers or otherwise influencing free market forces. ▪ Access to finance granted by institutions implementing public policy objectives.

various changes may net out to limited change in the short-term.

Trade defence instruments (TDI) reform redux

The more important issue may lie in what the European Commission is proposing in parallel to scrapping the analogue country test. It has resurrected a set of proposals, initially tabled in 2008 and then refined in 2013, designed to reform the EU's anti-dumping system.

These would add an element of new transparency, by mandating greater publication of investigative documents. They would introduce a so-called 'shipping clause' that would oblige the Commission to warn importers ahead of time of any forthcoming imposition of duties. The reforms would also give the Commission power to initiate trade defence cases on its own, instead of waiting to be triggered into action by petitions filed by EU industries. This has long been a demand of producer interests concerned about retaliation from Beijing or unable to produce a sufficiently large industry coalition to meet investigation thresholds. There is no doubt that this has the potential to increase the number of investigations conducted by the EU, although, Commission resources are finite.

The most significant aspect of the reform would be the removal of the 'lesser-duty rule' (LDR) which requires the Commission to impose duties on dumped imports at the smallest of the dumping margin or the injury margin (injury caused to EU industries by the imports under investigation). As the former is routinely found to be higher, removing the LDR is widely expected to bring higher duties. This is one of the key distinctions in the way the EU and the US conduct anti-dumping cases. However, in the face of resistance from importers the Commission has suggested that the LDR should be lifted for imports of raw materials only. This greatly limits the scope of application, but could satisfy member states on both sides of the divide for now.

Finally, the wider process has been a reminder of how EU trade defence policy is likely to change with the UK outside the EU. London has long been by far both the most important advocate of granting China MES and opponent of making the EU trade defence system more aggressive. The UK tends to see trade defence measures as protectionist tools whose end result is to increase the cost of imported goods for consumers and downstream industries. On a case by case basis, the UK has always put pressure on the Commission to depress dumping margins and consequent duties - or not to impose duties at all. The ongoing British charm offensive with the Chinese

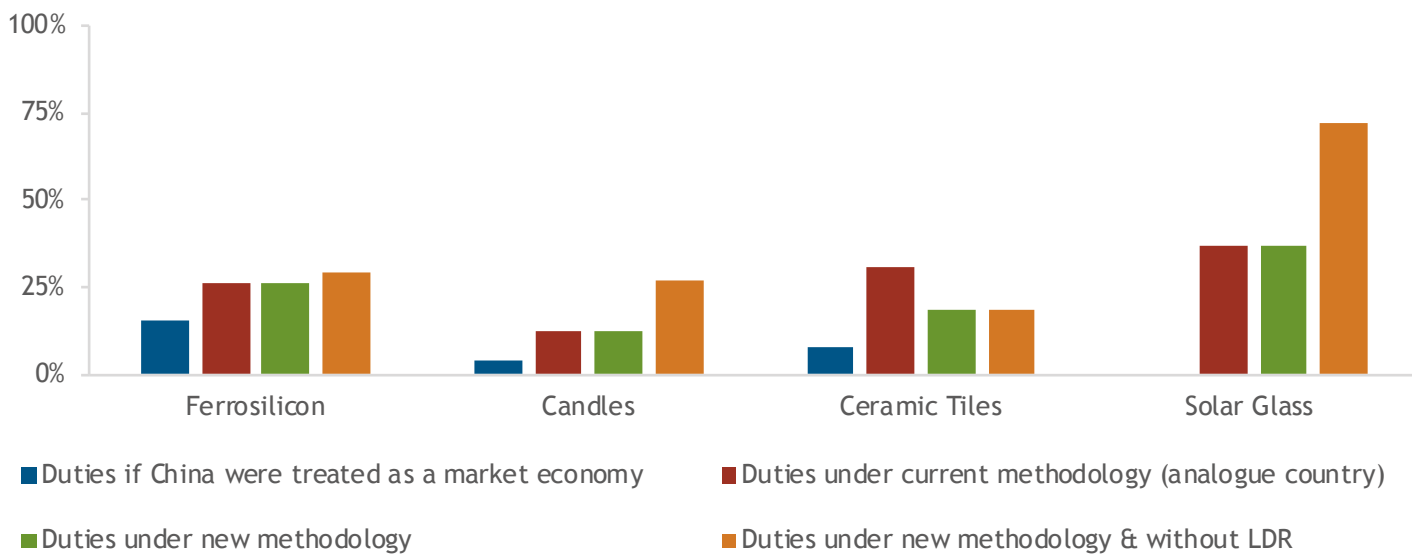


Figure 1: Current EU anti-dumping tariffs on select Chinese imports: 4 scenarios

Source: European Commission

has made London even more inclined to block any reform strengthening EU trade defence. But a telling sign of London's now fading influence in Brussels is the removal in the new reform package of provisions on the Community interest test – a tool initially pushed into EU rules by the UK to waive application of anti-dumping duties when it would be against the wider interest of EU consumers and the EU economy.

What all this means is that the balance of power in Brussels is shifting towards protection-minded member states and a third time lucky on TDI reform. London's ability to maintain a coalition in 2013 against serious toughening of the EU's approach to trade defence is unlikely to be repeated with these proposals. As in 2013, a strong majority in the European Parliament favours a tougher stance on trade defence issues, and Berlin is likely to back a consensus package. So an agreement between the Council and the Parliament can now be envisaged in a way that proved difficult three years ago.

What this means

So what does all this mean for importers? The material question is not actually whether MES is granted today or not, but what happens in anti-dumping cases. The EU trade rulebook will not formally change before some time in 2017, irrespective of today's deadline. Excluding the highly unlikely option that the EU would simply put on hold all anti-dumping cases – because this would prove too damaging to sensitive EU industries – there are two possible routes.

The first one consists of maintaining the status quo until adoption of the new antidumping methodology at some point in 2017. This implies continued application of the rules currently on the EU book,

including the analogue country methodology, in all cases. There is obviously a risk that China will challenge all these measures at the WTO, but the EU strategy here would rely on timing: by the time any dispute has been fully adjudicated by the WTO, the EU will have had sufficient time to adopt its new methodology and claim it is compliant. In the meantime, a high level of anti-dumping duties will have been maintained on Chinese imports – and any challenge of these duties at the WTO would simply later lead to an investigative review applying the new methodology. This makes this approach likely to be strongly supported by EU industries. It would, however, almost certainly mean retaliation by Beijing, notably through increased trade defence measures against EU imports in China - targeted as always at products like French wine which Beijing knows will be disproportionately sensitive in Europe.

The second route involves renouncing the analogue country methodology in all investigations until the EU rulebook has been amended with the new anti-dumping methodology. Imports of Chinese goods would be evaluated under the same conditions and methods as goods from market economy countries, even though these are more lenient. Such a route would please China and avoid facing litigation at the WTO (unless or until the new EU methodology is adopted and implemented), while also potentially speeding up adoption of the reform package by the Council and Parliament, but it would mean lower anti-dumping duties on Chinese imports for as long as the new methodology is not in place: something EU industry lobbies will fiercely resist.

Whatever happens to the EU analogue country test over the weeks ahead, the EU will almost certainly be back at the drawing board on the new “representative country” methodology following

successful litigation from the Chinese at the WTO a few years from now. In sum: this question is far from settled. This obviously adds an element of uncertainty for EU producers invested in the trade defence system. However, with the Trump administration in the US almost certain to ramp up trade defence action against China, the pressure for the EU to be 'more American' in its approach to anti-dumping is certain to increase, especially if US measures start deflecting China-US trade flows into the EU market. With the UK on the way out, a new element of policy flexibility in Brussels and the mood on Chinese competition arguably hardening, there is a material prospect of both more cases against China and higher duties. Not the anniversary present Beijing was after.

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