

Chasing a ghost: China and market economy status

By François Godement

The media and the public tend to treat the question of “market economy status” for China as more important than it is. In fact, market economy status (MES) is an empty shell. The World Trade Organization (WTO) does not even use the term. It is a purely political issue, even if some WTO members have legislated on it, using varying criteria.

What actually matters is whether the European Union will continue to use non-standard criteria to identify and sanction cases of Chinese “dumping” – i.e., when exports are sold at below cost price, or below the domestic price. China’s WTO accession protocol sets out the “surrogate country” method that WTO members can use against China. It allows countries to identify unfairly low prices by comparing export prices to domestic prices in comparable economies, as China’s domestic prices may themselves be artificially low.

The EU faces an impending deadline on 11 December, when this provision expires. It has to decide whether these non-standard criteria can still apply, whether it can legitimately apply other special provisions to Chinese exports, or whether China should join the ranks of the WTO’s market economies and be treated according to the same criteria.

In contrast to most other WTO members, anti-dumping rules are a legislative process in the EU rather than an administrative process. Yet, even for Europe, MES remains a political decision first, with a major media impact. The issue of cheap steel exports in particular is currently causing political and social tension. Although Beijing maintains that only 14 percent of EU steel imports are Chinese, the rise in volume in the last two years has been enormous. China has turned down many opportunities for high-level economic dialogue, instead insisting on sticking to the letter of the WTO agreement, as Beijing understands it. In the words of one EU official, “China has not helped us to help it”.

Europe is torn between the wish to attract Chinese investment and enjoy low Chinese prices, and fear of the job losses that softening its anti-dumping measures would bring. There is debate even within the countries

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that would likely suffer the highest proportion of job losses. Italy, for instance, is officially opposed to granting MES, but some officials and members of the country's business community voice different opinions, influenced by the fact that the country was the top European destination of Chinese investment in 2015, with the acquisition of Pirelli.

Because Europe's trade defences are exceptionally weak, some propose introducing new trade defence instruments (TDIs). But there are also deep divisions between member states on this issue. Some see TDIs as a much-needed defence for European industry, while others see them as outdated protectionism and prefer the path of cheap imports, services, and finance. Ultimately, Germany is likely to play a decisive role. It had cautiously welcomed the granting of MES, but Berlin's position has undergone a shift in recent months, and there are internal divisions.

The way forward

Leaving the "surrogate country" method in place after 11 December can only be a short-term option. China will immediately launch a legal challenge. This process could take two to three years, which would offer a breathing space for the industries hardest hit by Chinese exports. However, this course of action – avoiding a decision by relying on ambiguity and delays in the legal process – would not enhance the EU's reputation for supporting international law. Still, a European failure to abide by the spirit, if not all the terms, of a WTO treaty would be a propaganda gift to China's government, which would swiftly denounce it as hypocrisy.

The clean way out of the legal entanglement is a general reform of Europe's TDIs, though this will imply the delegation of more power to the Commission, clashing with the renationalisation of policies in recent years. At stake is "the very survival of EU trade policy".

In the meantime, a full reform of EU TDIs will clearly not be possible before the December deadline. Dismantling the existing trade defences before revamping the system opens a huge vulnerability, as China constitutes 80 percent of European dumping cases by volume. This means that there will be an uneasy period once the deadline has passed where China may choose to legally challenge the EU or to fuel a trade war. It

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is therefore essential for Europe to cooperate with other G7 and possibly G20 members to avoid becoming isolated. At the same time, the EU should make a renewed effort to push China to commit to economic dialogue and to voluntary verified export restrictions in some sectors.

The EU should attempt to reach an understanding with China on the following point: that there can be no rescinding of the surrogate country criteria until an alternative is put in place. It should reassure China on its intention to award MES, while working to reform TDIs. A joint Franco-German policy draft, submitted to the European Council in May, outlines a series of key measures that will allow for the defence of European industries while avoiding illegitimate trade discrimination against Chinese exporters. These include using cost estimates of market prices while avoiding the surrogate country method, applying similar criteria to those in force for Russia, with the addition of financial subsidies and land prices, as well as those of energy and raw materials. Finally, the Commission should be able to initiate anti-dumping investigations without a complaint from a third party.

As the deadline approaches, it is worrying that the EU's position is likely to crystallise only in the final months of 2016, increasing the difficulty of gaining concessions from China. Speed is therefore of the essence, if the EU does not want to be overtaken by events. The outcome of the twin debates – on China's MES and on the modernisation of the EU's TDIs – will be a test of Europe's capacity to stay ahead as a beacon on international law and to pursue the European interest.

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