



# China: NME at the Gates?

Article 15 of China's WTO Accession Protocol:  
A multi-perspective analysis



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# List of abbreviations

AD	Anti-dumping
ADA	Anti-dumping Agreement
ADI	Anti-dumping Investigation
AIIB	Asian Infrastructure Investment Bank
AP	Accession Protocol
ASEAN	Association of Southeast Asian Nations
BIA	Bilateral Investment Agreement
EC	European Commission
EFSI	European Fund for Strategic Investment
EP	European Parliament
EPI	Economic Policy Institute
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
ICT	Information and Communication Technology
INTA	Committee on International Trade (European Parliament)
IPR	Intellectual Property Rights
ITRE	Committee on Industry, Research and Energy (European Parliament)
ME	Market Economy
MES	Market Economy Status
MIIT	Ministry of Industry and Information Technology (China)
NME	Non-Market Economy
PV	Photovoltaic
SOE	State-owned Enterprise
TDIs	Trade Defense Instruments
WTO	World Trade Organisation

# Table of contents

- 1 Introduction to the debate ..... 1
- 2 Legal Perspective ..... 5
  - 2.1 Market Economy Status and WTO Law..... 6
  - 2.2 Interpretation 1: De facto MES..... 7
  - 2.3 Interpretation 2: Continued use of alternative methodologies ..... 8
  - 2.4 Legal Interpretation of the European Union ..... 9
- 3 Economic Perspective ..... 13
  - 3.1 EU-China economic state of play ..... 14
    - 3.1.1 Trade in goods and services..... 14
    - 3.1.2 Foreign direct investments..... 15
  - 3.2 Trade defense in EU-China trade ..... 16
    - 3.2.1 Protecting against unfair practices: the options available..... 16
    - 3.2.2 Anti-dumping in EU-China trade ..... 16
  - 3.3 The EU-China relationship: a disunited union vs. unprecedented reforms..... 19
  - 3.4 Case Study: Solar Energy..... 21
  - 3.5 Case Study: Steel Industry ..... 22
- 4 Political Perspective ..... 28
  - 4.1 The EU’s internal debate on MES – a plurality of voices ..... 28
  - 4.2 Brussels – Beijing: Strategic Cooperation..... 30
  - 4.3 Addressing Common Challenges ..... 30
    - 4.3.1 Security cooperation..... 31
    - 4.3.2 Connectivity ..... 31
    - 4.3.3 Global governance..... 32
    - 4.3.4 People-to-People Exchanges ..... 32
  - 4.4 Case Study: Australia – One Pioneer amongst Many ..... 34
  - 4.5 Case Study: Russia – A Gift Box from the EU..... 35
- 5 Conclusion ..... 39

## Article 15

"Article VI of the GATT 1994, the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 ("Anti-Dumping Agreement") and the SCM Agreement shall apply in proceedings involving imports of Chinese origin into a WTO Member consistent with the following:

- (a) 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.
- (b) In proceedings under Parts II, III and V of the SCM Agreement<sup>1</sup>, when addressing subsidies described in Articles 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."

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<sup>1</sup> Agreement on Subsidies and Countervailing Measures

# 1 Introduction to the debate

On a gray and chilly day in February 2016, thousands of disgruntled European steel workers marched into the streets of Brussels in a protest against cheap steel imports from China.<sup>1</sup> Declining steel prices, caused by an overcapacity as a result of the sputtering demand worldwide, have put pressure on the European steel industry and sparked fears of job losses. During the protests, it became clear that China and its overcapacity of steel were taking the blame.

Over the past months, discussions on China's Market Economy Status (MES) have hijacked the debates on EU-China trade relations in the corridors of the European Institutions. Think tanks and academic institutions based in Brussels have organised dozens of conferences, workshops and hearings to discuss the matter. The MES conundrum pertains to the methods that the European Union can employ to determine the prices which are used in calculating the dumping margin in anti-dumping (AD) investigations against China. These are initiated to protect import competing industries, such as the steel sector, against unfair competition. The terms and conditions to do so derogate from general WTO rules, and are stipulated in Article 15 of China's WTO Accession Protocol.

At this point, the EU is invoking the prices of a third analogue country in anti-dumping cases against Chinese enterprises - which usually results in a higher dumping margin - unless the producers under investigation can prove that market economy conditions prevail in their industries. According to paragraph (d) of Article 15 of China's Accession Protocol however, provision (a)(ii) would "in any event" expire 15 years after the date of China's WTO accession.<sup>2</sup> This particular provision contains the conditions for

applying alternative methodologies to calculate the normal value, and its approaching expiration on 11 December 2016 has induced lively and ongoing discussions between legal experts.

According to one interpretation, the expiration of this provision implies that the European Union will have to start using China's domestic prices for the calculation of the dumping margin from December onwards, which is standard practice for AD investigations according to WTO rules. Any other scenario would likely draw the EU into muddy legal waters, including the idea that China should first comply with the EU's five market economy criteria, which are not incorporated in EU legislation.<sup>3, 4</sup> This approach thus deems China's Market Economy Status irrelevant since provision (d) of Article 15 rules out the use of alternative methodologies as mentioned in (a)(ii) after the December deadline, irrespective of whether China is considered a market economy by the EU or not.

Another interpretation however claims that the remains of Article 15 in China's Accession Protocol justify the continued use of alternative methodologies. Proponents of this vision assert further that China should first establish that it is a market economy, "pursuant to the national law of the importing WTO member", before domestic prices will be used in AD investigations.<sup>5</sup> As follows, China should first meet the EU's five criteria for determining a market economy, and should then be removed from the EU's NME-list, which would entail an amendment of the EU's basic Anti-Dumping Regulation. Despite all its intricacies, the discussion is often reduced to an antithesis between those who

oppose and those who favour MES for China.

This debate has triggered controversy and has occasionally led to emotional responses by stakeholders and the public opinion. However, as several experts have argued, the December deadline would actually have passed without too much fuss in better economic circumstances.<sup>6</sup> Due to a post-recession *modus operandi*, Europe is still struggling to reignite its economic growth in order to generate more jobs in a quest against unemployment. It is in this light that the December deadline comes at a particularly inconvenient time since the prospect and fear of eventual job losses has created a protectionist reflex amongst industries that might be affected if the EU can no longer apply its current methodology. Nonetheless, the few preliminary studies that have been undertaken do not provide a clear and objective assessment of the situation, whereas the results of the Commission's in-depth assessment have not been published yet. Furthermore, little is known or said about the consumer and job gains if China's domestic prices were to be used in AD investigations.

Despite the predominance of legal analyses on the issue, economic considerations and political decisions play a crucial and decisive role. According to a considerable number of experts, any decision by the European Union will, in essence, be a political decision, and will have substantial legal, political, and economic ramifications.<sup>7</sup> What should not be forgotten is that the MES-issue is - next the arms embargo on China - one of the main irritants in their respective relations. As one opinion leader stated: "...the EU and China have the first chance in a decade to use a symbolic change to express a new way to think about each other and expand the parameters of what they are willing to do".<sup>8,9</sup>

The European Union is internally divided on the future steps to take. On 12 May, the Parliament issued a non-binding resolution, stressing that "China is not a market economy and [...] the five criteria established by the EU to define market economies have not yet been fulfilled".<sup>10</sup> Hence, "the EU should use a non-standard methodology in anti-dumping and anti-subsidy investigations into Chinese imports in determining price comparability until Beijing meets all five EU criteria". The resolution was approved by a large majority of 546 MEPs, with 28 against and 77 abstentions, which is a rather firm signal from the Parliament.<sup>11</sup>

The position of the Council has not been made public, although it is clear that the UK, the Netherlands, and the Nordic countries, who are traditionally in favour of free trade, endorse China's Market Economy Status. Germany supports it in principle but only when sensitive industries are safeguarded. Italy and other Mediterranean countries are however strongly opposed.<sup>12</sup>

The European Commission took a more low-profile stance to the matter. It organised a public consultation and ordered an in-depth impact assessment study. On 20 July as well as 19 October, the College of Commissioners issued a statement calling the Council to move swiftly in the adoption of a proposal to modernise the EU's Trade Defense Instruments (TDIs), while stressing that China should address its (steel) overcapacities.<sup>13, 14</sup> Furthermore, Jean-Claude Juncker, president of the European Commission, explicitly linked China's Market Economy Status and its steel overcapacity, stating that it must close down steel mills dumping excess production in Europe.<sup>15</sup> Earlier, Commissioner Malmström, responsible for trade, announced three options for the EU with respect to China<sup>16</sup>:

1. Make no changes in EU legislation and **continue to apply the current methodology**
2. Remove China from the list of NME-countries, which implies that MES would be granted and **domestic prices shall be used**
3. Remove China from the list of NME-countries, but take **mitigating measures** in the EU's trade defense instruments (TDIs)

This prudent and even harsher position versus China marks a shift in the Commission's stance compared to 2013, when commissioner for trade De Gucht explicitly stated that "in 2016 China will receive market economy status".<sup>17</sup>

Unlike the European institutions, Beijing has maintained a clear position. Government representatives consider the analogue country methodology as "unfair treatment" and argue that the protocol requires all WTO members to stop using the methodology after the December deadline.<sup>18</sup> As a result, this would render it impossible to disregard domestic prices in new AD cases against China.<sup>19</sup>

Until now, many policy papers have focused on the legal nature of the discussion and the foreseen impact of the three different scenarios on employment after December 2016. However, the (geo)political repercussions of these scenarios and their consequences for wider EU-China relations have gained little attention. Furthermore, the heterogeneous distribution of AD investigations amongst member states, industries and even within sectors, calls for a nuanced and careful approach to the debate.

This research paper will attempt to address the analysis gap by means of a threefold approach. The first chapter will briefly explore the different legal perspectives, which is indispensable to understand the origins of the discussion.

This will be followed by an economic analysis that will consider Commissioner Malmström's three options, and will place the existing analyses regarding anti-dumping measures and their linkages to trade, investments, and employment into context. A final section will shed light on the (geo)political origins and implications of the matter. Other than providing an overview of the general debate on China's Market Economy Status, this analysis endeavours to place the controversy on Article 15 of China's WTO Accession Protocol within the wider relations between the EU and China.

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<sup>1</sup> Crisp, J. (2016, February 15). Thousands march in Brussels against cheap Chinese steel imports. *EurActiv*. Retrieved from <http://www.euractiv.com/section/trade-society/news/thousands-march-in-brussels-against-cheap-chinese-steel-imports/>

<sup>2</sup> WTO (2001). Accession of the People's Republic of China WT/L/432, p. 8-9

<sup>3</sup> MES Requests are evaluated on the basis of five criteria:

1. a 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.
2. an absence of state-induced distortions in the operation of enterprises linked to privatisation and the use of non-market trading or compensation system

3. the existence and implementation of a transparent and non-discriminatory company law which ensures adequate corporate governance (application of international accounting standards, protection of shareholders, public availability of accurate company information).

4. the 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.

5. the 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.

Retrieved via:

[http://trade.ec.europa.eu/doclib/docs/2009/june/tradoc\\_143599.pdf](http://trade.ec.europa.eu/doclib/docs/2009/june/tradoc_143599.pdf)

<sup>4</sup> Bellis, J. (2016). The Interpretation of Section 15 of China's WTO Accession Protocol, in Workshop – Market Economy Status for China after 2016?, p. 29 ; Interview with Mr Richard W.D. Luff, Van Bael & Bellis ; Statement by Mr Edwin Vermulst, VVGB Law, during ECIPE Seminar on Trade Defense in the EU: The case of PV imports from China on 5 April 2016, Retrieved from

[http://ecipe.org/app/uploads/2016/03/Vermulst\\_ECIPE-Event\\_Trade-Defense-Solar-Panels-China.pdf](http://ecipe.org/app/uploads/2016/03/Vermulst_ECIPE-Event_Trade-Defense-Solar-Panels-China.pdf)

<sup>5</sup> WTO, Article 15(d) of Accession of the People's Republic of China

<sup>6</sup> Interview with Mr Richard W.D. Luff, Van Bael & Bellis

<sup>7</sup> Yalcin, E., Felbermayr, G. and Sandkamp, A. (2016). New Trade Rules for China? Opportunities and threats for the EU. *DG For External Policies, European Parliament & Ifo Institute*, p. 5-6

<sup>8</sup> Puccio, L. (2015). Granting Market Economy Status to China, An Analysis of WTO Law and of Selected WTO Members' Policy. *European Parliamentary Research Service*, p. 25; Brown, K. (2016, January 5). Why the EU should grant China Market Economy Status. *The Diplomat*. Retrieved from <http://thediplomat.com/2016/01/why-the-eu-should-grant-china-market-economy-status/>; Bellis, The Interpretation of Section 15 of China's WTO Accession Protocol, p. 29

<sup>9</sup> Brown, K. (2016, January 5). Why the EU should grant China Market Economy Status. *The Diplomat*. Retrieved from

<http://thediplomat.com/2016/01/why-the-eu-should-grant-china-market-economy-status/>

<sup>10</sup> European Parliament (2016). European Parliament resolution (2016/2667) of 12 May 2016 on China's market economy status. Retrieved from <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2016-0223+0+DOC+PDF+V0//EN>

<sup>11</sup> Vancutsem, W. (2016, May 12). Parliament vote urges Commission to reject market economy status for China. *Politico*. Retrieved from <http://www.politico.eu/article/eu-parliament-vote-urges-commission-to-reject-market-economy-status-for-china/>

<sup>12</sup> Zhong, N. and Fu, J. (2016, May 14). EU 'has obligation' to recognize MES. *China Daily*. Retrieved from [http://www.chinadaily.com.cn/world/2016-05/14/content\\_25267993.htm](http://www.chinadaily.com.cn/world/2016-05/14/content_25267993.htm)

<sup>13</sup> European Commission (2016, July 20). College orientation debate on the treatment of China in anti-dumping investigations. *Press Release*. Retrieved from <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1531>

<sup>14</sup> European Commission (2016, October 19). Commission urges Member States to support proposals to strengthen European defences against unfair trade. *Press Release*. Retrieved from [http://europa.eu/rapid/press-release\\_IP-16-3475\\_en.htm](http://europa.eu/rapid/press-release_IP-16-3475_en.htm)

<sup>15</sup> Tovey, A. (2016, 13 July). Juncker tells China to cut steel production or be frozen out of global trade club. *The Telegraph*. Retrieved from <http://www.telegraph.co.uk/business/2016/07/13/juncker-tells-china-to-cut-steel-production-or-be-frozen-out-of/>

<sup>16</sup> European Parliament (2016). Press Release of plenary session on 2 February 2016. Retrieved from [http://www.europarl.europa.eu/pdfs/news/expert/infopress/20160129IPR11943/20160129IPR11943\\_en.pdf](http://www.europarl.europa.eu/pdfs/news/expert/infopress/20160129IPR11943/20160129IPR11943_en.pdf)

<sup>17</sup> European Commission (2013). Speech/13/889 Modernisation of Trade Defense – Getting the Job Done. Retrieved from [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>18</sup> Barone, One year to go: The debate over China's market economy status (MES) heats up, p. 11

<sup>19</sup> Yalcin, Felbermayr, Sandkamp, New Trade Rules for China? Opportunities and threats for the EU, p. 5

## 2 Legal Perspective

- MES is a technical concept which is specifically used when calculating the **normal value in AD investigations**
- **The definition of a Market Economy is not found in the WTO regulations**, but possibly in the national legislations of WTO member states. The European Union does however not include a definition of a market economy in its Anti-Dumping Regulation.
- **Paragraph 15(a)(ii) of China's Accession Protocol (AP)** offers the possibility for WTO member states to consider **China as an NME in AD investigations**, i.e. not use Chinese prices and costs in calculating normal value
- This paragraph **expires on 11 December 2016** – there are several diverging legal interpretations of the consequences on China's status as a ME
  - 1) China has to be considered as a **de facto ME**, i.e. a methodology that is not using Chinese prices cannot be based on the AP
  - 2) Remaining parts of the AP permit countries to **continue using alternative methodologies** until China complies with their criteria
- **Legal services of the EU are divided** in their opinion – the European Commission's legal service supports granting MES, whereas the European Parliament's is inclined toward continued treatment of China as an NME
- Due to different opinions among EU policy makers on the **legal interpretation** of Article 15, a decision on whether to grant MES will mainly be a political one

When in a given country an enterprise exports a product at a lower price than its value on the domestic market, it is considered as dumping.<sup>1</sup> Article 15 of China's Accession Protocol permits WTO members to derogate from the general methodology for calculating the normal value in anti-dumping proceedings that is applicable under the GATT/WTO framework. It is indisputable that after one part of this document – subparagraph (a)(ii) – expires in December 2016, member states will no longer be able to apply this provision. What European experts consider to be unclear, however, is the effect of the remaining part of Article 15 on China's status as a market economy (ME), and the utilisation of alternative costs and prices for determining dumping margins.

Given the very complex nature of the subject, various interpretations exist among experts. This chapter does not aim to determine which of the individual interpretations should be accepted. The objective is to provide an overview of different legal opinions and

understandings of the meaning of the provisions in the Accession Protocol and their supporting arguments. Therefore, the debate focuses on the relevant sections of the Accession Protocol that deal with a non-market economy status – i.e. paragraphs 15(a) and 15(d).

Some lawyers and scholars agree that the termination of subparagraph (a)(ii) results in a *de facto* granting of MES to China. According to the proponents of this approach, part (a)(ii) of Article 15 is the sole basis in the Accession Protocol for the right to use non-Chinese prices and costs. After its expiration, no legal ground will remain in Article 15 for detracting from the ordinary method in anti-dumping proceedings – i.e. using domestic prices of Chinese exporters – and the EU will be obliged to treat China as an ME.

Others dispute this claim and maintain that nothing will change unless China proves that it fulfils the conditions for being removed from the list of non-market economies (NMEs) under EU law. This premise is considered to be provided

in other parts of Article 15 since (a)(ii) contains only an NME presumption. As a result, countries should be allowed to continue to use alternative methodologies until the conditions set in national laws are met. The government in Beijing asserts that, based on international law, the expiration of the provision is a deadline for applying an analogue country methodology in anti-dumping proceedings, regardless of whether MES will be admitted<sup>2</sup>, or as China's Ministry of Foreign Affairs stated: "In accordance with Article 15 in China's Protocol of Accession to the WTO, WTO members should drop the "surrogate country" practice in anti-dumping investigations against China after December 11, 2016. All WTO members should abide by this international obligation, whatever domestic standards they have. China is firmly opposed to any country's refusal to honour the obligation under any excuse and the pursuit of trade protectionism. It is not only an issue of law but also politics and good faith".<sup>3</sup>

## 2.1 Market Economy Status and WTO Law

The non-market and market economy are technical concepts used in anti-dumping legislation.<sup>4</sup> They represent a methodology employed in trade remedy disputes for setting the normal value when determining the dumping margin.<sup>5</sup> According to the WTO, dumping occurs when "a company exports a product at a price lower than the price it normally charges on its own home market."<sup>6</sup> Derogation from a method using domestic prices and costs provided by exporters, and the application of alternative methodologies is allowed only if the state displays characteristics of an NME<sup>7</sup> under either the second interpretative Ad Note to Article VI(1) of the GATT 1994 (Ad Note)<sup>8</sup>, or under the specific provisions in the Accession Protocol to WTO.<sup>9</sup> Otherwise, only in the occasion of a

'particular market situation' – set forth in Article 2(2) of WTO ADA – when an appropriate comparison of prices cannot be made, alternative means of calculation can be applied.<sup>10</sup>

However, the WTO legal system does not offer any other definition of the term (N)ME or conditions for granting MES. Instead, criteria are set under the national laws of individual WTO members, as is also acknowledged in China's Accession Protocol.<sup>11</sup> Without explicitly mentioning the term 'non-market economy', only the Ad Note points out a specific category of this system, where there is a "complete monopoly of the trade" and "all domestic prices are fixed by the state".<sup>12</sup> However, these conditions for allowing to apply alternative methodologies in anti-dumping investigations, adopted more than 60 years ago, set an immensely strict definition and do not correspond with the contemporary situation in the world anymore, since it then referred to soviet-type economies with a centrally planned economic system.<sup>13</sup> Therefore, special measures were introduced 15 years ago when the Accession Protocol was adopted. They allowed for considering China as an NME, and put the burden of disproving this on Chinese exporters under the conditions of the importing country.<sup>14</sup> Section (a)(ii) of Article 15 of the Accession Protocol, which enables the use of an analogue country methodology for calculating the normal value in AD investigations, will expire in December 2016.

The Appellate Body of the WTO interpreted part (a)(ii) of Article 15 for the first time in 2010 in its decision in the EC-Fasteners dispute.<sup>15</sup> It supported the notion that rules allowing for alternative calculations will expire by the end of the year and are, therefore, temporary.<sup>16</sup> On the other hand, the implications of termination of (a)(ii) were not under the

scrutiny of this ruling, which led to this interpretation being disputed by some experts.<sup>17</sup> However, in case Beijing brings the issue to the WTO court, the arguments used by the Appellate Body in the EC-Fasteners decision imply that a potential ruling on the application of the analogue country methodology could be in favour of China.

Most of the lawyers, who are dealing with the meaning and consequences of Article 15, refer in their arguments to general rules of treaty interpretation set in the Vienna Convention on the Law of Treaties<sup>18</sup>, which also apply to agreements under the WTO.<sup>19</sup> The Appellate Body of the WTO provides further guidance on interpretation practices in its various decisions. The main principles of explaining the content of treaties stipulate that the general intention of the drafters and the context of the adoption of the treaty have to be taken into consideration.<sup>20</sup> Additionally, a textual approach has to be undertaken,<sup>21</sup> and one cannot “add to or diminish rights and obligations provided in the WTO Agreement.”<sup>22</sup> Furthermore, “the interpretation of a treaty must give meaning and effect to all of its clauses and, thus, [cannot] reduce individual provisions to inutility.”<sup>23</sup>

However, even when following these instructions, legal sources do not offer a unanimous response to the question of what methodologies will be applicable after December, if China or its exporters do not demonstrate that they operate under market economy conditions.<sup>24</sup> In the legal debate, one can distinguish two main opinion groups, each containing subgroups which slightly deviate from the core line of reasoning. The first group proposes that the investigating authorities would be able to disregard the ordinary methodology only if conditions in the Ad Note are met, which equals to *de facto* awarding MES to China, while others state

that WTO members can still use criteria set in their legislations.<sup>25</sup>

## 2.2 Interpretation 1: De facto MES

Several legal experts argue that by expiration of (a)(ii), WTO members will lose the right to deviate from the standard methodology in setting a normal value based on section 15 of the Accession Protocol and, hence, China will be de facto considered an ME. Whether MES is awarded under national rules will be independent from the international law, since member states will be obliged to apply the ordinary methods as set in the WTO Anti-Dumping Agreement, and approach China as any regular member state. Therefore, the normal value will have to be set using Chinese prices and costs as stipulated under ordinary rules set in Article 2 of the ADA.<sup>26</sup>

***“Several legal experts argue that by expiration of (a)(ii), WTO members will lose the right to deviate from the standard methodology [...] and China will be de facto considered a Market Economy”***

As a result, whether China is classified a market economy is relevant only until December, seeing that paragraph (d) provides for the possibility of early termination of NME methodology. Consequently, article 2.7(b) of the EU Basic AD Regulation will have to be adapted, which would otherwise contradict the EU’s commitments in the WTO, since the only possible calculation of normal value will be by using Chinese prices and costs.<sup>27</sup>

Taking into consideration the context of the adoption of the Protocol, paragraph 151 of the Working Party Report further supports claims that (a)(ii) provides only “a temporary derogation from the ADA” instead of a lasting alteration.<sup>28</sup> This

report – drafted by a team established in 1987 to analyse the request of PRC to join the GATT, and later the WTO, and to negotiate the conditions of accession – hence reflects the intentions of the mediators.<sup>29</sup> A statement given by a former US Trade Representative, Ms. Barshefsky, who was involved in the negotiations of the draft agreement further supports this narrative. In her remarks, she referred clearly to a 15 year period, within which dumping calculations using a “special non-market economy methodology” could be applied.<sup>30</sup>

Therefore, if the termination of (a)(ii) does not result in the cessation of the analogue country methodology for Chinese exporters, then the meaning of this provision would be reduced to only providing a presumption that Chinese producers operate under a non-market economy. This argument is invalid as it is not supported by the text of Article 15, since the same presumption is equally present in part (a)(i), and therefore is not reserved only for (a)(ii).<sup>31</sup> Instead, the actual meaning of (a)(ii) is to provide the possibility of using an alternative methodology, and to serve as the sole provision in Article 15 enabling this. Comparisons in anti-dumping investigations not based on Chinese figures could be possible in the future if based on the Ad Note, but not on the Accession Protocol.<sup>32</sup>

Other legal experts believe that although Article 15 does not specifically label China as an NME, it allows for the same treatment as countries under the Ad Note. Despite the fact that the expiration of (a)(ii) does not provide for the unquestionable status of market economy, it will be acquired for at least a ‘juridical second’ on December 12, since importing members will not be able to base the application of a methodology without domestic Chinese prices and costs on the Accession Protocol anymore. Instead, if

governments wish to derogate from the ordinary methodology, the importing member will have to prove that conditions set in the second Ad Note and WTO ADA apply.<sup>33</sup>

Therefore, this would essentially classify China as an ME, since Article 15 will no longer provide a basis for the application of an analogue country methodology. Even if the status of China as an NME remains unchanged, this would not have any practical implications for calculations of the normal value in anti-dumping proceedings.<sup>34</sup> Contrary to what some claim, this interpretation does not render the rest of paragraph 15 irrelevant, since it would still be possible to base special calculations referred to in the chapeau of Article 15, on the Ad Note.<sup>35</sup> Instead, a different interpretation would render the second sentence of (d) purposeless, since its expiration would not have any influence.<sup>36</sup> As a consequence, if an importing member still applies alternative methodologies after December, China will be able to raise the matter before the WTO Dispute Settlement Body, and call for the EU to comply with the WTO rules, which could open the door for retaliation by China, authorised by the WTO.<sup>37</sup>

### **2.3 Interpretation 2: Continued use of alternative methodologies**

On the other hand, advocates against awarding MES to China claim that the chapeau of subparagraph (a) and (a)(i) can still serve as a sufficient basis for allowing member states to apply alternative methodologies after December 2016. This could be invoked unless China establishes that it complies with the market economy conditions of respective WTO members. However, it was admitted that after the termination of (a)(ii), the remaining provisions do not provide clear instructions for the treatment of Chinese products in case the producers cannot demonstrate that they operate under

market economy conditions. Arguably, this blank space in legislation is up to the interpretation of individual member states as the wording of 'based on' in chapeau (a) allows for a flexible application of the NME approach.<sup>38</sup>

Additionally, the remaining parts of Article 15 need to be taken into account, in accordance with the treaty interpretation rules. Thus, provision (d) still lays the burden of proof on China or its exporters to showcase that they operate in market economy settings according to

***"Advocates against awarding MES to China claim that the chapeau of subparagraph (a) and (a)(i) can still serve as a sufficient basis for allowing member states to apply alternative methodologies after December 2016"***

preconditions set in national laws of importing countries. Only when they meet these conditions, the whole subparagraph (a) will cease to apply, and the importing country will follow the ordinary methodology based on Article VI of the GATT and the ADA.<sup>39</sup> Different conclusions would render the rest of (a) and (d) insignificant.<sup>40</sup> Therefore, according to supporters of this interpretation, there is no deadline for the EU to adapt its Anti-Dumping Regulation at the end of the year.<sup>41</sup>

Other experts see subparagraph (a)(ii) as serving only as a basis for using non-Chinese prices and costs in AD calculations automatically for all exporters of sectors that did not meet ME criteria as defined by an importing country. Therefore, the sole effect of the expiry of (a)(ii) would be the future obligation to grant individual Chinese exporters the right to prove ME conditions for their respective businesses, outside of the sector as a whole, which shall still exist

under an NME presumption until proven otherwise. However, this would not affect the EU legislation as it already allows for a separate market economy treatment.<sup>42</sup> On the other hand, contrary to previous interpretations, the second sentence of (d) could also be understood as terminating the presumption of Chinese producers functioning under an NME. Consequently, after December, the burden of proving that NME conditions prevail would shift to investigating authorities.<sup>43</sup> Alternatively, there are claims that although MES does not have to be granted, the methodology of the EU, based on the analogue country calculations, will have to be terminated. To protect its businesses, the Union would have to adopt new trade defense instruments.<sup>44</sup>

Since the option of EU non-compliance and refusal to use domestic prices and costs of Chinese exporters is not aligned with the present interpretations and expectations of China's government, it is to be expected that China would raise the issue before the WTO Dispute Settlement Body. If the ruling is in Beijing's favour – which is the presumed outcome by some experts<sup>45</sup> – and the EU still does not adapt to this resolution, China would be legally allowed to retaliate.<sup>46</sup>

## **2.4 Legal Interpretation of the European Union**

An 'analogue country' methodology is currently employed by the EU to imports from China in anti-dumping investigations, based on the subparagraph (a)(ii) and the report of the Working Party on China's Accession to the WTO.<sup>47</sup> A list of states considered as NMEs – including China – was first incorporated in the EU legal framework in 1998. However, there is no definition of a 'market economy' in the EU Basic Anti-Dumping Regulation<sup>48</sup>, only a list of requirements for individual companies wishing to obtain market economy treatment. Instead, criteria

applying to a country as a whole were published outside of the Council Regulations, in the European Commission's assessment of Beijing's request to be granted MES in 2008.<sup>49</sup> MES Requests are evaluated on the basis of five criteria<sup>50</sup>:

1. A 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.
2. An absence of state-induced distortions in the operation of enterprises linked to privatisation and the use of non-market trading or compensation system
3. The existence and implementation of a transparent and non-discriminatory company law which ensures adequate corporate governance (application of international accounting standards, protection of shareholders, public availability of accurate company information).
4. The 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.
5. The 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.

The prominence of the political and economic arguments over the legal reasoning in the decision to treat China as an NME is emphasized by the fact that the EU could have possibly acted in violation of the WTO's rules after Beijing's accession.<sup>51</sup> The treaty establishing the entry of China was a result of negotiations

between Beijing and Washington and, as such, was based on the American AD legislation. This led to discrepancies between the Accession Protocol and the Basic EU Anti-Dumping Regulation. Provision 15(d) of the Accession Protocol states that market economy requirements should be published in national legal framework. However, as mentioned above, the EU law does not contain any criteria for granting MES to a country as a whole. Additionally, the U.S. system and, consequently, China's Accession Protocol, do not contain the notion of Market Economy Treatment included in the EU law, allowing for respective individual producers to be regarded as if operating under Market Economy circumstances. However, this practice is beneficial for Chinese companies, as it offers an additional opportunity for exporting producers to have their own prices and costs used in calculating the normal value, instead of having to meet the Market Economy criteria as a sector or country as a whole.<sup>52</sup>

The legal services of the European institutions provided their own interpretation on the future treatment of China. However, reflecting the division of experts on the matter, opinions vary among the legal services of the European Parliament and the Commission as well. The latter allegedly considers the termination of subparagraph (a)(ii) in the Accession Protocol as a deadline for using the analogue country method in anti-dumping investigations. Since, in their opinion, opposing explanations lack the adequate justification and legal basis, China should be taken out of the list of non-market economy countries in the Basic Anti-Dumping Regulation, and be,

***"The decision on how to treat China at the end of the year remains a political one, with strong economic implications"***

de facto, granted MES.<sup>53</sup>

On the other hand, the legal advisers in the European Parliament acknowledge the ambiguous implications of Article 15. They recognise that the use of alternative prices for calculating the normal value cannot be based on this section any longer. However, chapeau (a) provides for the possibility of applying a different methodology if it is proven that the producers do not operate in a market economy environment.<sup>54</sup> Moreover, “an objective assessment of economic conditions in China” should be equally taken into account.<sup>55</sup> In any case, the EU regulations will have to be adapted under the ordinary legislative procedure<sup>56</sup> to either consider China as a Market Economy, or to create additional mechanisms and update trade defense instruments to protect European businesses against dumping.<sup>57</sup>

Due to the different interpretations of China’s Accession Protocol, there is no consensus about the consequences of the expiry of provision 15(a)(ii). The uncertainty over the legal interpretation among European lawyers has led to various contradicting conclusions on the status of China as a (non)market economy and the application of alternative methodologies in calculating the normal value in anti-dumping proceedings after December 2016. The definite answer to this dilemma can be provided only by the Appellate Body of the WTO serving to clarify the treaties under the WTO framework.<sup>58</sup> Unless this happens, the decision on how to treat China at the end of the year remains a political one, with strong economic implications, as demonstrated in the following chapter.

<sup>1</sup> European Commission. Anti-dumping. Retrieved from <http://ec.europa.eu/trade/policy/accessing-markets/trade-defense/actions-against-imports-into-the-eu/anti-dumping/>

<sup>2</sup> Ministry of Foreign Affairs of the PRC (2011). *Premier Wen Jiabao Attends the Opening Plenary Session and Business Dialogue of the World Economic Forum Annual Meeting of New Champions 2011*. Retrieved from [http://www.fmprc.gov.cn/mfa\\_eng/wjdt\\_665385/zyjh\\_665391/t859433.shtml](http://www.fmprc.gov.cn/mfa_eng/wjdt_665385/zyjh_665391/t859433.shtml); Xinhua (2016). *China urges EU to accept its market economy status*. Retrieved from [http://news.xinhuanet.com/english/2016-03/10/c\\_135175998.htm](http://news.xinhuanet.com/english/2016-03/10/c_135175998.htm)

<sup>3</sup> Hua, C. (2016, June 23) at Foreign Ministry Spokesperson Hua Chunying's Regular Press Conference. Retrieved from <http://www.china-un.ch/eng/fyrth/t1374859.htm>.

<sup>4</sup> Foreign Trade Association (2015). To ME or not to ME: China’s Status After 11 December 2016. Position Paper. Retrieved from <http://itp.fta-intl.org/sites/default/files/FTA%20Position%20Paper%20%2819.11.15%29%20-%20To%20ME%20or%20not%20to%20ME%20-%20China's%20status%20after%2011%20December%202016.pdf>

<sup>5</sup> Yu, Y. (2013). Rethinking China's Market Economy Status in Trade Remedy Disputes after 2016: Concerns and Challenges. *Asian J. WTO & Int'l Health L & Pol'y*, 8, 77.

<sup>6</sup> WTO. *Understanding the WTO: The Agreements; Anti-dumping, subsidies, safeguards: contingencies, etc.* Retrieved from [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm8\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm)

<sup>7</sup> Liebman, B. and Milhaupt, C. (2016). *Regulating the Visible Hand? The Institutional Implications of Chinese State Capitalism*. New York: Oxford University Press.

<sup>8</sup> This provision is incorporated in Article 2(7) of the WTO ADA.

<sup>9</sup> Rao, W. (2012). China's Market Economy Status under WTO Antidumping Law after 2016. *Tsinghua China L. Rev.*, 5, 151.

<sup>10</sup> Tietje, C. and Nowrot, K. (2011). Myth or reality? China's market economy status under WTO anti-dumping law after 2016. *Policy Papers on Transnational Economic Law*, 34, 1-12.

<sup>11</sup> Deynoot, C.G. et al. *Towards China's Market Economy Status*

<sup>12</sup> General Agreement on Tariffs and Trade 1994. Note 2 Ad Article VI:1

<sup>13</sup> Bellis, The Interpretation of Section 15 of China's WTO Accession Protocol

<sup>14</sup> Puccio, L. (2015). *Granting Market Economy Status to China: An analysis of WTO law and of selected WTO members' policy*. European Parliamentary Research Service. Retrieved from [http://www.europarl.europa.eu/RegData/etudes/IDA N/2015/571325/EPRS\\_IDA%282015%29571325\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDA N/2015/571325/EPRS_IDA%282015%29571325_EN.pdf)

<sup>15</sup> WTO Dispute Settlement: Dispute DS397. European Communities — Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China.

<sup>16</sup> Rao, *China's Market Economy Status under WTO*

<sup>17</sup> NCTM Studio Legale (2015). *Much ado about 'nothing' - 2016, China and market economy status*. Retrieved from <http://www.lexology.com/library/detail.aspx?g=e53c3fe2-fdf5-4e6b-aa14-4cbb4f97eb8e>

<sup>18</sup> Articles 31 and 32.

- <sup>19</sup> Report of the Appellate Body. India - Patent Protection for Pharmaceutical and Agricultural Chemical Products - AB-1997-5, para. 46 (WT/DS50/AB/R).
- <sup>20</sup> Vienna Convention on the Law of Treaties (with annex), concluded at Vienna on 23 May 1969.
- <sup>21</sup> Report of the Appellate Body. Japan - Taxes on Alcoholic Beverages - AB-1996-2, II, p. 34, DSR 1996:I, p. 97 at 122-123
- <sup>22</sup> Report of the Appellate Body. India - Patent Protection for Pharmaceutical and Agricultural Chemical Products - AB-1997-5
- <sup>23</sup> Rao, *China's Market Economy Status under WTO*.
- <sup>24</sup> Ibidem.
- <sup>25</sup> Malvarez, F.M. *China's NME treatment after December 2016*. Retrieved from <https://static1.squarespace.com/static/5537b2f8e40e49a1e30c01c/t/5645f48be4b0abd1d824c753/1447425163219/Malvarez+-+China+2016+Methodology+-+Final+version.pdf>
- <sup>26</sup> Bellis, *The Interpretation of Section 15 of China's WTO Accession Protocol*; Graafsma and Kumashova, *In re China's Protocol of Accession and the Anti-Dumping Agreement*; Rao, *China's Market Economy Status under WTO*; Tietje and Nowrot, *Myth or reality?*; Vermulst, E., J.D. Sud and S.J. Evenett (2016). Normal Value in Anti-Dumping Proceeding against China Post-2016: Are Some Animals Less Equal Than Others? *Global Trade and Customs Journal* 11, Issue 5.
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- <sup>29</sup> WTO (2001, October 1). Report of the Working Party on the Accession of China, WT/ACC/CHN/49
- <sup>30</sup> Barshefsky, C. (2000, May 3). Hearing before the Committee on Ways and Means, House of Representatives, 106<sup>th</sup> Congress. Retrieved from <https://www.gpo.gov/fdsys/pkg/CHRG-106hhrg67832/html/CHRG-106hhrg67832.htm>.
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- <sup>45</sup> Rao, *China's Market Economy Status under WTO*
- <sup>46</sup> Interview with Mr Jean-François Bellis, Van Bael & Bellis
- <sup>47</sup> NCTM, *Much ado about 'nothing'*
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- <sup>55</sup> Heath, *Secret Legal Opinion*
- <sup>56</sup> De Marcilly and Garde, *Status of market economy to China*
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### 3 Economic Perspective

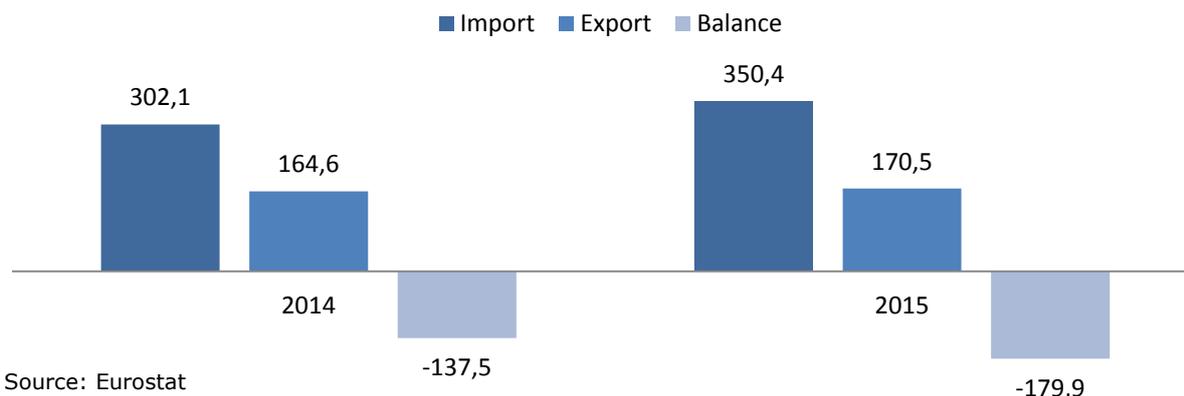
- China is currently the **largest source of imports for the EU**, with a share of approximately 20% of extra-EU imports
- There is **positive momentum** in EU-China economic relations seeing the BIA negotiations; EU-China connectivity platform; complementarity between EFSI & the Belt and Road initiative; increased trade and investment flows
- However, the current debate (and outcome) over MES could dampen the mood in EU-China economic relations. The fragile state of the EU economy, and the testing times for EU integration have made the **MES-debate more sensitive**
- China is subject to most EU anti-dumping investigations; a total of 122 out of 472 in 1995-2015
- A great majority of industrial associations and other **stakeholders echo deep concerns** that exist within the European business community about China's overcapacity and dumping practices
- Various impact assessment have been conducted with estimated job losses ranging from 73.000 as high as 3.5 million
- **A more balanced view on the debate is required**: both China and Europe are experiencing changes and challenges within their socio-economic fibre. They face common challenges and continued cooperation is of prime importance
- A decision by the European Commission to maintain the status quo on anti-dumping investigations – or a decision to introduce novel mitigation measures could **jeopardize other modes of cooperation** in a detrimental and immutable manner
- China and the EU have proven their ability to reach a **mutually acceptable agreement** with regards to the **solar panel** dispute. A similar deal for **steel exports** could lighten tensions

Both China and Europe are faced with acute changes in their socio-economic fiber. Whereas the former is going through economic restructuring, the latter is confronted with a complex mix of sluggish growth, Euroscepticism, uncertainties after the Brexit, and migratory pressures. The EU's internal deliberations on how to address these aforementioned issues have recently been compounded by discussions on Article 15 of China's Accession Protocol to the WTO. Consequent debates on China's Market Economy Status have signaled the complexity and consequentiality of the decision that the EU has to make. Imbued with strong pressures from within its member states, the potential impact of a change to the status quo on EU industries, competitiveness, and social cohesion will undoubtedly influence the debate. The outcome on granting MES, and/or whether a change in the methodology for calculating prices in anti-dumping cases is

opted for, might have substantial ramifications for China-EU trade relations. This section of the paper will, on the outset, present the economic and trade foundations of EU-China trade relations on which the current debate takes place. This is followed by an assessment on how the recent debate over MES is positioned within the larger framework of EU-China trade relations, and ongoing economic changes and challenges in both Europe and China. Lastly, this is followed by two case studies on the solar and steel industry.

***"The outcome on granting MES, and/or whether a change in the methodology for calculating prices in AD cases is opted for, might have substantial ramifications for China-EU trade relations"***

**Figure1: Trade in goods: EU with China - in billion EUR**



Source: Eurostat

### 3.1 EU-China economic state of play

#### 3.1.1 Trade in goods and services

As goes for the overall EU-China relationship, the economic interactions and trade relations have been mainly driven by Member States rather than by a coherent and integrated EU approach. China-EU trade has, for long, predominantly focused on trade in goods, and only as of recently has its trade in services been augmented.

**Figure 2:**

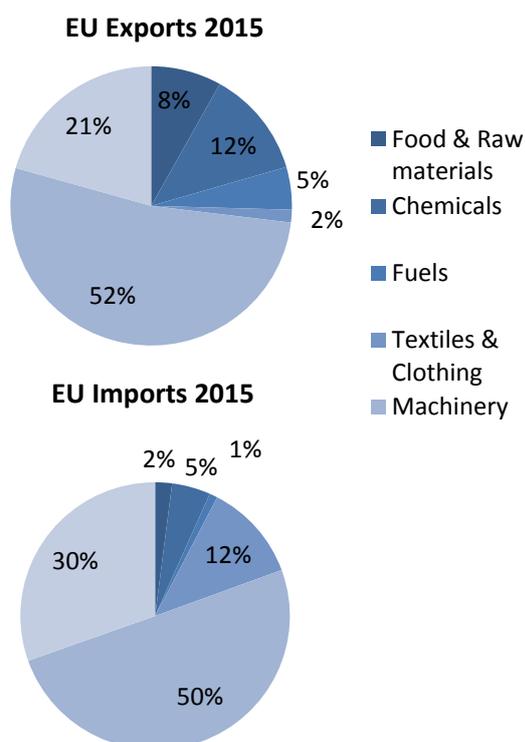
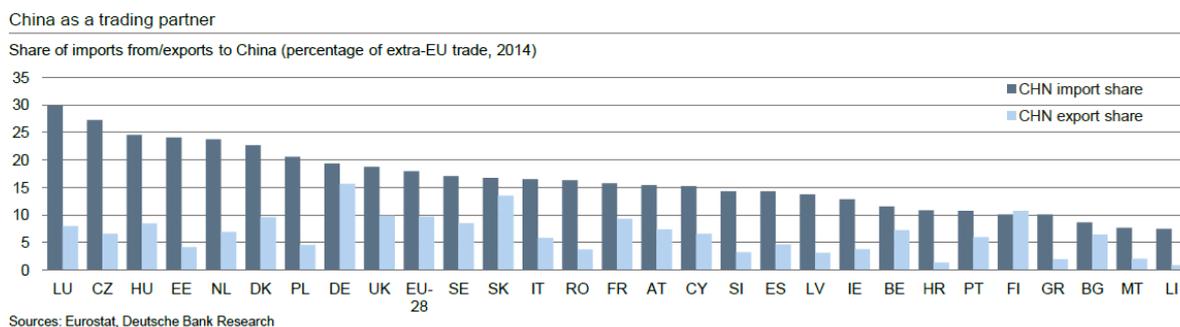


Figure 2 shows that both imports and exports are dominated by trade in machinery and textiles. It is evident the presence of a vast dissimilarity across member states in terms of both export and import dependence on China, which is exemplified in Figure 3. It visualizes the share of imports from (and exports to) China as a share of extra-EU trade. The general trend visible is that a large majority of member states run significant trade deficits, with the exception of Finland, Germany, and Slovakia, who respectively run a surplus or minor deficits. The sizeable deficit of EU exports in its bilateral trade with China has an impact on public perceptions, although the competitiveness of a country must be assessed by its worldwide trade balance, which for China is much more even.

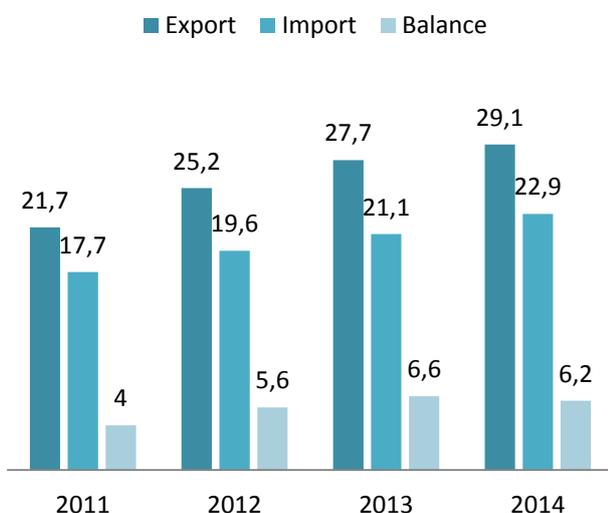
Whereas trade in goods between the EU and China has steadily increased over the past years, trade in services has only recently witnessed a clear boost, averaging around 10 per cent growth. Following the United States and Switzerland, China is currently the EU's third most important partner in terms of extra-EU trade in services. Both exports and imports of services have substantially increased, and the EU currently boasts a trade in services surplus of around 6 billion EUR. The surplus is mainly due to the tourism and travel industry, charges

**Figure 3: Share of imports from/export to China**



for the use of intellectual property, and ICT-services. The most significant deficit discerned was in the transport and logistical services. Figure 4 showcases the clearly visible upward trend in the development of trade in services over the 2011-2014 time period.<sup>1</sup>

**Figure 4: EU-China Trade in Services<sup>2</sup>**  
- in billion EUR



### 3.1.2 Foreign direct investments

Regarding foreign direct investments (FDI) between the EU and China, one can discern that, to a large extent, the majority of EU-member states have been rather welcoming towards Chinese FDI. Compared to almost zero capital inflows from China to the EU in the mid-2000s, FDI flows into EU28 were valued at

around 14 billion EUR in 2014<sup>3</sup>, with the United Kingdom, the Netherlands, Germany, and Italy as most favored destinations.<sup>4</sup> Conversely, since the beginning of the 1990's, China has gained increased attention amongst European firms who are often attracted by 'the low labour costs in the export-gearred manufacturing, but even more by the potentially huge outlets in China's domestic market.'<sup>5</sup> China is currently regarded as the largest recipient of FDI. Notwithstanding the substantial growth of EU FDI flows and stocks into China, the figures remain rather modest. Current negotiations on a BIA, through enhanced reciprocity, are to provide easier access for both European and Chinese investors, thereby tapping into the vast investment potential. Also, China's domestic reforms will have a bearing on the future of EU-China investment flows; the removal of certain bureaucratic hurdles to outbound investment should further trigger the interest of Chinese investors in advanced economies. However, the sustained increase of Chinese FDI will, in large part, depend on the measure to which the EU can spur growth within its member states, and have them remain attractive investment destinations. Therefore, according to a Baker & McKenzie report, "structural reforms will be critical to ensure that Chinese capital will flow into productive assets that enhance Europe's long-term competitiveness and prosperity."<sup>6</sup>

### 3.2 Trade defense in EU-China trade

#### 3.2.1 *Protecting against unfair practices: the options available*

In line with the WTO framework, the European Union has a variety of trade defense instruments at its disposal against what it deems unfair trade practices. The core focus throughout this paper is on anti-dumping measures, but there are an additional two instruments the EU can rely on. For the EU as for other countries the availability of these instruments is quintessential in upholding their commitment to open markets. The EU is one of the main users of trade defense instruments (TDI)<sup>7</sup>, however it should ensure that procedures are followed rigorously and that all interests of the European Union, its member states and other stakeholders, such as consumers and further processors, are taken into account. In 2013, the European Commission made a proposal to modernise the EU's TDIs, has been blocked in the Council up to present.

The first type of TDI is referred to as **anti-dumping**, and is imposed as a duty in addition to any normal customs duty for which the goods being imported are liable. It enables the European Union and its member states to take action against goods sold at a substantially lower price than their 'normal value' – which is defined as a price that is lower than the price of similar goods in the country from which they originate. The duties can be fixed, variable or a percentage of the total value (ad-valorem) and can last up to 5 years.<sup>8</sup> When imposing these anti-dumping duties, the EU applies The Lesser Duty rule<sup>9</sup>, in line with WTO recommendations, and a Union Interest Test.<sup>10</sup>

A second principal defense measure **anti-subsidy and countervailing measures** stems from the WTO Agreement on

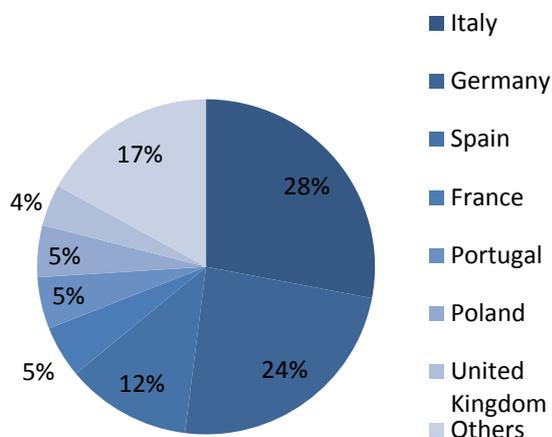
Subsidies and Countervailing measures (ASCM).<sup>11</sup> These measures target two separate, but closely linked situations. Anti-subsidy measures allow importing countries to take action against certain kinds of subsidised imports. 'Subsidies' are defined as financial assistance from the government of a third country to a company or group of companies in that country. They also allow for measures against other types of subsidy that are 'actionable'. This means that the importing country must investigate and be able to demonstrate how the subsidised imports have caused damage to the domestic industry before it imposes any countervailing duties on the subsidised products.<sup>12</sup>

The third principal instrument is the so called **safeguards**. Unlike subsidies and dumping, "safeguards are not taken to address unfair trade practices. Rather they are concerned with imports of a certain product that increase so suddenly and sharply that EU producers cannot reasonably be expected to adapt immediately to the changed trade situation." In such eventuality "WTO and EU rules allow for short-term measures to regulate the imports, giving EU companies temporary relief and time to adapt to this unforeseeable surge." Generally speaking these safeguard measures apply to imports from non-EU countries, and also require the respective EU industry involved to restructure.<sup>13</sup>

#### 3.2.2 *Anti-dumping in EU-China trade*

Disregarding intra-EU trade, China is currently the largest source of imports for the EU, with a share of approximately 20 per cent of extra-EU imports.<sup>14</sup> A less impressive statistic is that China is subject to most anti-dumping investigations; a total of 122 out of 472 in 1995-2015<sup>15</sup>. The current debate on China's Market Economy Status has given rise to a multitude of voices and concerns.

**Figure 5: Employment in sectors subject to AD measures concerning China**



Source: European Commission<sup>14</sup> and Deutsche Bank Research<sup>15</sup>

order to shed light on the possible economic implications of granting MES. A great majority of industrial associations and other stakeholders echo deep concerns that exist within the European business community. Ultimately, the core question in Europe centers on what the expiry of parts of Article 15 means for the EU's anti-dumping, competitiveness, trade patterns, and employment.<sup>18</sup> In 2015 the Economic Policy Institute (EPI), which closely connected to American trade unions, used two models to approximate the numbers of jobs that would be lost. The authors estimate that between 1.7 million and 3.5 million jobs would be at risk until 2020 if the EU were to grant MES.<sup>19</sup>

According to data of the European Commission, the economic impact and job losses are less severe than presented by

***"In light of the testing circumstances in Europe and restructuring in China's economy, the timing of any decision will prove imperative"***

the EPI, as of end 2015, the share of EU imports that concerns anti-dumping measures is rather small – somewhere in the order of 1.4 per cent in terms of value.<sup>20</sup> By virtue of their position in global markets, some sectors are more acutely impacted than others. In the European Union, one can see that it is the chemical and steel industries in particular that often resort to anti-dumping measures. However, with respective import values of EUR 2.1 billion and EUR 673 million, the electronics and ceramics sectors witness most measures in terms of value.<sup>21</sup> With reference to employment, the European Commission estimates that around 234,000 jobs (predominantly in Italy, Germany, Spain and France) are directly linked to anti-dumping measures against China, of which the majority in the ceramics, iron and steel sectors. If no mitigating measures are imposed once China is treated as a market economy in anti-dumping proceedings, the Commission found that between 73,300 and 188,300 jobs would be directly at risk (see table 1).<sup>22</sup>

Referring to the three options that are currently on the table with regard to a post December 2016 scenario, the European Commission has made the following preliminary economic assessments.<sup>23</sup>

**Option 1 - Status Quo:** it is considered that if the EU were to opt for this response that it could be in breach of WTO obligations. However a quantification of economic impact at this point in time depends on too many contingencies.

**Option 2 - Change without mitigating measures:** at the end of 2015, there were still 52 measures in place on imports coming from China. By removing China from the NME list, and thereby using the regular methodology in anti-dumping investigations, gross import prices could fall by 19 per cent after duties are

imposed. In addition, “the lower anti-dumping duties on Chinese imports are estimated to result in lower Chinese prices to EU consumers and downstream industries.”<sup>24</sup> Under this scenario, Chinese imports are expected to increase between 17 and 27 per cent, compared to the situation in which the analogue country methodology is to be used. Based on past imports quantities and prices from China, table 1 will give an indication of the impact on employment in the EU if option 2 were to be chosen.<sup>25</sup>

Many believe that the ‘deterrence’ effect as a response to ADI, which is believed to restrict the number of Chinese exporters, could be substantially diminished under option 2 - leaving European producers in an uncomfortable predicament.<sup>26</sup> However, whereas upstream and import competing players will face some hardship, downstream companies would actually benefit from lower import prices.

These findings by the European Commission largely corroborate other findings that posit the view that the granting of MES would have heterogeneous consequences. Regardless of what precise decision is made, it will impact member states in various ways; also, within industries, one can witness differences between upstream and downstream companies. An unequivocal win-win solution therefore does not exist. Aside from the impact on economic activity and employment, there seems to be consensus on the necessity of taking regard of trade distribution, and possible changes in trade patterns (e.g. possible trade diversions as a consequence of different responses to the expiry of the Accession Protocol). For the EU, it is therefore not only advisable to pay attention to decisions being made in other countries (e.g. United States, Japan, and India), but most of all make its own decision based on its assessment of

**Table 1: Employment impact under Option 2**

	Lower bound	Upper bound
Direct effects on Jobs	-73,300	-188,300
Indirect upstream effects	-20,700	- 53,100
Indirect downstream effects	+30,400	+30,400
Total effect	-63,600	-211,000

Source: Assessment of the economic impact of changing the methodology for calculating normal value in trade defence investigations against China. 21 December 2015

**Option 3 - Changing methodology including mitigating measures:** as was clearly mentioned in the European Commission’s paper, “until such mitigating measures are defined, it is difficult to predict their precise impact.”<sup>27</sup> One can, however, expect that the impact predicted under option 2 would be significantly reduced. A challenge for the EU is to ensure that the mitigating measures that are being put forward are WTO compatible.

potential costs and benefits, and the importance of the comprehensive relationship with China. Another element that warrants consideration is the fact that, according to some, anti-dumping measures in their current form are not able to deal with the fragmentation of global production; many of the products coming from China are in fact from companies owned by European companies.<sup>28</sup> The international community will have to address these issues in multilateral fora such as the G20 in order

to get a clearer picture on the fragmentation, and what it entails for both import and export oriented companies in any given country.

It seems inevitable that certain industries in the EU will have to face hardship, and any decision on MES will reverberate throughout the wider socio-economic fabric in both China and the EU. What stands out is that the current deliberations in Europe on granting MES take place on a complex backdrop of legal, geopolitical, and commercial concerns.<sup>29</sup> In light of the testing circumstances in Europe and restructuring in China's economy, the timing of any decision will prove imperative. The next part of this chapter will briefly elaborate on the domestic theatre in both China and Europe, on which this play unfolds.

### **3.3 The EU-China relationship: a disunited union vs. unprecedented reforms**

The complex mix of legal, commercial, and geopolitical considerations, compounded by concerns of various interest groups, and the ambiguous nature of the debate, has made the pending decision on MES one of the most consequential in the EU-China relationship to date.

Last year saw the celebration of 40 years of EU-China relations. The celebrations were taken as a unique opportunity to further strengthen a relationship that had already witnessed substantial improvement in previous years. Connectivity has often been used as a keyword to illustrate the direction and future of the relationship. In 2012, negotiations on a Bilateral Investment Agreement commenced, which could eventually lead to the establishment of a FTA; and more recently, China pledged billions of euros in support of the

European Commission's European Fund for Strategic Investment (EFSI), the first indication of concrete attempts to link China's Belt and Road initiative to Europe's plans to re-invigorate growth and connectivity.<sup>30</sup> The need for liquidity in European markets along with China's drive to find a secure and stable environment for its investments made for a natural fit.<sup>31</sup>

***"The complex mix of legal, commercial and geopolitical considerations, [...] has made the pending decision on MES one of the most consequential in the EU-China relationship to date"***

Regardless of the anniversary, the current debate over MES could dampen the mood in EU-China relations. Ongoing changes and reforms in both China and Europe add some further complex variables to the relationship. China is currently going through a new series of reforms and economic restructuring – transitioning from an export-led, investment-heavy model to one driven by innovation and consumption. Over the past two years, global headlines have depicted a grim picture of China's economic restructuring – pointing at the fragile state of China's stock market, lower levels of growth, inefficient SOEs, and overcapacity. The latter is the result of a lethal mix of global economic crises, decreased domestic demand, and inefficient SOEs. Among European industries, China's overcapacity has led to a wave of criticism and fear of out-competing European players – causing factories to close and workers to lose jobs.

The EU Chamber of Commerce in Beijing published a report that highlighted the ubiquitous overcapacity in some core Chinese industries: crude steel, electrolytic aluminum, cement, chemicals, oil refining, flat glass, shipbuilding, and

paper industries.<sup>32</sup> Whilst accommodating the interest of third countries, under its Going-out policy China has exported a lot of its overcapacity. Nonetheless, the Belt and Road Initiative and the AIIB are not able to absorb all. The Chinese authorities recognise the problem of overcapacity, and have labeled it as an impediment to China's present-day reform path. They have henceforth put forward measures to drastically reduce industrial overcapacity (e.g. cut crude steel capacity by 100-150 million tons by 2021).<sup>33</sup> A policy mix that targets both the government and private sector should tackle overcapacity. This is done by means of targeting outdated production facilities, optimizing the rapport between central and local governments, greening production, and by addressing the issue of so called 'zombie enterprises', which are companies that have not been able to be profitable over the last three years.

Yet, despite some rough edges, a more balanced view on China's economic performance is merited. Notwithstanding lower levels of growth, the incremental economic output spawned by the forecasted 6.5 per cent GDP growth over 2016 is substantially higher compared to the years during which China was administering double digit-growth.<sup>34</sup> China can now be typified as a two-track economy. One 'traditional' track in low cost and labour-intensive basic manufacturing and traditional industries is grappling with new structural economies' realities. The second track – in advanced manufacturing, services and consumer markets – is actually unveiling strong growth potential.<sup>35</sup> Moreover, the internal disparities between Chinese provinces should definitely be considered when analysing China's economic performances.

On the other side of the Eurasian continent, the European Union finds itself in a complex predicament. Faced with sluggish economic growth, 'the EU juggles

a myriad of policy objectives which are difficult to reconcile; it must protect jobs at home while securing economic growth in a high-cost environment, and soothe inward-looking populist movements while also enhancing its global footprint.<sup>36</sup> The EU relies increasingly on Chinese investment, and will do so for years to come. Similarly European companies, despite facing a difficult regulatory environment, have innumerable opportunities in China. The EU and China need each other, and it is in the interest of the European Union, China, and their citizens to have a sound, and mutually beneficial, economic relationship. Whereas a decision by the European Commission to maintain the status quo on anti-dumping investigations – or a decision to introduce novel mitigation measures might satisfy companies and industrial situations, it could jeopardize other modes of cooperation in a detrimental and immutable manner. International partnerships rest on trust and require long-term visions that can set aside short-term imperfections. Not granting MES would lead to distrust and lack of constructive engagement from the EU side, which can backfire on the overall relationship, and might deter China from seeking constructive ways of strengthening and seeking cooperation in the future. The vast scale of China-EU trade and investment relations has proven to be a source for growth, jobs and innovation, and shall remain so for decades to come.

***"Despite the challenges and irregularities which have crossed the path of the EU-China relationship, Brussels and Beijing have proven their ability to reach a mutually acceptable agreement over sensitive issues"***

Nevertheless, despite the challenges and irregularities which have crossed the path of the EU-China relationship, Brussels and

Beijing have proven their ability to reach a mutually acceptable agreement over sensitive issues. The following case studies will shed light on one industry where such agreement has been made, the solar panel case, and a sector which might benefit from a deal between Brussels and Beijing: the steel sector.

### 3.4 Case Study: Solar Energy

From the turn of the century, photovoltaic (PV) panels and related ingredients like polysilicon inspired a growing number of firms in countries, such as the United States and Germany, to join what was viewed as an alluring and profitable novel industry. In a world that wanted to move away from fossil energy sources, it was generally acknowledged that this sector still needed government assistance. The enthusiastic reaction in the business world, followed soon by the same development in China, induced many firms to borrow heavily. This resulted, as from 2012, in overproduction by over-indebted firms in the major countries – the USA, the EU (mainly Germany), and China – in a still immature sector wherein technologies evolve rapidly. Solar energy benefited from generous government subsidies for the production of solar panels – as was the case in China and the USA – or for installers and consumers – as was typical for European countries.

The output of solar panels in China grew spectacularly once the government had spelled out – starting in 2006 with the Renewable Energy Law – that renewable energy was one of the priority sectors. Between 2009 and 2011, the output of panels quadrupled, but this oversupply was a major cause of the 40 per cent price decline of the panels.<sup>37</sup> As the domestic electricity grid could not yet absorb the supply by solar panels, Chinese producers – being able to manufacture at about 20 per cent lower cost – found outlets abroad. However, in

2012, the worldwide boom in solar energy abruptly collapsed while the governments in European countries were curtailing their lavish subsidies. In the USA, Germany as well as in China, a number of well known, though indebted firms went bankrupt. In China, the number of PV panel producers declined from 262 in 2011 to 112 in 2013.<sup>38</sup>

Facing massive imports from China, authorities in the USA and the EU invoked trade defense measures to protect their producers of solar energy. In Washington, the German company Solar World in 2012 secured anti-subsidy and anti-dumping tariffs on solar cells and panels, respectively. These measures seriously hampered the access of Chinese firms to the US market, in addition to the non-attribution, as yet, of the market economy status by the USA (and the EU), which greatly enhances prospects for the successful indictment of dumping. Simultaneously, importers and installers of solar panels from China, eager to serve their customers in America with comparatively cheaper imported products, protested these actions.

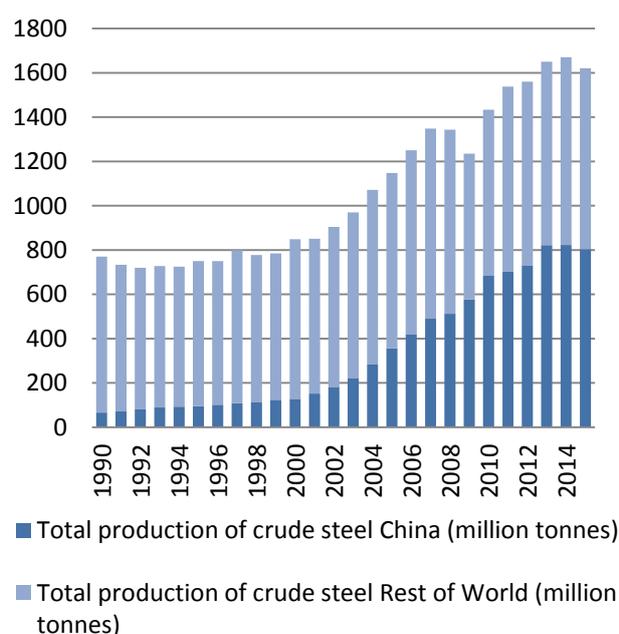
In the EU, the same German firm spearheaded an anti-dumping attack by a coalition of producers. This move was protested by an *ad hoc* Alliance of about 400 importers, including installers and large distributors. EU member states also openly staged differing positions. In 2013, the EU Commission imposed a preliminary anti-dumping duty, and threatened with a much higher one if no satisfactory solution was arranged over the next months.<sup>39</sup> Close to the deadline, the EU and a high number of exporters from China entered into an 'amicable agreement', which contained an 'undertaking' by the Chinese exporters to practice a specified minimum price. This agreement, valid for two years, has averted a trade war about a large trade volume.<sup>40</sup>

While the agreement did not fully soothe more limited disputes in the solar energy area, as from 2015, the outlook for solar (and wind) energies is much brighter. Moreover, steps are taken in China to consolidate the solar sector and to redirect it more towards domestic use. In the meantime, in absolute figures, China is now the largest producer of solar and wind energy – as befits the Earth’s most populous country.

### 3.5 Case Study: Steel Industry

The European steel industry is one of the main protagonists in the MES discussion. This is not surprising as it is one of the traditional beneficiaries of AD duties, accounting for the largest share of AD measures with 17 AD measures in force against China. The sector provides jobs for 350,000 people in Europe, and its unions as well as business interest groups have forged a rare and strongly organized partnership, raising their voices against China’s steel overcapacity.<sup>41</sup>

**Figure 6: China’s share of total crude steel production**



Source: World Steel Association

Their main concern stems from the idea that the use of China’s domestic steel prices in ADIs would flood the European continent with unfairly cheap steel, which could jeopardise thousands of jobs in an industry already under pressure by weakening global demand.

Beijing acknowledges that the overcapacity is an issue. According to Premier Li Keqiang, “China should put unyielding effort into restructuring by eliminating outdated capacity and forbidding the construction of new capacity”.<sup>42</sup> China’s total production capacity has indeed considerably grown over time. According to the EU Chamber of Commerce in China, capacity almost doubled from 644 million tonnes in 2008 to 1,140 million tonnes in 2014. The global demand for steel lagged behind and consequently, the utilisation rate in China dropped from 80 per cent – which is commonly considered as the minimal ratio to ensure sustainable profitability for the industry – to 71 per cent in 2014.<sup>43</sup>

As shown by figure 6, China’s share in global steel production has boomed since the new millennium. As a matter of fact, its steel production is now more than double the combined production of the four next leading producers: Japan, India, the U.S. and Russia.<sup>44</sup>

The massive expansion of China’s steel industry should, however, be put into context. First, one should not ignore the market forces that have driven the rise of China’s steel capacity. China’s booming economy encouraged strong demand from infrastructure construction, real estate, machinery, and the auto industry, pushing up the steel price and incentivising steel companies and even SMEs to expand their capacity.<sup>45</sup>

Second, figure 7 shows that the majority of steel production has always been destined for the domestic market. China is indeed the largest producer of steel,

but it is also the largest consumer.<sup>46</sup> At the outburst of the financial crisis, Beijing addressed the global recession with a massive fiscal stimulus package including a lending programme and infrastructure investments, which have allowed the country to withstand the worldwide economic setback. Beijing was even lauded as an engine for global growth. More recently however, China's economic transition curbed the domestic demand for steel. Moreover, the sputtering demand worldwide since the economic recession did not make things easier, and even underlines the global scale of the problem.<sup>47</sup> From the supply side, China's crude steel production kept rising until 2014, but the market appears to have begun rebalancing with a contraction of 2.28 per cent by 2015.<sup>48</sup>

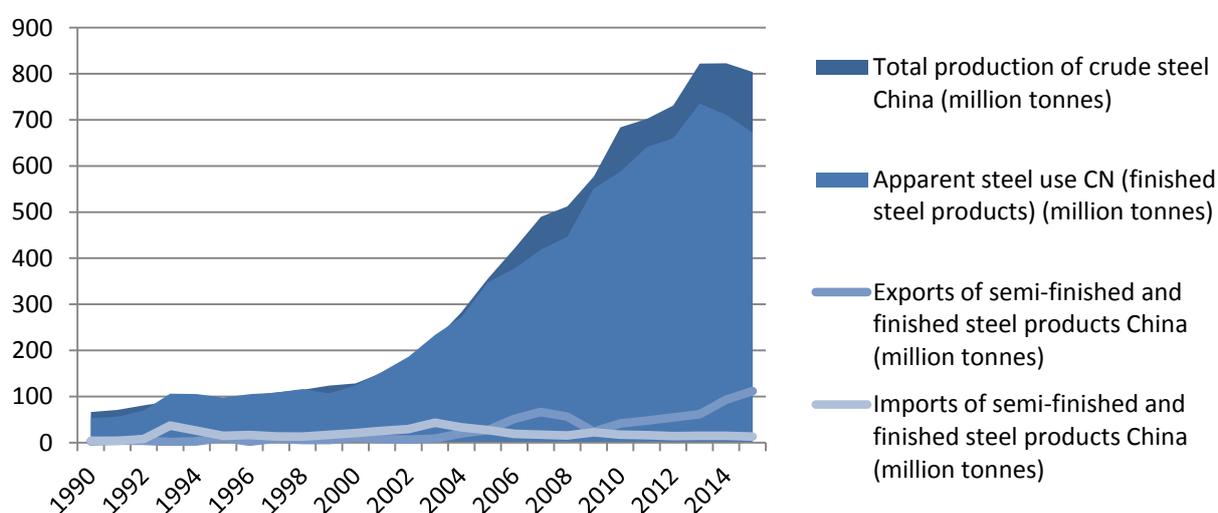
Third, only a limited share of China's steel production is exported abroad, as shown in figure 7. Steel exports collapsed after the onset of the crisis in 2008, followed by a gradual recovery, and a recent surge (which has fueled the anxiety of the European steel sector). Nevertheless, the scale of exports is still sufficiently large to have an impact on foreign markets.

Fourth, despite the current harsh tone

against Beijing in Brussels, China does not deliberately target the EU to drop its steel surpluses. As shown by figure 8, the EU's share of China's total steel exports remains largely unchanged.

As mentioned before, the Chinese government is aware of the problem. Already back in 2004, Beijing started advocating slower growth in steel industries.<sup>49</sup> Besides, the 2009 *Steel Industry Adjustment and Revitalisation Plan* released by the State Council aimed to control steel production by implementing stricter standards and consolidating the sector around several giants such as Baosteel.<sup>50</sup> Unfortunately, several factors - including the domestic development boom, a rising global demand and the pressure felt by local authorities to maintain employment and generate revenues - complicated efforts to shut facilities down. Then, in 2013, China's central government called for a reduction in production capacity of 80 million tonnes by 2017 and introduced a ban on approving new iron and steel projects for the regions.<sup>51</sup> In 2015, the MIIT (Ministry of Industry and Information Technology) announced a plan to bring the steel industry back to a "basically balanced level", aiming to raise

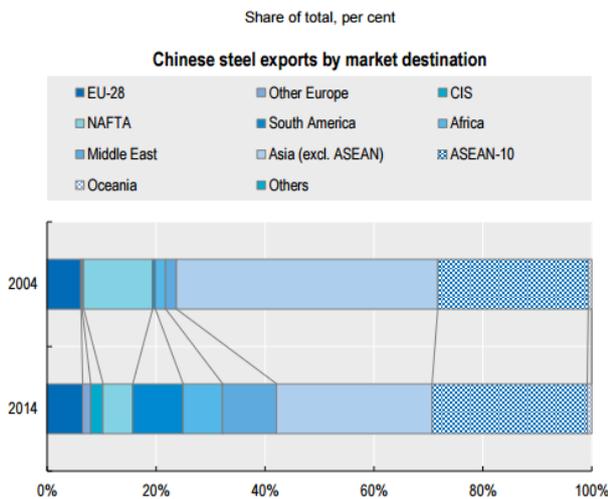
**Figure 7: Total production of crude steel; consumption of finished products and exports & imports of semi-finished and finished steel products in China**



Source: World Steel Association

the utilization rate to 80 per cent by 2017, which would require a large decrease of 2015 production levels.<sup>52</sup> Beijing seems to take its engagement to cut the steel production capacity seriously. In the 13<sup>th</sup> five-year plan 2016-2020, a target has been set to cut production by 150 million tonnes. The restructuring policies will probably cause 1.3 million coal workers and 500,000 steel workers to lose their jobs, of which a majority is working for state-owned enterprises. In this light, Yin Weimin, the Chinese minister for human resources and social security, announced that a 15 billion USD fund would help to resettle laid-off workers.<sup>53</sup> In the meantime, the Chinese government has already ceased to license steel projects and has started to eradicate zombie companies. On top of that, China is aiming to spur the international demand for steel through infrastructure development projects and its Belt and Road Initiative.<sup>54</sup>

**Figure 8: Chinese steel exports by market destination and product, 2004 and 2014<sup>55</sup>**



Source: OECD

The EU, for its part, is observing the ongoing developments in China with vigilance. According to Eurofer, the European steel industry has lost about 7000 jobs in the last six months, and the announcement of Tata Steel’s plans to

pull out of Britain, which would threaten 15,000 jobs, has only increased tensions.<sup>56</sup> In February 2016, the European Commission opened three new anti-dumping investigations against steel from China. EU Commissioner for trade, Cecilia Malmström, thereby expressed “[determination] to use all means possible to ensure that our trading partners play by the rules [...] and to effectively address legitimate concerns of our industry.”<sup>57</sup> Moreover, the Commission decided to take action “on the basis of ‘threat of injury’ rather than waiting for the injury to materialise.”<sup>58</sup> Jean-Claude Juncker, president of the European Commission, even linked China’s Market Economy Status and its steel overcapacity, stating that it must close down steel mills dumping excess production in Europe.<sup>59</sup> This hardening tone towards China marks a shift in the Commission’s position towards Beijing. The U.S. took even a harder line, imposing duties of 265.79 per cent for several Chinese steelmakers in March.<sup>60</sup>

Despite the doomsday predictions about future employment perspectives in the European steel sector, little is said about the eventual positive implications of cheap steel for downstream industries. The European car industry may, for instance, experience lower material costs, which could in turn result in lower consumer prices, boosting demand and generating job gains in other sectors.<sup>61</sup> Furthermore, the current peak in global steel overcapacity will not continue to exist on the long term. Several experts consider the low steel prices seen in late-2015 an anomaly and estimate the Chinese steel market to have already reached its turning point.<sup>62</sup> They foresee the market to correct in 2016, be rebalanced in 2017, and return to normal from 2018.<sup>63</sup> Some even predict that the capacity cuts may happen on a bigger and faster scale than announced by the Chinese government.<sup>64</sup> The recent

contractions of steel consumption and production in China seem to confirm this image. According to Xu Kunlin, Deputy Secretary-General of China's National Development and Reform Commission, China is indeed ahead of schedule in phasing out excess steel capacity, already cutting down 40 million tons of capacity compared to the annual target of 45 million tons.

The concerns of the European steel industry about job losses are understandable and legitimate. The global overcapacity in steel resulted in a major drop in prices, threatening the profitability of steel mills and forcing them to lay off labourers. These corrections are very painful indeed. The idea that the EU would no longer be allowed to use alternative methodologies to determine the normal value when calculating dumping margins in AD cases against China have sparked fears for even more job losses. However, despite the harsh statements towards Beijing, China and Europe are in this together. The EU employs 350,000 people in the steel sector of which 55,000 manufacture products that are covered by AD measures.<sup>65</sup> What is often forgotten is that China, from its side, will have to absorb job losses and provide resettlements for millions of labourers.

Both Brussels and Beijing are committed to address overcapacity and to protect their workforces. However, rather than turning to protectionism, which could temporarily safeguard the domestic market but would be harmful on the long term due to retaliations or even a trade war, the EU and China should operate hand in hand in these times of economic hardship. This could, for instance, be achieved through the upcoming EU-China bilateral platform on steel overcapacity, which was established following the EU-China Summit on 19 July.<sup>66</sup> China and Europe reconfirmed their willingness to

maintain a dialogue on overcapacity at the 6<sup>th</sup> High-level Economic and Trade Dialogue, thereby stating that they are "committed to make operational the Global Steel Forum on Excess Capacity".<sup>67</sup> The solar panel case has already proven that both parties are able to reach an amicable and mutually acceptable agreement. A similar deal with regard to the exports of steel between the EU and China or, preferably, within a WTO-setting, could furthermore ease tensions when it comes to China's Market Economy Status.

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<sup>1</sup> Eurostat (2016). Retrieved from: [http://trade.ec.europa.eu/doclib/docs/2012/march/radoc\\_149251.pdf](http://trade.ec.europa.eu/doclib/docs/2012/march/radoc_149251.pdf)

<sup>2</sup> Ibidem

<sup>3</sup> Hanemann, T. and Huotari, M. (2015). Chinese FDI in Europe and Germany – Preparing for a New Era of Chinese Capital. *Mercator Institute for China Studies and Rhodium Group*, p. 5. Retrieved from [http://rhg.com/wp-content/uploads/2015/06/ChineseFDI\\_Europe\\_Full.pdf](http://rhg.com/wp-content/uploads/2015/06/ChineseFDI_Europe_Full.pdf)

<sup>4</sup> Baker & McKenzie (2016). Reaching New Heights: An update on Chinese investments into Europe. Retrieved from: [http://www.bakermckenzie.com/files/Uploads/Documents/ar\\_emea\\_reachingnewheights\\_mar16.pdf](http://www.bakermckenzie.com/files/Uploads/Documents/ar_emea_reachingnewheights_mar16.pdf)

<sup>5</sup> Plasschaert, S. (2016). Assessing the Solar Energy Dispute between the European Union and the People's Republic of China. *ECIPE Working Paper No.01/2016*

<sup>6</sup> Baker & McKenzie, Reaching new Heights

<sup>7</sup> European Commission- DG Trade. Retrieved from: [http://ec.europa.eu/trade/policy/accessing-markets/trade-defense/index\\_en.htm](http://ec.europa.eu/trade/policy/accessing-markets/trade-defense/index_en.htm)

<sup>8</sup> Government of the United Kingdom. Retrieved from: <https://www.gov.uk/guidance/anti-dumping-duty-to-protect-eu-businesses-against-cheap-imports>

<sup>9</sup> The Lesser Duty Rule (LDR) means that the dumping margin is compared to the injury margin. As the EU aims to protect the domestic industry from unfair behaviour rather than harming foreign exporters, the AD duty will always be based on the lower of the two margins.

European Union. (2009). Council regulation (EC) No 1225/2009 on protection against dumped imports from countries not members of the European Community. *Official Journal of the European Union*. Retrieved from [http://trade.ec.europa.eu/doclib/docs/2010/april/tradoc\\_146035.pdf](http://trade.ec.europa.eu/doclib/docs/2010/april/tradoc_146035.pdf)

<sup>10</sup> The Union Interest Test considers "whether the positive effects on EU industry are offset by negative effects in other areas/sectors of the economy, after considering all relevant EU interests".

Barone, B. (2015). One year to go: The debate over China's market economy status (MES) heats up. *DG For External Policies, European Parliament*, p. 7

<sup>11</sup> World Trade Organisation, Agreement on Subsidies and Countervailing Measures. Retrieved

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<sup>12</sup> Government of the United Kingdom. Retrieved from: <https://www.gov.uk/guidance/anti-dumping-duty-to-protect-eu-businesses-against-cheap-imports>

<sup>13</sup> European Commission – DG Trade. Retrieved from: [http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc\\_151014.pdf](http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_151014.pdf)

<sup>14</sup> Wruuck, P. and Levinger, H. (2016). Ending China's differential treatment. Deutsche Bank Research Briefing. Retrieved from [https://www.dbresearch.com/PROD/DBR\\_INTERNET\\_EN-PROD/PROD000000000394871/Ending\\_China%E2%80%99s\\_differential\\_treatment%3A\\_What%E2%80%99s\\_at\\_s.PDF](https://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD000000000394871/Ending_China%E2%80%99s_differential_treatment%3A_What%E2%80%99s_at_s.PDF)

<sup>15</sup> Global Anti-Dumping Database. Retrieved from: <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTD/EXTRESEARCH/EXTPROGRAMS/EXTTRADERESEAR/0,,contentMDK:22571408~pagePK:64168182~piPK:64168060~theSitePK:544849,00.html>

<sup>16</sup> European Commission (2016). Change in the methodology for anti-dumping investigations concerning China. Retrieved from: <http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc.154241.pdf>

<sup>17</sup> Wruuck and Levinger, Ending China's differential treatment?

<sup>18</sup> Business Europe (2015) China's Market Economy Status. Position Paper. Retrieved from: <https://www.buinesseurope.eu/publications/chinas-market-economy-status>

<sup>19</sup> Scott, R.E. and Jiang, X. (2015). Unilateral Grant of Market Economy Status to China would put Millions of EU Jobs at risk. *Economic Policy Institute, EPI Briefing* No. 407

<sup>20</sup> European Commission. Change in the methodology for anti-dumping investigations concerning China.

<sup>21</sup> European Commission. Change in the methodology for anti-dumping investigations concerning China.

<sup>22</sup> Ibidem

<sup>23</sup> The assessment was carried out by an external agency.

<sup>24</sup> European Commission. Change in the methodology for anti-dumping investigations concerning China.

<sup>25</sup> European Commission. Change in the methodology for anti-dumping investigations concerning China.

<sup>26</sup> Wruuck and Levinger, Ending China's differential treatment?

<sup>27</sup> European Commission (2016). Change in the methodology for anti-dumping investigations concerning China.

<sup>28</sup> Zanardi, M. (2016). Market Economy Status for China after 2016? Some Considerations, in Workshop - Market Economy Status for China after 2016? Retrieved from [http://www.europarl.europa.eu/RegData/etudes/STUD/2016/535023/EXPO\\_STU%282016%29535023\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2016/535023/EXPO_STU%282016%29535023_EN.pdf)

<sup>29</sup> Deynoot, C.G. et al., *Towards China's Market Economy Status*

<sup>30</sup> Ibidem

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## 4 Political Perspective

- The debate on MES has shown that it is difficult for the EU to speak with **one single voice**
- **Member states are divided** over changes in legislation on Trade Defense Instruments and China's MES. As a result, the European Council is currently in a gridlock over legislative changes
- The **European Parliament** is by far the most outspoken on MES – a recent vote showed that a **vast majority is against** the granting of MES to China
- The **EU-China 2020 Strategic Agenda for Cooperation** currently sets the direction for engagement. The **EU-China Summit in July 2016** further cemented the relationship
- Debates over MES coming one year after the EU and China celebrated the **40<sup>th</sup> anniversary of diplomatic ties**
- Progress in the EU-China relationship is not limited to burgeoning trade figures, and has taken root in a myriad of **joint initiatives, collaborative platforms, and dialogues** that put flesh on the bones of the Strategic Partnership
- Despite some obstacles China and the EU have found pragmatic ways to uphold **cooperation in a number of key areas** (security, connectivity, global governance and people-to-people exchanges)
- In order to come up with a legislative proposal on the calculation method for investigations in anti-dumping cases, the European Commission is presently considering **different options** whilst analysing the outcome of an impact assessment
- The recognition of a country as a Market Economy is often a **political decision**, as shown by Australia's granting MES to China, and the EU to Russia

### 4.1 The EU's internal debate on MES – a plurality of voices

Over the past months, ever since the MES issue surfaced in EU-China relations, the EU institutions and member states have been cloaked in a political conundrum veiled in polarity. The particular nature of the EU, with its 28 (and soon to be 27) member states, increases the difficulty of reaching a common agreement. This is made even more convoluted by the heterogeneity in trade balances, differing economic setups and jarring political climates. Furthermore, it is yet to be seen what the impact of the Brexit-referendum on EU-China political and trade relations will be. Before this paper will lay out a political perspective on the MES debate, it is crucial to provide a brief overview of the dynamics at play within the EU institutions – where the debate on MES is still very much alive. Nonetheless, as December 11 approaches, there is an increased urgency to find a common position before this deadline.

The **European Commission** - Whilst going through the motions of weighing the impact assessment and working on a proposal that will find support in both the European Parliament and European Council, caution seems to be the leitmotif for the European Commission as they also try to maintain a collaborative approach towards China.<sup>1</sup>

Already back in 2008, the Commission released its first analysis on China's progress towards becoming a market economy, referring to the important and substantial reform efforts undertaken by Beijing.<sup>2</sup> In a communication in 2013, the European Commission commended Beijing on its progress, but reiterated that China still does not fulfill all the five MES criteria.<sup>3</sup> This prudence marks a shift in the Commission's stance compared to 2013, when commissioner for trade De Gucht explicitly stated that "in 2016 China will receive market economy status".<sup>4</sup>

DG Trade plays a dominant role in trying to find a compromise and solution that could find support with all parties involved. In referring to the Commission's three internal working options to steer discussions and deliberations on MES, Commissioner Malmström has been quite clear "that none of these options is cost free"<sup>5</sup>, especially because "China is firmly against any misinterpretation or delay in performance of the clause".<sup>6</sup>

On July 20, the College of Commissioners held a debate on the three options that were discussed in the impact assessment. EU Commission Vice-President Jyrki Katainen, responsible for Jobs, Growth, Investment and Competitiveness, stated that "... [the] discussion is not about whether or not China is a Market Economy. It is about how to adapt our trade defense instruments to deal with the realities of overcapacity and a changing international legal framework".<sup>7</sup> Commissioner Malmström added that "... The current situation of overcapacity, notably in steel, has shown that we need effective trade defense instruments to uphold fair trade and address market distortions in the future".<sup>8</sup> By consequence, the Commission called upon Member States to "move swiftly in the adoption of the proposal tabled in 2013 to modernise the EU's trade defense instruments". In the same communiqué, the Commission stated that "China should make significant and verifiable cuts in industrial overcapacity based on a clear timeline of commitments and an independent monitoring mechanism."<sup>9</sup> The Commission however insists on maintaining a dialogue with China concerning the overcapacity issue, which was demonstrated by the establishment of the – upcoming - EU-China bilateral platform on steel during the EU-China Summit in Beijing on 19 July.

Other than the European Commission, the **European Parliament** has been more

adamant in stating its position. With the reform of the Lisbon Treaty, the European Parliament has become more involved in the co-decision process which in some instances has complicated decision making, and has occasionally led to a tedious back-and-forth between the EP and Commission. With regard to MES, the debate reached its apex when the Parliament issued a non-binding resolution on 12 May, stressing that "China is not a market economy"<sup>10</sup>, followed by a counter-consultation, launched by a group of 68 MEPs after the decision of the Commission not to provide a completely free form audit.<sup>11</sup> In this they found that 91 per cent of the respondents were against the granting of MES to China. Public opinion seems to be against the granting of MES (or a change in methodology), and seeing that MEPs align their voting with the interest of their constituencies, it is highly plausible that the European Parliament will remain an anti-MES bastion in the EU.

The **European Council** – as one of the legislative bodies in the EU, plays a critical role. Yet, the different interests and positions of the Member States on international trade matters have emerged and obstructed decisiveness on several occasions. A particular case here was a Council meeting in 2014 on the possible amendment of Trade Defense Instruments (TDI), during which member states were unable to find an agreement, once again showing the lack of resolve and disunity. As of today there is still no consensus on the reform of the EU's TDIs.<sup>12</sup>

This disunity in the Council is driven by two different approaches. The first one is more oriented towards the consumers while the second one is more industry and producer-oriented. While France, Germany and Italy pushed for stronger TDIs to safeguard against the import of goods from emerging economies; less

protectionist countries such as the United Kingdom, Sweden, and the Netherlands believe that more stringent trade defense instruments could undermine their market performance.<sup>13</sup> With regard to MES, the Council has not yet released an official position, and is awaiting a concrete proposal by the European Commission. The presidency of Slovakia could however lead to a tougher approach towards China, due to the importance of the steel industry for Slovakia's economy.<sup>14</sup>

#### **4.2 Brussels – Beijing: Strategic Cooperation**

Despite the present division within the European Institutions on China's Market Economy Status and the looming reforms on trade defense instruments, the EU-China relationship is more profound than the mere debate on MES.

"China and Europe need each other today more than ever for solving problems together. And the world needs China and Europe to cooperate in solving global problems more than ever".<sup>15</sup> With this strong statement last year, the President of the European Parliament, Martin Schulz, delivered a speech in Beijing to remark the importance of the diplomatic relations between two of the major players in the international arena. The visit to China was just one of many events organised to mark the 40<sup>th</sup> anniversary of diplomatic ties between the EU and China. The numerous ministerial meetings and high-level visits are testament to the many achievements reached since the establishment of diplomatic ties in 1975.

By virtue of the Strategic Partnership signed in 2003, the two sides have established a well-structured framework to guide their interactions, which is divided into three pillars and includes different areas of collaboration:

1. Strategic Dialogue;
2. Economic and Trade Dialogue;
3. People-to-People Dialogue.<sup>16</sup>

The amicable intentions were confirmed in 2013 by the adoption of the EU-China 2020 Strategic Agenda for Cooperation, which allowed the two parties to seek synergies whilst implementing the new strategies as envisaged in China's 13<sup>th</sup> Five-Year Plan and the EU 2020 Strategy.<sup>17</sup> The strong linkage between Beijing and the member states has been exemplified by growing trade figures, currently valued at 1.5 billion EUR per day, leading commercial relations to flourish.<sup>18</sup> As discussed in the previous chapter, China has become the EU's second largest trading partner after the US with a trade volume of 467 billion EUR.<sup>19</sup> Nonetheless, progress in the EU-China relationship is not limited to burgeoning trade figures, and has taken root in a myriad of joint initiatives, collaborative platforms, and dialogues that put flesh on the bones of the Strategic Partnership.

#### **4.3 Addressing Common Challenges**

Within a year after the celebration of the 40<sup>th</sup> anniversary of EU-China diplomatic relations, the friendly and harmonious tones seemed to have been replaced by fierce ones as a result of the MES-debate. It is widely accepted that "frictions in such a large and varied relationship as ours will always exist".<sup>20</sup> Nonetheless, these tensions could undermine the future relationship between EU Member States and China.<sup>21</sup> While the importance of the economic impact, and possible effects of recognising China as a Market Economy is often emphasised, the political perspective is less clear. Although there will almost inevitably be economic costs, several experts in the field have argued that the MES issue "is a profoundly political and strategic issue".<sup>22</sup>

Bilateral interactions between states are in constant flux. The continuous change of leadership, priorities, and variations in the international landscape make for a complex mixture. The EU-China relationship is a case in point, further compounded by the fact that the EU itself is a complex union of different member states with varying development paths, political agendas, and global views. Of worthy consideration is also the wider symbolic value that Chinese policy makers attach to obtaining Market Economy Status, in accordance with China's return to its "rightful place in the global economy".<sup>23</sup> Despite all this, and substantiated by over 70 bilateral dialogues, the EU and China have managed to find their way around most obstacles - thereby finding pragmatic ways to uphold cooperation. The next sub-chapter will highlight some of these core achievements, initiatives, and identify future possibilities.

#### *4.3.1 Security cooperation*

Cooperation in the security field is often challenging, not the least if one has differing views on international threats and different means towards an end. China's non-interference principle adds an intricate variable to the mix. Nonetheless, Brussels and Beijing have managed to make significant headway in terms of security cooperation. The anti-piracy campaign in the Gulf of Aden, and the proactive role played by the EU and China during the P5+1 negotiation for Iran's nuclear program, are prime examples.<sup>24</sup> Even though trade issues might dominate the agenda, both have a stake in regional and global stability. With a number of potential hotbeds (e.g.: Korean peninsula, South China Sea, the Middle East) security cooperation has become ever so important. "Not only because economic and security concerns are becoming increasingly intertwined, but also as non-traditional security threats become more

pronounced in international relations."<sup>25</sup> The EU and China have found one another in a shared "doctrinal concern with non-traditional security."<sup>26</sup> This should lay a robust foundation from which, in the years to come, one will see increased cooperation between the EU and China on security issues of common concern; religious extremism, water security, migration, and food security. For these specific challenges, as they play out in geographic areas that are fragile and still rather unstable; the Middle East, the Mediterranean, and Central Asia - a cooperative mindset is quintessential to avoid a spill-over to protracted conflicts.

#### *4.3.2 Connectivity*

A word very much in vogue, 'connectivity' seems to capture the spirit of EU-China relations. It not only encapsulates the vision of the end goal of the many physical infrastructure projects, but moreover appeals to a sense of belonging and community across the Eurasian continent. China's unprecedented Belt and Road project is the principal vanguard of EU-China connectivity.<sup>27</sup> Through a high number of infrastructure projects and billions of euros in investments, physical barriers to enhanced interaction are to be removed. The outer edges of the Eurasian landmass are to be brought in closer proximity, be it through enlarged trade flows, shortened travel times, or digital links. Given the high complementarity between China's grand projects and EU projects, it comes as no surprise that the EU was keen to welcome China's initiative. In addition to a vast number of member states joining the Asia Infrastructure Investment Bank (AIIB), the European Commission was eager to seek synergies amongst its own flagship programmes - the European Fund for Strategic Investment (EFSI), the Trans-European Transport Networks, as well as the Belt and Road project and some recently established financial institutions that were

initiated by China (e.g.: Silk Road Fund, New Development Bank).<sup>28</sup> To this end, during the EU-China Summit in June 2015, leaders agreed to establish the EU-China Connectivity Platform.<sup>29</sup> As such, a dialogue is procured that should improve the flow of information between the two counterparts, whilst pragmatically seeking constructive ways to tackle the challenges that persist in both Europe and China.

#### 4.3.3 *Global governance*

Most of the challenges that we face today are multifaceted in nature, and therefore necessitate a multilateral approach. To achieve relevance and a long-lasting impact, unity amongst international players is vital. Nonetheless, one can observe contradictory dynamics in international relations. While major players attempt to establish their global strategies and secure their significance, politicians are simultaneously elected and policies endorsed that are inward looking and even protectionist. The EU is a clear example of this; whilst trying to set a global footprint, a lot of its member states are becoming more inward looking and seem to fall for populist arguments, fear mongering, and protectionist tendencies. This is putting great strains on the European project, but could moreover compromise the resolve of the EU abroad. A continued global view is fundamental for the EU as it will ensure goodwill from its partners as well as allow it to share its wealth of knowledge and experience to drive global processes.

To tackle global challenges, a strong and committed China and EU in a global governance setting are needed. Accounting for around 25 per cent of the global population, their policies have a true global bearing. The outcome of COP21 in 2015 was in many ways groundbreaking, not the least because of the commitments of the United States and China, and the behind the scenes

preparatory work of the EU. By means of numerous dialogues, the EU and China have taken climate change as one of the core pillars driving cooperation. The 2015 EU-China Joint Statement on Climate Change is representative of this.<sup>30</sup> The statement confirms that both sides aim to 'further enhance their policy dialogue and practical cooperation on the transformation to a resource efficient, green, low-carbon and climate resilient economy and society.'<sup>31</sup>

Likewise, numerous other fora have provided opportunities where the EU and China find each other. The G20 summit in Hangzhou, which took place in September this year, is one such opportunity. Its members discussed international global economic cooperation, cooperation on investments, innovation, taxation, financial cooperation, and diverging trade patterns, in order to ensure that free trade is truly a win-win situation. In the end, global governance environments provide for a unique setting where the EU and China (and other members) can enter into dialogue on issues of mutual concern. It is only through dialogue that one can truly come to understand the intricacies at play, and seek policy convergence.

#### 4.3.4 *People-to-People Exchanges*

As the third pillar of the strategic partnership, people-to-people relations are a prime feature of the EU-China relationship. The citizens are on the receiving end of all the policy legwork that is being done through all political and economic dialogues. The ever-expanding exchanges provide a human touch. Especially in a global context, where security threats lure and globalisation has driven people simultaneously closer towards each other, and yet farther away at the same time, inciting forces of nativism and 'otherness'; mutual understanding, respect, and appreciation

for ones differences and similarities is crucial.

In order to strengthen and foster people-to-people exchanges, the EU and China have established a wide variety of programmes. Both China, through a high number of scholarships, and Europe, through such programmes as Erasmus Mundus, are promoting the mobility of students and academics. Moreover, the European Commission's Horizon2020 programme seeks to fund innovation and research cooperation between European and Chinese researchers. More recently, the *Europe-China OBOR Culture & Tourism Development Committee* was established, bringing together representatives from the business, tourism, and public sector in order to streamline cultural initiatives and promote tourism along the New Silk Road. Last but not least, sub-national cooperation is fundamental in fostering exchanges. Through city-to-city partnerships, and provincial exchanges, the most concrete methods of cooperation and implementation are established.

The abovementioned examples serve the purpose of showing that the EU-China relationship is not merely limited to trade flows, investments, and high-level political dialogues. The relationship is diverse and plays out on numerous levels; from European students returning after studying Mandarin, to a forum where mayors of cities convene to discuss urbanization and demographic challenges, to representatives of innovation-driven companies that meet to discuss Industry 4.0. The relationship is by no means

***"The decision on MES has to be a political decision in order to avoid a situation in which the focus on connectivity is steered in the direction of a disconnected Europe and China"***

perfect, and there is still ample room to improve and authenticate cooperation. Currently, the Market Economy Status is dominating public debate, and figures on job losses and messages on the loss of EU competitiveness proliferate. Better awareness of the multifaceted EU-China relationship puts the MES debate in perspective. Any decision other than granting MES to China and changing the methodology to calculate dumping margins could be to the detriment of the overall relationship. Trust, vision, and the right appreciation for a cost-benefit analysis are essential to maintain cooperative, friendly, and rewarding relations. The decision on MES has to be a political decision in order to avoid a situation in which the focus on connectivity is steered in the direction of a disconnected Europe and China.

The EU needs to be fully aware of all the great achievements made in collaboration with China and the importance of this strategic partnership. Not only to drive an international agenda of cooperation, but also to find integrated solutions to address domestic challenges in both Europe and China. The accomplishments made by virtue of the Beijing - Brussels alliance, and the consequent risk to jeopardize all that has been achieved, must be the basis for a more constructive approach to find a solution for a trade issue that has become a political flashpoint.<sup>32</sup>

The last section of this political part will present two case studies; the EU's decision to grant Russia Market Economy Status, and Australia's decision to grant China Market Economy Status. How do the experiences of these examples hold up against the current MES-debate? And why could they be relevant?

#### 4.4 Case Study: Australia – One Pioneer amongst Many

One way for the EU to consider whether and how to grant MES is to examine one of pioneer countries that opted for an early MES recognition to China. Australia, like many countries such as New Zealand, Peru, Chile, and ASEAN nations, has decided to grant early recognition of MES to China in order to establish an FTA. This section attempts to examine the rationale behind Australia's decision and its ensuing consequences, aiming to shed light on the political considerations at play.

China claims that the recognition of MES is a compulsory precondition for FTA negotiations, as this would guarantee the equal position of both parties.<sup>33</sup> On the Australian side, Treasury Department Secretary Ken Henry confirmed that economic integration with China would be more an opportunity rather than a threat on the basis that the sum of export trade would continuously increase despite the possibility of the manufacturing industry reducing its percentage of GDP growth.<sup>34</sup> Australia's early recognition of China's Market Economy Status does undoubtedly raise the issue of unfair competition. However, many Australian policy-makers believe the costs of this would be exceeded by the benefits of the Free Trade Agreement, although only time will demonstrate if this is the case since the FTA has only come into force in December 2015. In fact, the early recognition has already raised some concerns, not the least because of Australia's usage of 'particular market situation' methodologies in handling AD cases against China since 2010.

"A particular market situation implies 'abnormal' market conditions that hinder the calculation of adequate prices and costs, or the non-existence of the 'ordinary course of trade' inside China to legitimize special methods for price

calculations in AD procedures".<sup>35</sup> This allows for the usage of the analogue country methodology against China in case of AD investigations, the implementation of which, may however bring Australia into relatively uncharted and contested legal territory.

According to the WTO Anti-Dumping Agreement, Article 2.2 "... [B]ecause of the particular market situation ... sales do not permit a proper comparison, the dumping margin shall be determined by comparison with a comparable price of the like product when exported to an appropriate third country, provided that this price is representative."<sup>36</sup>

This article clarifies that a non-general methodology is still viable for countries that were granted MES as long as an importing country considers the situation in an exporting country to qualify as a particular market situation. Nonetheless, what remains unclear in the article is what determines a particular market situation. In response, the Anti-Dumping Commission in Australia specifies three circumstances to determine whether the exporting country might distort the price of exported goods: 1) "where a major input is produced by an associate of the exporter", 2) "where a major input is produced by a subsidiary company over which the exporter exercises control, or from an integrated processor" and 3) "where a major input is influenced by the government".<sup>37</sup> If the exporter falls into any of these scenarios, which might draw the presumption that scrutinized countries might benefit 'the particular market situation', it might lead to the measure that "...the other country surrogate methods are possible."<sup>38</sup> This renders it legitimate for Australia to grant MES to China while simultaneously continuing to use the analogue country methodology in exceptional circumstances. However, this would hinder China from attaining the full benefits of its MES recognition.

However, this method has “a high degree of legal uncertainty about the long-term viability of such an approach to trade defense”.<sup>39</sup> This is due to the likelihood that the usage of a particular market situation may be scrutinized in the event of a complaint by China against Australia at the WTO, the results of which could be unfavourable to either country.

#### **4.5 Case Study: Russia — A Gift Box from the EU**

The case of Australia is an exceptional one since its specific desire of an FTA with China drove Canberra to make the political decision of granting Market Economy Status to China. Nonetheless, there are additional reasons to argue that MES could be a political decision instead of an economic consideration. The EU’s decision to grant MES to Russia is exemplary due to the fact that Russia was granted MES without being scrutinized by the EU’s five criteria. The Russia-case raises questions over the rationale of the EU to use different arguments in the context of China. What was the EU’s rationale on Russia? And how is this case linked to the current conundrum on China? The subsequent section will attempt to answer these questions.

As Romano Prodi stated in 2002: “...as Russia’s principal trading partner, it is right and proper that we be the first to recognize and reward the considerable efforts undertaken by this country in recent years by treating it as a fully fledged market economy...”.<sup>40</sup>

This granting of MES to Russia, just ahead of the EU-Russia Summit, was revealed without informing DG Trade, and was considered a political decision on the initiative of the (then) president of the European Commission. There was no technical underpinning for this decision except for reference to “the considerable efforts undertaken by this country in

recent years”. However, some facts, including the significance of the date of publicizing Russia’s market economy status, could be relevant as an explanation.<sup>41</sup> This recognition came just before the EU-Russia Summit in 2002, during which a contemporary issue was Russia’s request to build a visa-free corridor for Russians to travel between Kaliningrad and Russia once Poland and Lithuania joined the EU. Putin, despite claiming that “without exaggeration, one can say that how our relations with the European Union develop depends on how this dispute is settled”, failed to convince European officials over a visa-free corridor to Kalinigrad.<sup>42</sup> Thus, the EU hoped to mitigate tensions over the bitter dispute of Kaliningrad by granting MES to Russia, before even the US doing so. This was furthermore thought to potentially enhance the EU’s image in Russia because “Europeans were making a very strong public point that they want to be seen as a more reliable partner to Russia than the US”.<sup>43</sup> Thus, the EU’s granting of MES to Russia, like in the case of Australia, was a political decision, the consequences of which, along with the EU’s response, are stated below.

To mitigate the consequences of granting MES to Russia, the commission published an amendment to its regulation (EC) No 384/96 in November of the same year. Two of the changes are briefly introduced here. First, in Article 2(3), the definition of a particular market situation is specifically addressed as below:

“A particular market situation for the product concerned within the meaning of the preceding sentence maybe deemed to exist, inter alia, when prices are artificially low, when there is significant barter trade, or when there are non-commercial processing arrangements.”<sup>44</sup>

Second, in article 2(5), one sentence is added:

"If costs associated with the production and sale of the product under investigation are not reasonably reflected in the records of the party concerned, they shall be adjusted or established on the basis of the costs of other producers or exporters in the same country or, where such information is not available or cannot be used, on any other reasonable basis, including information from other representative markets."<sup>45</sup>

These two changes de jure negate all benefits Russia could obtain from the political recognition of MES as the definition of a particular market situation is almost akin to a non-market economy, and Russia falls into this category. In addition, the earlier Article 2(5) states "...it is appropriate to allow normal value for Russian exporters and producers...".<sup>46</sup> But the newly added sentence in the amendment allows the EU to re-investigate the exporting prices of Russian companies. These two legislative changes – also known as the Russian Amendment –, guarantee the EU's usage of the cost adjustment methodology and the analogue country methodology despite Russia being granted Market Economy Status, reasonably supporting the idea that "it's very likely that whatever the commission gives as a political gesture, it might take back on the technical side".<sup>47</sup> So it appears to be that the EU's granting MES to Russia is like a gift box. What is inside the box is determined by EU-legislation. So far, if Russia cannot find a way to force the EU to use the WTO standard methodology to investigate AD cases, it could be argued that the gift box for Russia has been an empty one.

This in some way advances the question that if the granting of MES to Russia was a political decision with technical backup, why does the EU not do the same to China? China is far more complicated than Russia when it comes to the handling of

AD investigations due to the diversified nature of Chinese exports involving various consumer goods instead of raw materials like energy as in the case of Russian exports.<sup>48</sup> In addition, at the time Russia was granted MES, it was not a member of the WTO. The EU therefore had more opportunities at its disposal to protect itself against dumping of Russian products. Therefore, the costs of granting MES to China cannot adequately be compensated by legislation changes, as done in the case of Russia, resulting in hesitations from the EU to make the same political decision with regard to China. In addition, Argentina's complaint against the EU at the WTO<sup>49</sup>, where the EU lost its case for anti-dumping measures on biodiesel in Argentina, could potentially have set a precedent for the inappropriate usage of the cost adjustment methodology against market economies, and encouraged Russia to launch two WTO complaints against the EU.<sup>50</sup>

To conclude, granting MES to China is possible if there are persuasive political benefits ahead for the EU, such as the FTA in the case of Australia or the Kaliningrad visa issue with Russia. Granting MES in this case would arguably be a political decision, albeit on a different path from what Australia has taken with China, or the EU with Russia. Currently, it is presumed that if the EU would politically decide not to grant MES to China, this would buy the EU around three years of time - the average duration of a case at WTO - before the WTO would decide that the EU does not comply with WTO rules when applying non-regular methodologies.<sup>51</sup> This would give rise to another political consideration; that of whether this three-year extension is really necessary for the EU. Given the aforementioned strategic cooperation between Brussels and Beijing (strategic, economic and trade, and people-to-people dialogues) and core achievements (security cooperation, connectivity, global

governance, and people-to-people exchanges), one can argue that the MES-debate is just a minor organism in the larger ecosystem that sustains and shapes EU-China relations. The EU would therefore have a lot to gain by adhering to its international obligation to cease using the third country methodology.

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## 5 Conclusion

The discussion about article 15 of China's WTO accession protocol was initially reserved for legal experts. However, as the legal perspective of this research paper demonstrated, there is still no consensus and different opinions are omnipresent. This uncertainty indicates that the EU will eventually have to make a political decision about its future anti-dumping methodology against China; a decision that could have major economical and (geo)political ramifications. Nonetheless, the persisting economic malaise in Europe in the aftermath of the economic recession, in conjunction with China's temporary slowdown as part of its transformation towards a value-driven economy has complicated matters.

In the EU, the economic challenges and several difficulties such as the migration crisis and social unrest, have led populist and inward-looking parties to expand their political power. In this light, the public opinion has become rather vigilant when it comes to job losses, and growth and employment have climbed to the top of the political agenda. At the same time, China's economic transition compounded by a global decrease in demand for goods such as iron and steel has led to overcapacity and, consequentially, a major drop in prices.

With this combination of events taking place, the December deadline comes at a particularly inconvenient time. Import-competing industries that traditionally benefit from AD measures against China fear for job and profit losses, and feel intimidated by the perspective of cheap imports. They have embarked upon an intensive lobbying campaign and claim that China is not a market economy since it does not meet the EU's five criteria. As shown by its recent resolution, also the

European Parliament takes a tough stance when it comes to the EU's anti-dumping methodologies concerning China. Whereas the Council still seems to be divided, the European Commission is taking a prudent position and has postponed the announcement of its official stance to a later date before the end of this year. This research paper argues that the following factors and perspectives should be taken into account:

First, the job losses and gains of either scenario are hard to estimate and will vary across member states and industries. A few early impact assessments have been undertaken and they largely differ in their outcomes. Only 1.38 per cent of EU-China trade is affected by AD duties, and the employment subject to those measures is mainly located in Germany, Italy, France and Spain. This heterogeneous distribution across member states is also applicable to industries, where mainly the chemical, steel, ceramics and electronics sectors are covered by AD measures. For other sectors, such as the retailing, solar panel or ceramics importers, the duties are an impediment to their business. Furthermore, the interests of European enterprises that produce in China and export to Europe are often disregarded in the debate.

Second, China is the second most important trade partner to Europe. Whereas AD measures are only related to goods, the trade in services has significantly increased over the years, with an average growth of no less than 10 per cent. China is the EU's third most important partner in terms of extra-EU trade in services, which is furthermore one of the trade components in which the EU has a surplus with China. The future prospect of a Chinese consumer-driven

economy is a massive opportunity for Europe in this context, and it should be considered when a decision on China's MES is taken.

Third, although bilateral investment flows still remain rather modest, China is increasingly becoming an important source of FDI into Europe, in particular during these times of economic hardship. Moreover, European enterprises have massively invested into China due to beneficial manufacturing costs and the huge potential of China's consumer market. It must be admitted that there are still some concerns regarding market access, IPR and preferential treatments for Chinese SOEs. Nevertheless, the ongoing negotiations for an EU-China Bilateral Investment Agreement (BIA) could address these imperfections and unleash the immense investment potential between China and Europe. This could in addition be a first step towards a future Free Trade Agreement (FTA). An escalation of the anti-dumping debate with regards to China would arguably jeopardise this momentum.

Fourth, Brussels and Beijing have expanded their relationship to a level that transcends investments and trade. The past forty years of EU-China relations witnessed substantial achievements, ranging from global security, non-traditional threats, climate change and infrastructure investments to educational exchanges, mobility and tourism. Given the current migration crisis, alarming economic developments, environmental concerns, and security tensions, the global outlook may have some tough challenges in store that will require a coordinated multilateral response. A strong EU-Chinese partnership will prove indispensable in the future. It would be a cause for concern if this is put at stake for the MES-question, which is indeed controversial, but all in all covers only a

small fraction of the wider ties between China and Europe.

Fifth, even if the EU would decide to cease using the analogue country methodology – known as the second option – an array of other instruments can protect the domestic market against unfair competition. It is after December still allowed to initiate anti-subsidy investigations and to impose countervailing measures and safeguards. Moreover, the EU has already gained experience with applying a cost adjustment methodology to a market economy in the case of Russia, and a similar strategy is being applied by Australia towards China. These methodologies are based on precarious legal grounds but have not been dismissed by the WTO, despite several precedents which brought questions to the long-term viability of these methodologies. Nevertheless, it is clear that there are more alternative pathways than the analogue country methodology for the EU to protect its industries.

The most advantageous scenario for EU-China relations would be for the EU to cease using the third country methodology and to start using domestic prices in anti-dumping investigations against China from 12 December onwards. As a result of the coinciding economic developments in both Europe and China, the EU is divided along fault lines between member states, political groups, fractions opposing or supporting free trade and different sectors. It is hence improbable that the European institutions will be able to reach consensus before the December deadline. As a result of this gridlock, the EU might eventually end up not granting MES to China, which will involve tremendous legal, political and economical repercussions.

As a result, Europe would display its inability to act swiftly as an international actor. The MES-conundrum is in this

respect a litmus test for Brussels to showcase its political capabilities. Brussels and Beijing have proven in the past that they are able to reach an amicable and mutually beneficial agreement in the solar panel dispute. A similar approach for particular sectors under pressure (such as

the steel industry) could alleviate European concerns and allow the institutions to push for China's Market Economy Status. In this scenario, both the EU and China would gain. In any other scenario, they have a lot more to lose.

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**Interviews**

Interview with Mr Jean-François Bellis, Van Bael & Bellis

Interview with Mr Richard W.D. Luff, Van Bael & Bellis



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