

## Statement on Market Economy Status for China

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Article 15 of China’s Protocol of Accession to the World Trade Organization (WTO), dated November 10, 2001, generally allowed other WTO members to disregard Chinese prices and costs in antidumping (AD) cases and instead base the calculation of dumping margins using external benchmarks.<sup>2</sup> An exception was made if Chinese producers could “clearly show” that market economy conditions prevailed in the industry. Article 15 essentially authorized “nonmarket economy” (NME) methodologies long used by the United States and the European Union in AD cases against imports from communist countries.

Taking advantage of this provision, authorities in the United States, European Union, Japan, and Canada, among others, almost always use surrogate prices and costs to calculate Chinese dumping margins. Rarely are the authorities satisfied that market economy conditions prevail in Chinese industries.

The comparison of Chinese export prices with surrogate prices and costs, rather than Chinese prices and costs, typically leads to much higher dumping margins. Since China is a leading target of dumping cases worldwide,<sup>3</sup> the NME methodology is a sore point with Chinese officials. In fact, more than 10 years ago, China mounted a vigorous diplomatic campaign asking trade partners to accord China market economy status (MES). The campaign succeeded with New

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<sup>1</sup> This statement is largely based on a blog post by Gary Hufbauer and Cathleen Cimino-Isaacs, “Looming US-China Trade Battles?: Market Economy Status (Part II),” Trade and Investment Policy Watch, March 9, 2015, <http://blogs.piie.com/trade/?p=145>.

<sup>2</sup> As external benchmarks, the United States values Chinese factors of production (labor of different qualities, energy, materials, etc.) at prices published by the World Bank or another reliable source for conditions in a market economy. The European Union instead uses the costs of a surrogate firm in another country that makes the same product. Using such external benchmarks for normal value in an AD case actually compensates automatically for any undervaluation of the Chinese currency, since the values are expressed (and come from) currencies of market economy countries.

<sup>3</sup> In 2014, 63 AD cases were filed against China, out of a total of roughly 240 initiated worldwide. See [www.antidumpingpublishing.com/statistics/](http://www.antidumpingpublishing.com/statistics/).

Zealand (April 2004),<sup>4</sup> Singapore (May 2004),<sup>5</sup> Malaysia (May 2004),<sup>6</sup> Australia (April 2005),<sup>7</sup> and other countries, but not with the United States, the European Union, Japan, Canada, and several others.

Which brings us to the looming WTO issue. Article 15(a)(ii) of the Protocol states:

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....

However, buried in Article 15(d) is the critical sentence:

In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession.

Chinese officials insist that this sentence requires all countries to accord China market economy status on December 11, 2016, 15 years after China's accession, and that WTO members can no longer use surrogate costs and prices in AD cases.

Some lawyers read the text differently. While they agree that Article 15(a)(ii) effectively disappears on December 11, 2016, they do not agree that the Protocol confines WTO members to a binary choice between MES (strict comparison of export prices with Chinese prices or costs) and NME (comparison with surrogate prices or costs). They point to the opening language in Article 15(a), which states:

...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....

To be sure, under Article 15(d), the whole of Article 15(a) disappears:

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....

The United States might well argue, come December 11, 2016, that China has not established that it has become, in all important respects, a market economy. The Commerce Department could modify its current surrogate practices and instead use a "mix-and-match" approach—claiming on a case-by-case basis that some Chinese prices or costs reflect market conditions and others do not. For the prices or costs that do not reflect market conditions, the Commerce

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<sup>4</sup> "New Zealand Gives China Market Economy Status," *China Daily*, April 16, 2004, [www.china.org.cn/english/BAT/93136.htm](http://www.china.org.cn/english/BAT/93136.htm).

<sup>5</sup> "Singapore Recognizes China's Full Market Economic Status," *Xinhua News*, May 15, 2004, <http://china.org.cn/english/MATERIAL/95470.htm>.

<sup>6</sup> "Malaysia recognizes China's full market economy status," Embassy of People's Republic of China, May 29, 2004, <http://in.chineseembassy.org/eng/jjmy/t122928.htm>.

<sup>7</sup> "Australia grants full market economy status to China," *Asian Tribune*, April 20, 2005, [www.asiantribune.com/news/2005/04/20/australia-grants-full-market-economy-status-china](http://www.asiantribune.com/news/2005/04/20/australia-grants-full-market-economy-status-china).

Department could use surrogate prices or costs. This seems most likely in industries, such as steel, dominated by state-owned enterprises, with large losses financed by state-controlled banks.

Whether the United States takes a “mix-and-match” approach, rather than granting China blanket market economy status, will turn primarily on policy considerations, not legal parsing. The policy decision may reflect the general atmosphere of commercial relations with China late in 2016, including the evolution of the renminbi exchange rate (manipulated devaluation would inspire a harder line)<sup>8</sup> and the outcome of US-China bilateral investment treaty (BIT) negotiations (success would have the opposite effect).<sup>9</sup>

Assuming the United States adopts a “mix-and-match” approach, the stage will be set for China to initiate WTO litigation. In this scenario, the year 2018 seems the earliest date for a final decision by the WTO Appellate Body. My guess is that the Appellate Body would rule against the “mix-and-match” approach. Even so, China would not receive retroactive refunds for antidumping duties collected prior to the ruling. Moreover, within China, the US denial of full-fledged MES would resonate strongly, in a negative way. Antagonism would be particularly strong if, as I expect, the European Union and other major countries accord MES in December 2016. Consequently, China would likely retaliate in opaque ways against US exporters and investors.

On balance, the United States would lose more than it gains from withholding full-fledged MES. A very large irritant would be thrown into US-China commercial relations, with a modest benefit to US industries that initiate AD proceedings. Even without the use of surrogate costs and prices, AD margins are typically high. Adding an extra 20 percent penalty, through the use of surrogate cost and price methodologies, will not do a great deal more to restrain injurious imports.

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<sup>8</sup> See Kent Troutman, “China Chart of the Week: China’s Real Effective FX Appreciation in Perspective,” January 23, 2015, Trade and Investment Policy Watch, <http://blogs.piie.com/china/?p=4237>.

<sup>9</sup> For related analysis, see *Toward a US-China Investment Treaty*, PIIE Briefing 15-1, February 15, 2015, Peterson Institute for International Economics, [www.piie.com/publications/briefings/piieb15-1.pdf](http://www.piie.com/publications/briefings/piieb15-1.pdf).