



INSTITUTE FOR INTERNATIONAL BUSINESS, ECONOMICS & LAW

**China's Third Year in the WTO:  
Progress in Transitional Implementation & Frustration with Antidumping**

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Introduction

Thank you for inviting me to be with you today and giving me the opportunity to share my views on China's situation in the country's third year of WTO Membership. I was in Doha, Qatar, serving as Deputy Director-General of the WTO when China completed WTO accession formalities. It was a momentous occasion. Today, more than two years later, China is progressing in the implementation of its transitional commitments. Chinese business people and exporters are realizing tremendous new trading opportunities as a result of WTO membership, but they are also facing increasing frustration arising out of foreign antidumping actions.

Currently, I serve as a Senior Advisor to the Shanghai WTO Affairs Consultation Centre and also as a Senior Advisor to the Shenzhen WTO Affairs Centre. My work with these two important groups brings me into regular contact with the officials and business people of two key regions involved in the commercial aspects of China's participation in the WTO. In addition, our Institute at the University of Adelaide in Australia is currently involved in a number of China-related WTO projects, many of which are intended to assist Chinese officials and traders to take advantage of the opportunities afforded by participation in the global trading system. In my comments today, I plan to focus on the many actual and potential benefits and challenges that China faces internationally.

China's Evolving Place in World Trade

No discussion anywhere of the emerging outlook for international trade can be complete without reference to China and the increasingly important place China occupies in the global economy. China's economic growth is nothing short of phenomenal and since the country joined the WTO in 2001, this growth has been accelerating. The rate of growth is all the more astounding when we look at the base on which we calculate statistics such as per capita GDP.

In 2003 Chinese GDP grew by 9.1 percent, following on growth in 2002 of 8 percent. Trade is a huge part of this, with the ratio of exports to GDP hitting nearly 31 percent and imports to GDP ratio of 30 percent (by comparison, in the USA the ratio is much lower – with exports at around 11 percent of GDP and imports at around 15 percent). China replaced France as the

world's fourth largest auto producer. This year, auto production is estimated to rise to 5.15 million units and China will move into the number three slot ahead of Germany. Per capita GDP in 2003 stood at over US\$ 1,000 – no small feat when we consider the 1.3 billion person base.

Foreign direct investment in China exceeded \$60 billion last year, although this figure may be somewhat misleading. It has been reported that partly in response to China's WTO membership, many Chinese businesspeople channel investment funds through foreign third parties and then back into China in order to secure better legal protection, tax concessions and otherwise more favourable treatment. By some estimations, about half of the foreign direct investment flowing into China originated in China!

### Progress in WTO Implementation

Under the terms of its accession. China committed to implement a set of sweeping reforms designed to implement the WTO's market access, national treatment and transparency standards; to protect intellectual property rights, to limit the use of trade-distorting measures; and to make numerous changes to bring its legal and regulatory system into line with those of other WTO members.

Last year, China's second full year of WTO membership, there were a number of positive developments. The government began to take steps to correct what had been systematic problems in the administration of its import regime for bulk agricultural commodities. In response to outside pressure, it also reduced unreasonable capitalization requirements in certain financial services sectors and opened up the motor vehicle financing sector to outside competition. China also began to make improvements in the transparency of its regulatory environment.

But the news isn't all good. 2003 was also a year in which it was apparent that China's implementation efforts had lost a significant amount of momentum in important areas. Institutionalisation of market mechanisms is incomplete and intervention by Chinese officials in the market is still all too common. The greatest problem areas are those relating to WTO-mandated reforms affecting agriculture, trade in services and enforcement of intellectual property rights. There are also signs of increasing resort in China to industrial policies encouraging domestic industries at the expense of imports from overseas or foreign business operating in China. These issues are especially problematic in the rapidly growing automotive sector.

Counterfeiting is not just an issue for Rolex watches. Close to 200,000 Chinese reportedly died last year as a result of their use of fake pharmaceuticals. I am told that there is a company here that manufactures sub-standard automobile windshields that shatter in accidents and sells this glass under fake established brand names. Incredibly, Japanese friends of mine have documented the counterfeit production of entire motor vehicles, many with faulty brakes and other serious safety problems.

Most observers would agree that China needs to accelerate its implementation of WTO obligations in 2004, in part to make up for some important back-sliding in 2003. The need for progress is particularly important in the phasing in of reforms in certain services sectors.

A key area is that of trading rights. Foreign (and Chinese) companies' right to import and export goods – trading rights – is a key area where China committed to reforms and where these reforms are somewhat behind schedule. China's protocol of accession calls for phasing in full trading rights over a three-year period. By December of 2002, joint ventures with minority foreign stakes should have been accorded full trading rights. Instead only some very vague regulations granting these rights were promulgated – about four months late – making it extremely hard for business to make use of the changed rules in their Chinese operations. In the course of this year, the required registered capital for domestic Chinese trading companies is due to be reduced to \$120,773 – down from \$360,000.

There are some hopeful signs of progress on the trading companies front. The State Council reportedly approved revisions to the Foreign Trade Law, apparently revising the procedure for granting trading rights and, in line with China's WTO requirements, eliminating an examination and approval process. However, China has not yet released the details of the revisions which would confirm whether the new law would in fact fulfil the country's WTO obligations.

By the end of 2004, China is due to implement a series of important commitments affecting retailing, wholesaling and franchising. Draft regulations in this area were a year late and remain unclear in some respects, for example, whether an existing foreign invested enterprise will be able to obtain distribution rights. Whether the end of the year deadline can be respected remains to be seen.

It is important that China should do a credible and meaningful job of implementing its transitional obligations under the WTO arrangement. WTO membership opened many doors to world markets for Chinese exporters and in return foreign producers expect a fair chance to do business in China. These are legally binding obligations. If there is evidence to show that China is not adequately living up to its commitments, China will certainly be taken to WTO dispute settlement and this could eventually reduce or endanger the opportunities for Chinese firms in overseas markets.

### Antidumping and China's Treatment as a NME

As Chinese exporters take advantage of new opportunities to access foreign markets, it is perhaps not surprising that increasingly these exporters are the target of protectionist measures taken in other countries. Most commonly these measures take the form of antidumping actions. In many markets, the situation of Chinese exporters is considerably aggravated by other governments' treatment of China as a non-market economy.

In the most recent period of full year reports by WTO Members, running from July, 2002 to June, 2003, WTO Members initiated 222 separate antidumping investigations. China was the target of 42 of these 222 initiations. In the same period, of the 230 definitive duty determinations or final price undertakings, 37 involved Chinese exporters. No other country is the target of so many antidumping measures. Of course, we should point out as well that Beijing is also learning how to play this game. In the same period, China initiated 17 antidumping investigations of its own – ranking it as the third most active user of antidumping actions, following India with 67 actions and the United States with 29 initiations.

Now, China is clearly a dynamic country whose national economy is undergoing massive transformation at an accelerating rate. Many observers consider that the circumstances prevailing in the Chinese market are more characteristic of a market-based economy than they

are of a non-market economy. China, however, continues to be treated by many of its trading partners as a non-market economy for purposes of antidumping and countervailing duty investigations and this treatment normally results in less favourable treatment of Chinese exporters.

At this stage, I want to add that the aggressive pricing policies of many Chinese firms probably add to the suspicion that prices for inputs in China cannot be "real" prices. I was recently in Washington, DC where I was told by a friend who works with the International Trade Commission that many Chinese goods being sold on the U.S. market today are priced 80 or 90 percent lower than their American competitors' prices. Certainly, such low prices are not necessary to gain market share. But they do ring alarm bells.

Two recent cases in the United States demonstrate the extremely prejudicial effect of the combination of overly aggressive pricing, rapid surges in volume exported and the treatment of China as a non-market economy. In the case of wooden bedroom furniture, the re-calculated dumping margins range from 159 percent to 441 percent. In the case of frozen and canned warm water shrimp, the volume of Chinese shrimp exported to the US market rose 77 percent in a single year (2001-2002) and dumping margins are estimated to range from 113% to 264%. Figures like these do not inspire confidence in the operation of a "market economy". How long could anyone subject to real market forces stay in business if they are selling huge volumes of goods at hundreds of percent below a normal value cost of production?

I want to go deeper into this subject. I plan to cover the implications of non-market economy treatment; China's current situation; how China is treated by major trading partners; the outcome of recent US NME reviews of Russia and Vietnam; and, China's options for the future.

The issue of non-market economy treatment has its roots in an obscure provision of Article VI of GATT 1994. Through this provision, WTO Members explicitly recognize that non-market economy countries may need to be treated differently to market economies in antidumping cases. This provision dates from the 1954-55 Review Session of the GATT and has its origins in the consideration of issues relating to the Working Party on the Accession of Poland. The applicability of this rule has been carried through to the current Antidumping Agreement by Article 2.7 of the Agreement.

We need to recognize, however, that the GATT rule is framed in such a way as to allow discriminatory treatment only in the case of countries that have a complete or substantially complete government monopoly over international trade and where all domestic prices are fixed by the state. Later on, I will be talking about how the United States looks at antidumping and non-market economy status and you will see that the working definition today is quite different than the GATT rule.

Authorities administering antidumping legislation and investigations have generally taken advantage of the non-market economy clause to reject information provided on costs and prices in countries considered to be non-market economies. As an alternative to the use of such price and cost information, they have relied on obtaining cost and price information from surrogate third countries with market economies considered to be at or close to the same level of development as the non-market economy subject to the antidumping investigation. In the wooden bedroom furniture case, for example, the petitioners in the United States developed estimates of Chinese dumping margins by constructing manufacturing values for wooden

bedroom furniture if it were produced in India. In some other cases, investigating authorities have developed and used synthetic cost and price information.

Under normal “market” circumstances, antidumping cases are already extremely complex and there are many opportunities for investigating authorities to miscalculate correct normal values. Countries with a market economy have a clearly defined route to challenge such miscalculations through the WTO dispute settlement understanding (DSU). Non-market economies are at a real disadvantage because there is clearly considerable scope under the loose rules for manipulation of data on prices and costs in ways that would increase dumping margins and be difficult to challenge successfully under the DSU.

I think it’s fairly doubtful that the Chinese economy today would be accurately characterised by the description of a non-market economy found in the GATT’s Article VI. However, it is true that in its protocol of accession to the WTO, China has accepted that investigating authorities in other WTO Members may apply non-market methodologies in antidumping and subsidy-countervail investigations.

A careful reading of the applicable provisions of the protocol shows that they are not intended to serve as a *carte blanche* to apply non-market economy methodologies in all cases. In the case of antidumping investigations, importing country authorities are permitted to use alternative methodologies “...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.”

The intent of the language in the protocol seems clear: Chinese exporters should be given the chance to convince the investigating authorities that their price and cost information is legitimate and not distorted by the operation of a non-market economy. The provisions of the protocol allowing recourse to non-market methodologies expire in 2016, 15 years after China’s accession to the WTO.

Given the language of the protocol, it is worth examining how China is currently treated for purposes of antidumping investigations by the authorities in four of China’s major trading partners: the United States, the European Communities, India and Korea.

### United States

In the United States, the Department of Commerce Import Administration treats China as a non-market economy for the purposes of antidumping and countervailing duty investigations. The implication of this treatment is that in antidumping investigations the administering authorities will normally reject information provided on prices and costs in China and use information derived from surrogate sources.

Part of the way in which the American administering authorities deal with the non-market economy issue in actual investigations is through researching and publishing factor values for the Peoples Republic of China and other countries considered to be in non-market economy status. For example, in order to calculate labour inputs in antidumping cases, the Department of Commerce has calculated a series of wage rates through regression analysis –essentially an average of the wage rates in market economy countries viewed as being economically comparable to the non-market economy under investigation.

## European Communities

In the European Communities, a somewhat hybrid approach has been taken to dealing with antidumping cases involving China and other countries susceptible of being considered to be non-market economies. Commission Decision No 435/2001/ECSC of 2 March 2001 amended the EC's earlier approach to non-market economies by providing that it would be possible in limited circumstances to treat imports from China as coming from a market economy if it is shown that market economy conditions prevail for this producer or producers in respect of the manufacture and sale of the like product concerned

The European Communities' approach to the issue is an interesting one. The investigating authorities are not yet willing to consider that China is – in an overall sense – a market economy. However, they are willing to be convinced that market economy conditions might prevail in limited industry-specific cases and, in such cases, to treat the investigation as one involving a market economy.

## India

Like the European Communities, India has a hybrid approach to the issue. India considers China to be a non-market economy country. India's regulations provide that under normal circumstances, antidumping investigations involving China shall determine "normal value" on the basis of the price of constructed value in a market economy third country.

However, Indian authorities have adopted a policy that provides where it is shown that market conditions prevail for one or more such firms subject to an investigation, the investigating authorities are able to apply rules normally reserved for market economy country investigations.

## Korea

Korea is another Chinese trading partner that has adopted a flexible approach to dealing with antidumping investigations involving China and non-market economy issues. Until 1999, Korea normally applied regular non-market economy approaches to China. In that year, however, the Korean Trade Commission changed its approach and prepared detailed criteria to determine whether market economy conditions might apply in the case of specific industry sectors of an otherwise non-market economy country. Since that time, where the KTC has found market conditions applying in the sector, normal value has been determined using the domestic sales prices of the non-market economy country.

## Russia and Vietnam: Issues and Implications to Consider

Our discussion of China's status as a non-market economy will benefit at this point from a look at how two other countries – Russia and Vietnam – are currently treated for the purposes of antidumping and countervailing measures. In order to draw consistent comparisons, I will look at the outcome for both countries of recent reviews of their status by the United States Department of Commerce Import Administration.

## Russia

Russia's status as a non-market economy was reviewed by the United States in mid-2002. On June 6, 2002, the Department of Commerce announced that Russia had made the transition to a market economy for purposes of the United States antidumping and countervailing duty laws. Russia's designation as a market economy meant that Russia became subject to the countervailing duty law (from which it had been exempted) and that in antidumping cases, the Import Administration would in the future be required to use Russian prices and costs instead of relevant data from a comparable surrogate market economy.

In reviewing Russia's non-market economy status, the Commerce Department was required by U.S. law to take into account six factors.

The first factor is whether the country's currency is freely convertible. Russia agreed to assume IMF Article VIII obligations in 1996 when it made the ruble fully convertible for current account purposes. The ruble is also convertible for capital account purposes. As a result of its examination, the U.S. found that, notwithstanding limited currency controls, the Russian ruble is convertible and that the currency's exchange rate results from supply and demand on currency markets.

The second factor evaluated was the degree to which wage rates were determined by free bargaining between labour and management. Although the Americans found the existence of a number of institutional weaknesses and structural constraints, contracted wages were believed to reflect the relative bargaining positions of management and labour as adjusted for differences that might apply in the case of specific industries or local markets.

The third factor addresses the extent to which foreign investment is welcomed in the economy. In Russia, it was found that foreign investment is strongly encouraged and foreign investors are free to repatriate profits and capital and are protected against expropriation. All forms of foreign investment are permitted (e.g. joint ventures and wholly owned foreign companies) in all sectors of the economy.

As a fourth factor, the US examined the extent of government ownership or control of the means of production. While Russia retains a shareholding interest in a number of economic sectors (i.e., banking, telecommunications, transport, energy and defense industries) government investment in these sectors is normal in many other market economies. Land ownership by the private sector has been occurring on a limited basis, but a new Land Code is expected to facilitate greater ownership of private property. Overall, the American investigation concluded that Russia's privatisation program had been successful in largely denationalising the economy.

The fifth factor evaluated concerned the extent to which the Russian Government controlled resource allocation, prices and output decisions by enterprises. A Presidential Decree limits state regulation of prices to those for goods and services produced by natural monopolies. In addition, the State is not involved in allocating capital and ended its control of the banking sector in 1999. Russia was found to have a market-based resource allocation mechanism, with firms and individuals engaging in value-added investment and production activities based on private decision-making.

Finally in their evaluation of the sixth factor, the U.S. concluded there was no reason to believe that the level of corruption affected the fact that prices and costs in Russia are market-based. The incidence of barter transactions had fallen dramatically in recent years so that by 2002 what barter that remained could not be attributed to a non-market orientation.

### Vietnam

Vietnam's story in the United States is considerably different than that for Russia. Unlike Russia, Vietnam was not found to have made the transition to a market economy and its status as a non-market economy for purposes of antidumping and countervailing measures was confirmed. Why did the Department of Commerce reach a different decision in the case of Vietnam and what are the implications and lessons for China?

The same six factors that were the basis for the evaluation in the case of Russia were applied to the case of Vietnam. But Vietnam failed the tests on most counts. First, Vietnamese currency policies do not meet the necessary requirements of a market-based foreign exchange. Second, the government continues to direct and control FDI in a manner consistent with its state owned enterprise development philosophy and regularly discriminates against foreign investors with respect to financing, land use, business structure, etc. Third, the privatisation of state-owned companies was found to be moving at a very slow pace with less than 200 of 500 scheduled firms actually privatised in 2001. Fourth, State control over bank lending was seen as responsible for the fact that, while over 60 percent of state-owned enterprises are officially estimated as loss-making, only sixty of the original 12,000 state firms have ever been declared bankrupt.

Among the other factors taken into consideration was rule of law. This area was found to be weak, with a Communist Party controlled judiciary, a vague legal framework, rudimentary trial procedures and few lawyers. The unique area where U.S. investigators found Vietnam to have made the transition to a market economy was in the area of free bargaining for wages.

The implications of the Russian and Vietnamese reviews are that countries seeking exemption from non-market economy status should be able to demonstrate market-driven currency convertibility; commercially set wage rates; a favourable foreign investment climate, minimal levels of government ownership, price setting only in the case of natural monopolies; and an independent judiciary.

### China's Options for the Future

There are a number of ways in which China could approach resolving the problems for its export industries caused by treatment of China as a non-market economy country. The three basic options include: (1) aggressive pursuit of China's rights under the protocol of accession; (2) seeking an overall review of China's status in the USA and elsewhere; and (3) pursuing a change in the basic WTO agreements so as to preclude WTO Members being treated as non-economy countries.

The first option may well be the most productive course to pursue – at least in the near term. Our brief discussion of how China is treated by four of its trading partners shows that three of four of these countries are already providing a regular opportunity for Chinese enterprises to argue that they operate in a market economy context. China might press the USA and any

other countries currently applying an inflexible across-the-board approach to follow the lead of the others.

Chinese companies and those working with them need to take measures before they are subjected to antidumping investigations in order to ensure that they can properly document authentic price and cost data.

Seeking an overall review of China's status in the USA and elsewhere is another option to pursue. The purpose of providing background on the experience of Russia and Vietnam in this speech is to permit those familiar with the operation of China's actual economy to judge for themselves whether a request for a review of non-market economy status would be likely to succeed (as with Russia) or fail (as with Vietnam).

Finally, there is the option of seeking changes through the current WTO "Rules" negotiations. China is, in fact, pursuing this option. In March, 2003 China tabled a number of negotiating proposals aimed at modifying provisions of the current Antidumping Agreement, including the non-market economy clause. While China is probably right to include this option in its efforts to deal with the problem, there is little chance that a consensus can be reached to revoke this clause. This is not really because of a concern over China, where we have seen flexibility in the approach reflected in the protocol of accession but because Members may be concerned that future WTO members –and Vietnam is a good example – may not have made the full transition to a market economy by the time of their accession to the WTO.

The continued treatment of China as a non-market economy is a serious problem, but it is undoubtedly a temporary problem. China's WTO protocol sets a final date for this treatment, however, it is likely that effectively China will cease to be treated as a non-market economy long before 2016. I say this because, as a practical matter and looking at precedents such as the treatment of Russia, the continued development of the market and related government policies should demonstrate the increasingly market-based nature of the Chinese economy in the not too distant future.

Already, many countries have changed their antidumping legislation, either to treat China as a market economy or to permit the exporters targeted by an antidumping investigation to argue that they operate in market conditions. In Australia, the government has set aside plans to introduce new legislation which would have perpetuated the treatment of China as a non-market economy for antidumping purposes.

In the meantime, Chinese exporters seeking to protect themselves against unreasonable treatment in antidumping cases need to do two things. First, they need to keep the right kind of business records. Records showing actual prices and costs are particularly important in rebutting a presumption of non-market status. Investigators are supposed to use the exporters own records, but only if these records reflect the cost of production and sale; and contain cost allocations historically utilized (especially for amortization and depreciation, capital allowances and other development costs). The records also have to be kept in accordance with generally accepted accounting principles in the country.

### The Future of China in the WTO

To come back to the question of the benefits of WTO membership for China, we have only to look to the ongoing Doha Round of trade negotiations to see the possibilities for additional

trade-led economic development. The Doha Round may have been slowed somewhat by the collapse of the Cancun Ministerial meeting, but there are encouraging signs that momentum is re-building to engage on the negotiations. And this is good news for China.

China's experience since opening its economy to international trade has been spectacular. Between 1978 and 1998, the poverty rate in China dropped from 28 percent to 9 percent. Trade-led growth made this possible. The World Bank has published estimates that a new round of market opening resulting from the Doha Round would raise global output by between \$290 billion and \$520 billion by 2015. If industrial tariffs could be reduced by this round to average levels of one percent in the developed world and 5 percent in developing countries, the economic gain to developing countries alone could be as much as \$108 billion in increased exports.

Even if these numbers are off by 50 to 100 percent, the amount of economic gain remains extremely impressive. For China, joining the WTO to guarantee these opportunities for the future was clearly the right thing to do.

Thank you for your attention.