



INSTITUTE FOR INTERNATIONAL BUSINESS, ECONOMICS & LAW

**TREATMENT OF CHINA AS A NON-MARKET ECONOMY:  
IMPLICATIONS FOR ANTIDUMPING AND COUNTERVAILING  
MEASURES AND IMPACT ON CHINESE COMPANY OPERATIONS IN  
THE WTO FRAMEWORK**

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Andrew L. Stoler<sup>1</sup>  
Executive Director  
Institute for International Business, Economics and Law

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Introduction

Thank you very much for inviting me to be a part of this very important conference. I am very honoured to be a Senior Advisor to the Shanghai WTO Affairs Consultation Center and it is a genuine pleasure to be back here today in this exciting and forward-looking city.

China is 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 has the clear potential to treat Chinese exporters less favourably than exporters of other “market” economies.

Because antidumping actions are far more prevalent than countervailing duties and because the issue of non-market economy status has arguably more important ramifications for determining “normal value” than for subsidy assessment, the bulk of my comments will focus on antidumping implications of the non-market economy problem.

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<sup>1</sup> Andrew L. Stoler is Senior Advisor to the Shanghai WTO Affairs Consultation Center. He is currently the Executive Director of the Institute for International Business, Economics and Law at the University of Adelaide, Australia. From 1999 to 2002, he served as Deputy Director-General of the World Trade Organization.

My comments, like my lecture paper for this meeting, will 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.

### Implications of NME Treatment Under the WTO

The issue has its roots in the second paragraph to Ad Article VI:1 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 provision has been carried through to the current Antidumping Agreement by Article 2.7 of the Agreement. The provision allows discriminatory treatment 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.

Authorities administering antidumping legislation and investigations have generally taken advantage of this provision 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 some cases, these 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.

### China's Current Situation

China's economy has clearly undergone tremendous transformation and change over the past two decades. With the country's accession to the WTO in 2001 and the consequent need to implement reforms mandated by WTO membership, the pace of transformation of the Chinese economy has obviously accelerated. It seems doubtful that the Chinese economy today would be accurately characterised by the description in the note to Ad Article VI:1.

Most probably, Chinese officials, academics and businessmen would also argue today that the Chinese economy does not fit the standard UNCTAD definition

of a “non-market economy”. UNCTAD, the United Nations Conference on Trade and Development, defines<sup>2</sup> a non-market economy in the following way:

“A national economy in which the government seeks to determine economic activity largely through a mechanism of central planning, as in the former Soviet Union, in contrast to a market economy which depends heavily upon market forces to allocate productive resources. In a “non-market” economy, production targets, prices, costs, investment allocations, raw materials, labour, international trade and most other economic aggregates are manipulated within a national economic plan drawn up by a central planning authority; hence the public sector makes the major decisions affecting demand and supply within the national economy.”

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.

### How China is Treated by Selected Trading Partners

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

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<sup>2</sup> UNCTAD’s Glossary of Customs Terms found in the Automated Systems for Customs Data (ASYCUDA) website maintained by UNCTAD.

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. In 2000, before Russia was removed from the list of non-market economy countries, the Department of Commerce factor value tables showed expected hourly wage rates in U.S. dollars of \$1.52 for Russia, \$0.80 for China and \$0.62 for Tajikistan. It seems clear that the use of such artificially derived rates can only work to the disadvantage of China.

### 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.

1. The extent to which Russia's currency is convertible into the currency of other countries;
2. The extent to which wage rates in Russia are determined by free bargaining between labour and management;
3. The extent to which joint ventures and other investments by firms of other foreign countries are permitted in Russia;
4. The extent of government ownership or control of the means of production;
5. The extent of government control over the allocation of resources and over the price and output decisions of enterprises; and,
6. Such other factors as the Import Administration considered appropriate to the review.

The six factors that are required in the American assessment originate in the view that it is not sufficient that a country's economy is no longer controlled by the state to treat the country as a market economy. In its evaluation of Russia, the Import Administration considered whether the facts, as applied to the six factors, demonstrated that the economy is generally operating under market principles.

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.

Overall, the investigators concluded that Vietnam had made some progress toward establishing a market economy – particularly in the area of wage rates that they considered to be market-based. However, the country failed the test in most other areas studied, including exchange rate policy and currency convertibility, restrictive policies toward foreign investment, continued significant government involvement in the economy and distortion of the banking sector. Market forces were found to be not yet sufficiently developed to permit the use of prices and costs in Vietnam for the purposes of the Department of Commerce’s dumping analysis and Vietnam’s status as a non-market economy was confirmed.

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.

#### Conclusion

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 market-based nature of the Chinese economy in the not too distant future.

This is an area of WTO rules and policy that is very much in flux today. A number of countries have recently changed their approach to the so-called non-market economy situation affecting China and a certain number of economies in transition. In Australia, where I live and work these days, there is a very active debate over how the antidumping legislation should be applied to China. In all of this, one thing is fairly certain – there is probably no WTO member in 2003 where one could say that the original definition of a non-market economy applies. The time has come for the system to adjust to realities.

Thank you very much for your attention.