



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

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 the discussion in this paper will focus on antidumping implications of the problem.

In the paper, we discuss: the implications of non-market economy treatment under the WTO rules; China’s current situation; how China is treated by four of its major trading partners; recent experiences of Russia and Vietnam to see if there are lessons to be learned from those countries’ reviews of non-market economy status; and finally, China’s options for the future.

Implications of NME Treatment Under the WTO

In the second paragraph to Ad Article VI:1 of GATT 1994, 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

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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.

Accession of Poland. The provision has been carried through to the current Antidumping Agreement by Article 2.7 of the Agreement. The provision in question reads:

“It is recognized that, in the case of imports from a country that has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may exist in determining price comparability for the purposes of paragraph 1 [determination of normal value], and in such cases, importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.”

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 (see discussion of “factor values” employed in the USA below).

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 – which was written in the light of the situation applying in Communist Poland in the mid-1950’s.

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.”

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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.

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

In this section, we will examine 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. In the case of the United States, China is treated inflexibly as a non-market economy in all cases. The other three countries have adopted hybrid approaches which, while generally considering China to be a non-market economy, allow in specified circumstances for antidumping investigations to be conducted according to the rules applied to market economy countries.

#### 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. In the United States, non-market economies are exempted from the countervailing duty law on the theory that pervasive state control in non-market economies makes it impossible to establish an effective benchmark against which the Commerce Department could measure whether a particular government action created a "countervailable" subsidy.

No doubt in part because of the application of the non-market methodology to antidumping investigations involving China, average dumping margins in the United States have tended to be relatively high in recent years. According to testimony in the United States Congress<sup>3</sup>, the average of the final rates in recent years is show in the following table.

Year to Date – All Dumping Rates								
1995	1996	1997	1998	1999	2000	2001	2002	2003
85%	43%	45%	147%	47%	46%	92%	42%	83%
Individual Company Rates for Chinese Companies								
1995	1996	1997	1998	1999	2000	2001	2002	2003
18%	30%	30%	145%	30%	36%	5%	25%	73%

<sup>3</sup> Testimony by Under Secretary of Commerce for International Trade, Grant Aldonas, before the House Appropriations Committee on Commerce, Justice, State, the Judiciary and Related Agencies (May 22, 2003)

Although the use of non-market economy methodology should be no more than a technical issue designed to deal with unreliable price data, the way in which it has been described to American audiences causes one to wonder if it is not in fact being used in a way to treat Chinese exporters more aggressively. Mr. Aldonas added in his testimony: “We negotiated a provision in China’s protocol of accession that permits the United States to treat China as a non-market economy and use this methodology through the year 2016 for purposes of antidumping investigations and reviews. Thus we sought to ensure U.S. industries the full relief for a significant length of time from unfair trade from China.”

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. 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. Under Commission Decision No 2277/96/ECSC, a basic rule is provided for dealing with non-market economy countries. Article 2(7)(a) of the Decision provides that in the case of imports from non-market economy countries...normal value is, inter alia, to be determined on the basis of the price or constructed value in an analogue market economy third country.

Commission Decision No 435/2001/ECSC of 2 March 2001 amended the earlier decision (and here comes the hybrid approach) by providing that:

“In anti-dumping investigations concerning imports from the Russian Federation, the People’s Republic of China, Ukraine, Vietnam and Kazakhstan and any other non-market economy country which is a member of the World Trade Organization (WTO) at the date of the initiation of the investigation, normal value shall be determined in accordance with paragraphs 1 to 6 [the rules for market economies], if it is shown, on the basis of properly substantiated claims by one or more producers subject to the investigation and in accordance with the criteria and procedures set out in subparagraph (c) , that market economy conditions prevail for this producer or producers in respect of the manufacture and sale of the like product concerned. When this is not the case, the rules set out in subparagraph (a) [the normal rules for non-market economies] shall apply.”

The European Communities’ approach to the issue is an interesting one. The investigating authorities are not yet willing to consider that China and the other affected countries are – in an overall sense – market economies. 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, or the price from such a third country to other country, including India, or where it is not possible, on any other reasonable basis, including the price actually paid or payable in India for the like product, duly adjusted if necessary, to include a reasonable profit margin." However, while China is presumed to be a non-market economy, Indian authorities have adopted a policy that, in the light of the changing economic conditions in China, where it is shown on the basis of sufficient evidence in writing on the factors considered as distorted by non-market considerations 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 instead of the rules for non-market economy 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 and other non-market economies, substituting surrogate price and cost information for Chinese data. 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. According to reports, the KTC first applied this principle in the case of China when it investigated dumping of non-refillable disposable pocket lighters and used third country export prices to determine normal value. Due to a lack of domestic sales of these products in China, domestic sales prices could not be used in that case.

## 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, we 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 Import Administration in mid-2002. The review lasted nine months and provided many opportunities for comment by the Russian authorities, international organizations like the World Bank, OECD, EBRD and IMF, and interested private sector firms. 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 Import Administration was required by U.S. law to take into account the following 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. Because prices and costs are central to any analysis of dumping it is important that in a market economy prices and costs must be meaningful measures of value.

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 Import Administration 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. Russia and other commentators (e.g. the IMF) were able to convince the American authorities that the purpose of the limited currency controls was to combat capital flight and that they operated in much the same way as similar measures used by other market economy states.

Russian wage formation practices divide the employment market into two sectors. Workers in enterprises covered by the state budget (those working in schools, healthcare, government and state-owned firms) are paid according to a pre-determined wage scale – much like those used by government sectors in many market economies. For non-government work, there is some collective bargaining by unions, but it is more normal for individual employees to negotiate their own wage rates. Overall, Russian wage rates were found to be market-based, with individually-negotiated employment contracts being the norm in the country. 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 American authorities considered that Russia has been open to foreign investment since 1992. A 1999 Law on Foreign Investment and a 1999 Law on Investment Activity in the Form of Capital Investment were found to guarantee equal treatment of domestic and foreign investors with respect to investment activities and profits earned. 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. Recent changes to the Russian tax code were found to have created a positive effect on the investment climate more generally and there were signs that foreign direct investment was coming to Russia in increased quantities.

While Russia retains a shareholding interest in a number of economic sectors (i.e., banking, telecommunications, transport, energy and defence 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.

In its examination of the extent to which the Russian Government controlled resource allocation, prices and output decisions by enterprises, the Import Administration found that Russia had promulgated a Presidential Decree limiting state regulation of prices to those for goods and services produced by natural monopolies (i.e., electricity, oil and gas, etc.) and observed that distortions remained in these regulated sectors, particularly energy where prices were well below world levels. Investigators found that the State is also not involved in allocating capital and had ended its control of the banking sector through two laws passed in 1990 and 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, Import Administration economists studied the extent of corruption and barter in the Russian economy to determine their possible impact on the "market" nature of the economy. While they found no reason to believe that the level of corruption was not very high, that did not alter their view that prices and costs in Russia are market-based. While the Russian economy was found to have had a significant problem with barter in the mid-1990s- in part due to a then-serious problem with payment arrears – the incidence of barter transactions had fallen dramatically in recent years and by 2002 what barter that remained could not be attributed to a non-market orientation.

On the basis of this systematic evaluation of Russia's performance against the six factors, the Import Administration researchers recommended that Russia be henceforth designated as a market economy. They added their belief that, in general, it would now be possible to rely on prices and costs within Russia for the purposes of antidumping analysis.

### Vietnam

Vietnam's story in the United States is considerably different than that for Russia. Like for Russia, the Import Administration of the Department of Commerce conducted a review of the Vietnamese economy over a period of several months (July to November, 2002) and published a finding on Vietnam's non-market economy status on November 8, 2002. 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. There were a number of areas where American researchers found that Vietnam had made some progress toward transitioning to a market economy. In others progress was too slow or conditions still indicated heavy state involvement in the economy.

Vietnam, unlike Russia, has not yet assumed IMF Article VIII obligations on currency convertibility and the Vietnamese currency, the dong, is not fully convertible for either current

account or capital account purposes. The currency's official exchange rate is established on a daily basis by the government. Clearly, Vietnamese currency policies did not meet the necessary requirements of a market-based foreign exchange.

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 study of wage formation in the country found considerable labour mobility, the ability of state-owned enterprises to set actual wages up to 50 percent higher than the economy-wide mandated wage minimums, and a significant number of strikes by workers – generally over wage issues and workplace safety issues. Foreign investment enterprises and domestic private sector companies compete for labour, which is reflected in higher wages and a *de facto* free labour market was found to exist.

Vietnam encourages foreign direct investment in the economy and, according to the legal framework, a variety of forms of foreign investment are permitted, including 100 percent foreign-owned enterprises and joint ventures. Profits may be freely remitted and investment capital can be repatriated. However, the Import Administration found that 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. Prices of certain government-controlled services are discriminatorily higher in the case of foreign investors. In some cases, there are limitations on the permissible level of foreign ownership. Not surprisingly, the researchers concluded that the regulatory framework does not allow foreign direct investment to flow throughout the economy.

In their assessment of the extent to which the Government of Vietnam continues to own or control the means of production in the country, the Import Administration investigators found that privatisation of state-owned companies was moving at a very slow pace and noted that nearly 500 enterprises were scheduled for sale in 2001 but less than 200 were actually privatised. Private land ownership in Vietnam of any kind is strictly prohibited. A system of limited land-use rights makes a free market in this area impossible and there is no framework to protect the rights of participants in the land use market. Although 85 percent of the population is employed by the private sector, the state-owned share of the economy accounts for 40 percent of GDP and 42 percent of industrial output. In Vietnam, there is no effective competition between the private and public sectors.

Turning to the Vietnamese Government's control over the allocation of resources, prices and output decisions, the Americans accepted that most price controls had been removed but found that the government remained heavily involved in the banking sector. The situation in the banking sector had led to state control over lending to state-owned enterprises and exclusion of competition in the sector. 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.. The lack of competition in the banking sector and state control over lending were cited by the Import Administration in its conclusion that the private sector in Vietnam is constrained from access to the necessary credit for continued growth in accordance with the principles of a market economy.

Among the other factors taken into consideration by the Americans in assessing Vietnam's progress toward a market economy were trade liberalisation, the prevalence of the rule of law and corruption. On the first point, the Import Administration took note of market opening measures underway in the context of a bilateral trade agreement with the USA and WTO accession negotiations but concluded that in 2002, it was still too early to tell how effective these steps would be in contributing to the creation of a market economy. Rule of law was found to be weak, with a

Communist Party controlled judiciary, a vague legal framework, rudimentary trial procedures and few lawyers. Corruption was acknowledged to be significant, but was not found to be a problem in terms of establishing a market economy.

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.

### 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. Of course, having the opportunity to prove your case is different from successfully making the case. 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. Good records in proper format are required and it is too late to wait until a case is initiated before attention is devoted to this issue.

Seeking an overall review of China's status in the USA and elsewhere is another option to pursue. The purpose of providing relatively lengthy background on the experience of Russia and Vietnam in this paper 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). The question is: How would China's economy stack up against the six factors which the U.S. authorities used in looking at Russia, Vietnam and other transition economies?

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. The specific proposal found in document TN/RL/W/66 is that the "non-market economy" clause of the Antidumping Agreement should be revoked on the grounds that no economy could accede to the WTO with a complete or substantially complete monopoly of its trade and with all domestic prices fixed by the State. 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.