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Granting Market Economy Status to China: Implications for the EU and Poland

Damian Wnukowski

By December 2016, the European Union should decide whether to grant market economy status (MES) to China. If it does, MES would result in lower anti-dumping duties for Chinese goods and negatively affect the EU's labour market. In turn, refusal to grant MES would worsen political and economic relations with China. Poland should support MES for China but also strive to strengthen other instruments to protect the EU market in line with the European Commission's proposal from July this year.

Why China Wants MES. Market economy status (MES) means that the government of a given country does not interfere in production processes or price levels and thus does not disturb international competition. Without this status, other countries may use a special methodology to set "anti-dumping" duties on imports. The EU uses the "surrogate country" methodology, which takes into account prices in other states that have MES. In practice, granting MES to a particular country means lower anti-dumping duties on products imported from that country.

The World Trade Organization (WTO) has no uniform rules for granting MES, and therefore every member can stipulate its own conditions. The EU has established five criteria: 1) lack of government interference in company decisions and allocation of resources, 2) existence of an effective law pertaining to property and bankruptcy, 3) a transparent financial system, 4) application of corporate law, 5) non-interference in a private company's day-to-day activities According to the EU, China has fulfilled only the last condition. Moreover, the EU views China as excessively supporting its exports through such tactics as regulating the prices of energy or land usage. The scale of this interference is shown by the number of EU anti-dumping measures in place against China through WTO—53 were in force by the end of 2015, which was the most among all of the EU's trade partners. The Union's protection of its market is particularly important given the overproduction of several goods in China, including steel and aluminium, and its search for markets. Along with China, 14 other countries are perceived as non-market economies, including Belarus and Tajikistan.

The Controversial Article 15. According to China's accession protocol to WTO, after a 15-year transition period (ending 11 December 2016), there no longer will be the possibility to fix anti-dumping duties based on a selected methodology (such as "surrogate country") even if market economy conditions are not fulfilled by Chinese firms (Art. 15, a, ii). China claims that from December 2016, anti-dumping duties should be automatically based on Chinese prices. In that case, MES would no longer have practical meaning. Based on experience to now, anti-dumping duties could be lower on average by around 30% in comparison to the "surrogate country" methodology.

However, the provisions of Art. 15 are ambiguous and there is ongoing discussion on their interpretation. Some experts claim that market economy conditions remain in force, an argument underpinned by other parts of the protocol such as the requirement to use Chinese prices when it has been proved that a given good's production comes without state interference (Art. 15, a, i). Some countries, including the U.S. and Canada, have announced that they will not change their trade policy towards China because it has not fulfilled the MES criteria. Nevertheless, China can appeal their decisions to WTO.

Possible Economic Ramifications. There are significant discrepancies in the forecasts of what will happen if MES is granted to China. Initial calculations presented by the European Commission (EC) show that from

63,600 to 211,000 jobs related to sectors where anti-dumping measures are now in place could be in danger. The biggest number of threatened jobs are in Italy, Germany, Spain, France and Portugal, while Poland is sixth, with 11,000 jobs. Thus, the losses for Poland could be both direct and indirect as a result of problems with its EU trade partners. In turn, an analysis prepared for European businesses show that about 3.5 million jobs in the EU could be endangered (including 145,000 to 290,000 in Poland alone). This number could be higher if Chinese firms that have not been able to sell their products to the EU so far because of the high anti-dumping duties decide to enter the market. However, these estimations should be taken with caution. It is worth noting that lower duties could be beneficial to EU companies that produce goods in China or import cheap components. Moreover, cheap imports from China could result in lower prices for products in the EU market, which would be beneficial for consumers. Nevertheless, the change could also deepen the high EU trade deficit with China (€180 billion in 2015).

If the EU retains the ability to impose higher anti-dumping duties, there could be a reaction on the Chinese side that would make it more difficult for EU companies to enter the latter's market, e.g. through administrative instruments which are already a serious hurdle for European businesses. A trade war is rather improbable given the scale of bilateral trade (including services, it was €570 billion in 2015) and the interdependence of both partners. China is currently the EU's second-largest trade partner (after the U.S.) and the EU is China's main trade partner. It is possible that negotiations on an EU-China investment agreement could be suspended and Chinese involvement in the "Juncker Plan" limited (their input is initially estimated at €5 billion to €10 billion out of the total €315 billion planned).

Divided Union. Anxiety about the potential economic effects of granting China MES on the EU has contributed to an unfavourable political climate for China. Countries most threatened by the move, such as Italy or France, form what is being called the "anti-dumping coalition", which seeks stronger EU market protection including reform of trade defence instruments (TDI). The TDI position is supported by Germany, France and others. In 2014, changes in this area were blocked by half of the EU members, including the UK, the Netherlands and the Scandinavian states. These countries openly support granting MES to China, along with other EU members that count on close economic relations with China such as Hungary. China will most probably make use of these divisions in the EU, perhaps by offering investments or stronger trade relations, to block TDI reform in the Council of the European Union.

Because of the Brexit vote, the UK's influence on EU trade policy will diminish. Thus, the "anti-dumping coalition" is getting stronger. It also has the support of the European Parliament (EP). In the resolution of 12 May 2016, the EP by a huge majority (546 to 28) opposed granting MES to China. Its stance has to be taken into account as changes in trade regulations must be accepted not only by the Member States individually but also by the EP.

An idea to get past this problem was presented by the EC on 20 July. It proposes liquidation of the non-market economies list and the introduction of a new methodology for fixing anti-dumping duties, taking into account state influence on prices, and which will be applicable to all countries. Although specific details of the proposal should be presented by the end of the year, it has been announced that the new system would provide a similar level of protection as the "surrogate country" methodology. Furthermore, TDI and anti-subsidy measures will be strengthened. Altogether it should ensure effective EU market protection.

EU Priority—Fair Trade. The EU's and China's interests in trade policy are contradictory to a great extent. Therefore, decisions about trade instruments that can be used against China would have serious consequences, not only for the EU's economy but also on bilateral political relations with China. For example, the coordination of activities in the international scene could become more complicated. Also, political and economic relations with other partners may be affected, such as with the U.S., which is trying to convince the EU not to grant MES to China. The decision also will be a test for the EU regarding the reconciliation of its values and economic interests.

In expressing adherence to the rule of international law, the EU accepts the formal change of treatment of China within WTO. A clear objection would damage the EU's image and weaken its position towards states that contest international rules if they find it beneficial (notably, Russia). However, given that the Chinese economy is not transparent and that the government plays a significant role, the EU market should be protected against unfair competition. Passivity in this matter will hurt the EU's credibility as an organisation that protects the interest of its members. This has become even more important given the level of criticism of the EU as a result of the still-visible effects of the fiscal and economic crises (e.g. high unemployment in the southern part of the EU), Brexit and mass migration.

Therefore, the most probable scenario is acceptance of the EC proposals, including the new methodology to fix the anti-dumping measures and reinforce TDI. Poland should support this solution and engage with the EU to defining the proposal's shape. Poland's position can be expressed by backing the proposals of Germany and France presented in May this year that refer to demands for TDI reform from 2013. It should include such limitations as the "lesser duty rule" (when duties are fixed only to the level of losses for an EU industry) and an automatic reaction by the EU to dumping without needing a prior request from a Member State (which limits the EU's ability to threaten retaliation). It is important to speed up work on the new instruments to avoid a gap in EU market protection after 11 December 2016. Although supporting the EC's proposals is not likely to enhance Polish-Chinese cooperation, it seems to be the most advantageous given the potential economic and social ramifications of lower anti-dumping duties. Concurrently, Poland should back symbolically granting MES to China as a sign of support for the continuity of market reforms in the Chinese economy.