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# China's WTO Membership and the Non-Market Economy Status: discrimination and impediment to China's foreign trade

RUI PAN\*

*This article provides a Chinese perspective on the terms of China's WTO accession, highlighting the negative impact of some discriminatory conditions that China accepted in order to join the WTO on its foreign trade and global competitiveness in the last decade. The author uses the non-market economy status of China as a case study to support the argument that these discriminatory conditions imposed on China upon accession have not only impeded the healthy development of China's foreign trade, but also violated the 'non-discrimination' principle of the WTO.*

## Introduction

After more than a decade of prolonged and arduous negotiations, China finally became a member of the World Trade Organization (WTO) at the end of 2001. One of the main goals of China's accession to the WTO was to create a better and more stable environment for the country's international trade. However, China's WTO membership has not brought about a fair and equitable trading environment as China's foreign trade still encounters a number of unfriendly WTO rules and regulations. They are what China committed to upon its accession to the WTO, so the use of these rules and regulations by other WTO members is WTO-consistent, but such use has resulted in the discriminatory treatment of Chinese firms. For instance, the non-market economy provisions of *The Protocol of China's Accession to the WTO* have, at least partially, led to hundreds of anti-dumping cases against China since 2001. Nevertheless, China's foreign trade has developed rapidly since it became a member of the WTO. Such extraordinary achievements stand in sharp contrast with the unfair trade environment it still faces.

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## China's accession to the WTO

China formally requested to join the GATT, the predecessor of the WTO, in 1986. China's accession negotiation was one of the most complex and difficult accession processes in the history of the GATT/WTO despite the fact that the Chinese economy is 'more open than that of other East Asian economies at comparable stages of economic development and in certain respects is even more open than they are now'.<sup>1</sup> During the negotiation process there was a wide gap between China's offer and the demands made by the US and other developed countries. These differences significantly slowed down the process of reaching an agreement. Specifically, the main differences were the following: (1) the United States and other developed countries wanted to have special safeguard options to protect their economies against future possible import surges from China, but China didn't accept this; (2) the United States and other developed countries did not agree to grant the full range of special and differential treatments that all developing countries are entitled to, but China insisted on acquiring those protective measures; (3) the United States and other developed countries preferred to see rapid changes and a shorter grace period for China, but China wanted a long phase-out period in order to win more time for domestic adjustment; and (4) the United States and other developed countries set a 7–8% average tariff rate for industrial and agricultural products as a precondition for China to accede to the WTO, but China indicated its willingness to only cut its average tariff rate to 15% within three years for industrial products and within six years for agricultural products.

On 10 December 2001 China finally became a formal member of the WTO after 15 years of effort. China's WTO accession was seen by the outside world as the second revolutionary change in China's economic policy, following Deng Xiaoping's reform and opening up policy in 1978, and would undoubtedly have a profound impact on the future course of China's economic development. When it became a full member of the WTO, China made commitments on three levels. First, it committed to the objectives of the WTO, namely freer trade among all member nations. Second, Beijing agreed to abide by international rules governing trade for specific sectors, such as agriculture, textile goods, information technology and telecommunications. Third, it signed a series of bilateral agreements, such as China–US, China–EU and China–Japan bilateral agreements on market access, with its major trading partners to address their country-specific concerns related to post-accession China's trade ties with them. *The Protocol of China's Accession to the WTO* provides for 'additional liberalization of China's trade regime and further opening up of opportunities for foreign direct investment'.<sup>2</sup> These provisions encompass two broad categories of issues: improving market access of foreign firms and reforming the domestic trade rules, regulations and institutions within China. With regard to market access, China made significant commitments to expand market access to foreign businesses in its accession protocol. For agricultural products, China pledged to reduce tariffs from an

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1. Nicholas R. Lardy, *China in the World Economy* (Washington, DC: Institute for International Economics, 1994), p. 13.

2. Nicholas R. Lardy, *Integrating China into Global Economy* (Washington, DC: Brookings Institution Press, 2002), p. 65.

average 31.5% to about 15%. It agreed to eliminate export subsidies and rapidly increase the volume of tariff-rate quotas on most imports. For industrial products, China pledged to phase out restrictions and cut the average tariff from 24.6% to 9.4% by 2005. China also agreed to sign the WTO Information Technology Agreement, which would eliminate all tariffs on telecommunications equipment, semiconductors, computers and computer equipment, and other information technology products. The most far-reaching change, however, was expected to take place in the services sector, which had largely been closed to foreign competition. Specifically, China promised to open important services markets, including telecommunications, banking, insurance, securities and many other professional services, to foreign services providers. Foreign firms would be granted trading and distribution rights, so that they could engage in wholesale and retail trade, transportation, service and maintenance, as well as import and export.

Besides these commitments in the area of market access, China pledged to comply with almost all provisions set forth in the WTO agreements, with the aim of increasing the transparency of China's trade and investment regimes, including eliminating all prohibited subsidies and liberalizing trading companies. Perhaps the most significant commitment within the WTO agreement was Beijing's consent to accept the provisions of trade-related aspects of intellectual property rights (TRIPS). Overall, China's WTO commitments compare favorably with those of other WTO members. Both its market access and rule-based commitments far surpassed those made by the founding members of the WTO and new members who have joined the WTO since 1995.

### **The development of China's foreign trade after WTO accession**

It should be noted that the trade frictions between China and its trading partners following China's WTO accession resulted not so much from the WTO itself, but from China's continuing increase in its trade and sustained Chinese international competitiveness. As we all know, since the beginning of the reform era, China's economy has been revitalized. Especially since the mid-1990s, China's market economy has sustained high growth with low inflation, which is in sharp contrast with the frequently riddled financial crisis in neighboring countries and the doldrums of the world economy.

China has already become the world's second largest trading nation. According to statistics, among the 150 developing countries in the world, 60% of the exports of manufactured goods came from five developing countries, including Mexico and China.<sup>3</sup> China's rapid export growth has inevitably led to heightened trade frictions with its trading partners. As a matter of fact, after China's accession to the WTO, the US and the EU have continued to impose discriminatory restrictions against Chinese products.

The unprecedented market opening following China's WTO entry promoted the rapid development of China's imports and exports. In four years, China's foreign

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3. The Ministry of Commerce of China, *Foreign Market Access Report 2009* (Beijing: Renmin Chubanshe, 2009).

trade volume climbed from sixth to the world's third and then second, and its foreign exchange reserves jumped to the top. Table 1 shows that since China formally joined the WTO in 2001, China's imports and exports have shown steady growth. In 2003, China's annual imports and exports amounted to US\$851.21 billion, 37.1% more than the previous year, which was the biggest growth rate since the 1980s. In 2004, China's annual imports and exports for the first time exceeded US\$1 trillion to reach US\$1.15 trillion, and this allowed China to replace Japan as the world's third largest trading nation, smaller only than the US and Germany. From 2002 to 2007, China's total imports and exports averaged an annual average growth rate of 26.1%. Chinese exports expanded from US\$243.61 billion in 2001 to US\$1.428 trillion in 2008, with an average annual growth rate of 27.3%, while imports expanded from US\$266.15 billion in 2001 to US\$1.13 trillion in 2008 with an average annual growth rate of 24.9%, which represented the fastest growing period in Chinese history. In 2008, China's trade surplus reached US\$295.46 billion.

Due to the steady growth of China's exports, China's share in total global exports also improved steadily. Between 1995 and 2001, China's share in total global exports only increased 1.36%, from 3.09% to 4.45%; however, between 2002 and 2007, during the six years after China's accession to the WTO, this figure rapidly rose to 8.73%, a 3.49% increase.<sup>4</sup>

Data presented in Table 2 show that China's import and export growth covers a wide range of trade forms and product categories. In terms of trade forms, both general trade and processing trade maintained sustained and rapid growth. In terms of product category, China's trade structure has become more optimal, with mechanical and electrical products and high-tech products accounting for a large proportion of products and growing at a rapid pace.

If we focus on exports only, then how has China been able to maintain rapid export growth while withstanding unfair trade environment pressures like non-market economy status (NME) and technical barriers to trade (TBT)?

### Non-market economy status after China's WTO accession

While WTO membership seems to have stimulated the growth of its foreign trade, China faces a number of challenges from its trading partners regarding market access due to the presence of safeguard mechanisms as well as other WTO members' worries regarding China's rapidly growing international competitiveness. Since 2003, China's Ministry of Commerce began to issue its annual *Foreign Market Access Report* which catalogued trade and investment barriers put forward by China's major trading partners. The reports show that China's major trading partners, such as Japan, the US, the EU and India, are most notable for the maintenance of discriminatory trade barriers against China.<sup>5</sup>

4. Wang Xiaowen, 'China's accession to the WTO and change in the antidumping discrimination', *Practice of International Trade [Duiwai Jingmao Shiwu]* 1, (2009), p. 39.

5. The Ministry of Commerce of China, *Foreign Market Access Report 2004* (Beijing: Renmin Chubanshe, 2004).

**Table 1.** China's imports and exports after WTO accession (billion US\$)

Time	Total imports		Total exports		Total imports and exports		Trade surplus	
	Total	Year-on-year (%)	Total	Year-on-year (%)	Total	Year-on-year (%)	Total	Year-on-year (%)
2001	2,661.5	6.8	2,436.1	8.2	5,097.7	7.5	225.4	-6.5
2002	2,952.0	21.2	3,255.7	22.3	6,207.7	21.8	303.6	34.6
2003	4,128.4	39.9	4,383.7	34.6	8,512.1	37.1	255.3	-16.1
2004	5,614.2	36.0	5,933.7	35.4	11,547.9	35.7	319.5	25.4
2005	6,601.2	17.6	7,620.0	28.4	14,221.2	23.2	1,018.8	217.4
2006	7,916.1	20.0	9,690.8	27.2	17,606.9	23.8	1,774.7	74.0
2007	9,558.2	20.8	12,180.2	25.7	21,738.3	23.5	2,622.0	47.7
2008	11,330.9	18.5	14,285.5	17.2	25,616.3	17.8	2,954.6	12.6

Source: Website of Ministry of Commerce, online, available at: <http://zhs.mofcom.gov.cn/aarticle/cbw/200905/20090506218805.html> (accessed 8 April 2010).

Growing market access barriers against Chinese products resulted largely from the negative impact of the non-market economy provisions of *The Protocol of China's Accession to the WTO*. The so-called non-market economy status (NME) is often used to describe countries with public ownership and a planned economy, where production and sales activities and prices are decided by the government, and where there is no freely convertible currency. The non-market economy status originated during the GATT period. In retrospect, the term 'non-market economy country' came from the US Trade Act of 1974, which acknowledges that the general provisions of the Act shall not be applied to 'Communist Countries' with public ownership, including the former Soviet Union, Eastern Europe and China, because the governments of these countries seek to direct all economic activity, deciding what needs to be manufactured, to whom it should be distributed and at what price.<sup>6</sup> Moreover, the currency of these economies is not freely convertible. During the final stage of China's negotiations to obtain WTO membership, the US and the EU refused to recognize China as a market economy. However, in order to join the WTO as soon as possible, China made a concession to other WTO members and agreed to be treated as a non-market economy country for 15 years upon accession. This commitment was written into China's WTO Accession Protocol, Article 15:

The importing WTO member may use a methodology that is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product.

The provision further read, 'In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession'.<sup>7</sup> In other words, China did not

6. Pu Wenbin, 'The debate on NME: a game played by China, the US and the EU', *International Business [Guoji Shangwu]* no. 5, (2005), pp. 68-72.

7. World Trade Organization, *China Accession Protocol*, available at: <http://infochangeindia.org/trade-a-development/backgrounder/wto-negotiations-and-indias-stand-agriculture-nama-and-services.html>.

**Table 2.** China's imports and exports, 2006–2007 (billion US\$)

Index	2006	Growth over the previous year (%)	2007	Growth over the previous year (%)
The total import and export	17,606.9	23.8	21,738.3	23.5
Exports:	9,690.7	27.2	12,180.1	25.7
General trade	4,163.2	32.1	5,385.8	29.4
Processing trade	5,103.7	22.6	6,176.5	21.0
Other	423.8	39.3	617.8	45.8
Agricultural products (WTO-caliber)	220.2	12.2	366.0	18.0
Mechanical and electrical products	5,494.3	28.8	7,011.7	27.6
High-tech products	2,814.9	29.0	3,478.3	23.6
Imports:	7,916.1	20.0	9,558.2	20.8
General trade	3,331.8	19.1	4,286.5	28.7
Processing trade	3,214.9	17.4	3,684.0	14.6
Other	1,369.4	28.7	1,587.7	15.9
Agricultural products (WTO-caliber)	278.2	12.9	409.7	28.1
Mechanical and electrical products	4,277.3	22.1	4,989.8	16.7
High-tech products	2,473.1	25.1	2,869.9	16.0

Source: Website of Ministry of Commerce, online, available at: <http://zhs.mofcom.gov.cn/aarticle/cbw/200905/20090506218805.html> (accessed 8 April 2010).

**Table 3.** Top ten sources of China's trade surpluses in 2007 (billion US\$)

Ranking	Country (region)	2006	2007	Year-to-year % change
1	Hong Kong	1,444.7	1,716.2	18.8
2	US	1,442.2	1,633.3	13.3
3	Netherlands	272.1	364.9	34.1
4	United Kingdom	176.6	238.8	35.2
5	United Arab Emirates	86.1	140.2	62.9
6	Singapore	55.1	121.2	119.8
7	Spain	84.9	121.1	42.6
8	Italy	73.7	109.6	48.8
9	India	43.1	93.8	117.9
10	Turkey	65.4	91.9	40.5

Note: Trade surplus to the EU is US\$1.34 billion, year-to-year growth is 35.4%.

Source: Website of Ministry of Commerce, online, available at: <http://zhs.mofcom.gov.cn/aarticle/cbw/200805/20080505546807.html> (accessed 8 April 2010).

automatically have market economy status for the first 15 years after its WTO entry. In order to obtain full market economy status, China needs to be recognized by the importing country. This non-market economy provision is exclusively set for China, and China is the only victim of such a discriminatory provision while all other WTO members can invoke this provision at their own discretion to impose discriminatory restrictions on imports from China. The non-market economy provision has become an excuse for anti-dumping suits against China in the fair trade practices, because China can easily become the victim of anti-dumping investigations under this provision. The non-market economy provision imposes restrictions on Chinese



enterprise export competitiveness because they are vulnerable to anti-dumping, countervailing lawsuits. Until now, in all the anti-dumping proceedings against China, the United States and the European Union have been the two most active players. Moreover, of all WTO members, China is the only one subjected to such discriminatory treatment. Obviously, China's non-market economy treatment has already become the Achilles' heel for Chinese exporters with respect to anti-dumping investigations. For more than a decade, China has been the world's largest victim of anti-dumping investigations. From 1995 to the first half of 2008, China's export products have been subject to 640 anti-dumping investigations, accounting for 19.4% of the total global anti-dumping investigations. Moreover, 441 of these investigations ended up with the implementation of safeguard measures, which accounted for 20.9% of such cases. The ratio of anti-dumping investigations against China in total global anti-dumping investigations rose from 14.75% in 2001 to 37.20% in 2007.<sup>8</sup> According to Chad P. Bown,<sup>9</sup> the US anti-dumping investigations against China have been blatantly discriminatory. Since the 1990s, China has become the number one target for anti-dumping investigations. In the cases in which it was involved, China has been subjected to the highest proportion of anti-dumping duties. Moreover, not only is China frequently the victim, but anti-dumping duties against China were on average the highest compared to other WTO members. Bown also found that foreign discrimination against China via other trade policy instruments has continued. Indeed, the situation is even worse for a number of additional trade policy instruments. For example, other WTO member countries have increasingly resorted to safeguard measures so as to continue discrimination against Chinese exports in certain products since 2001.

China has made a major effort to remove the market economy status after its WTO accession. However, in June 2004, China's bid for market economy status was denied by both the United States and the European Union, because they still perceived China to be a non-market economy or a market economy in transition, and refused to recognize China's full market economy status.

The introduction of import-restricting measures may mean the loss of a major market for some industries, even though the share of these goods in total trade may not be high. The EU's anti-dumping lawsuit against China's color TV sets is a case in point. Moreover, in recent years, the list of Chinese products subject to developed-country anti-dumping investigations has expanded to include more than 4,000 commodities, including lighters, paints, bicycles, pencils, raw chemical materials and agricultural products.<sup>10</sup>

In addition, following WTO accession, China's exports face an increasing number of technical barriers to trade (TBT). Due to the hidden nature of implementation, equity in form and technical complexity, the TBT is an effective means of trade restriction against products from a developing country such as China. China's export products include traditional items such as agricultural products, textiles, toys and

8. Wang Xiaowen, 'China's accession to the WTO and change in the antidumping discrimination', p. 40.

9. Chad P. Bown, *China's WTO Entry: Antidumping, Safeguards, and Dispute Settlement*, NBER Working Paper No. 13349 (December 2008), available at: [http://www.nber.org/books\\_in\\_progress/china07/bown12-6-08.pdf](http://www.nber.org/books_in_progress/china07/bown12-6-08.pdf).

10. Tu Xinquan, *China in the WTO: Position, Function and Tactics* (Beijing: Foreign Economic and Trade University Press, 2005), p. 148.

other light industrial products. New-developed trade items such as mechanical and electrical products and high-tech products also face varying degrees of TBT restrictions. According to the Ministry of Commerce's estimate in 2000, China's direct and indirect export losses due to TBT amounted to US\$1.76 billion. In 2001, China lost more than US\$10 billion in exports due to its inability to meet international environmental standards. In 2002, 71% of China's export enterprises and 39% of export products were subject to TBT restrictions causing a loss of US\$17 billion, or 5.2% of that year's total exports.<sup>11</sup> In 2007, EU applicability of TBT increased, which created an unprecedented reduction in Chinese exports to the EU. For instance, the EU REACH bill, which came into force on 1 June 2007, probably represented the largest set of trade barriers, and the Chinese enterprises had to pay about US\$500 million–1 billion annually. The Eco-Design of Energy-using Products, which came into force on 17 August 2007, cost RMB50 billion or more in losses to the Chinese household electrical appliance industry. The EC 1881, which took effect on 1 March 2007, set maximum limits for food contaminants and elevated the threshold for Chinese food and agricultural products entering the EU market.<sup>12</sup>

### **Non-market economy status and its damage to China's foreign trade**

The international trading system after World War II is based on market economy conditions. The General Agreement on Tariffs and Trade (GATT) and World Trade Organization (WTO) rules are also based on market economy principles. Furthermore, tariff reduction, removal of quantitative restrictions, and the principles of MFN and national treatment only apply to market economies. In contrast, in state monopoly economies, countries' commitments made in multilateral negotiations could be offset in other ways. And there is a GATT Article 17 to deal with the trade issues concerning state monopoly products in market economy countries.

Non-market economy refers to Soviet planned economies and economies making a transition from a planned to a market economy. In these economies, state planning plays a central role in resource allocation and economic operation. The term 'non-market economy status' is in turn used to identify the properties of a certain kind of state economy. Socialist countries before the disintegration of the former Soviet Union and countries in transition are all identified as non-market economy countries.<sup>13</sup> For many years, how to deal with trade relations with non-market economies was at the top of the agenda of the GATT and the WTO. Obviously, GATT Article 17 cannot deal with the trade practices of non-market economies such as foreign trade monopoly by state-owned enterprises, dual prices between domestic and world markets, and serious tariff dysfunction at home. When Poland joined the GATT in 1967 and Romania in 1971, the

11. *WTO Economic Newsletter* 4, (2004), p. 11.

12. Shen Xiuqing, 'An analysis of China's countermeasures dealing with technical barrier of trade (TBT)', *Journal of Inner Mongolia Agriculture University, Social Sciences Edition* [*Neimengu Nonye Daxue Xuebao (Shehui Kexue Ban)*] no. 1, (2009), p. 110.

13. These countries include four Asian countries (China, Mongolia, North Korea and Vietnam), 12 former Soviet Union Republics, four eastern European countries (Albania, Poland, the Czech Republic and Slovakia) and three Baltic countries (Latvia, Estonia and Lithuania).

contracting parties demanded an increase in imported products at a certain percentage every year following their GATT accession for the two countries. In Poland's case, the number was an annual 7% increase. However, when Hungary joined the GATT in 1973, it insisted that its state-owned enterprises were simply agents for foreign suppliers, and rejected the precedents set by Poland and Romania. Nevertheless, the developed countries designed a discriminatory Specific Safeguard Mechanism in their Protocol on the Accession to the GATT,<sup>14</sup> even though these specific safeguard mechanisms ran against the non-discrimination and unconditional MFN principles. Eastern European countries' GATT Protocol created discriminatory precedents against non-market economy countries and legitimized such practices. Later, the WTO Anti-dumping Agreement Article 2.7 allowed the GATT Contracting Parties to use differential treatment or even discriminative actions against 'countries where there is a complete or substantially complete monopoly of trade, and where all prices are fixed by the state'.<sup>15</sup> This provision first appeared in the GATT Protocol for Poland and Hungary, but was often cited in response to export of goods from China. Meanwhile, another measure against non-market economies was the use of third country price data as the reference in anti-dumping proceedings. The best example of this approach was the Polish golf carts case, in which the domestic prices or costs of the Polish golf carts were based on a strict comparison with that of Spain. Although Poland won the lawsuits, this case created the precedent under the GATT Anti-Dumping Agreement for GATT contracting parties to use the prices or costs in an analogous country as the basis for calculating the normal value in determining price comparability.

Trade relations between market and non-market economies are largely influenced by political factors. During the 1960s and 1970s, the Soviet Union and eastern European countries applied for GATT membership at the same time but only eastern European countries were admitted under ad hoc conditions. The former Soviet Union was blocked and stayed outside the GATT. In the 1980s, the Soviet Union's bid to join the Uruguay Round negotiations was rejected once again. In fact, GATT's acceptance of non-market economies in Eastern Europe was based on their sound economic performance. Consequently these ad hoc arrangements were not regulation-oriented but results-oriented. They also created difficulties for implementation and supervision. Changes in the economic situation also made it difficult to detect and punish non-compliant actions. As a result, GATT contracting parties and WTO members insisted that new members must comply with the requirements of the GATT and the WTO. Therefore, since the 1990s, in dealing with non-market economies' trade relations, the GATT, and subsequently the WTO, adopted an inherently self-contradictory approach: on the one hand, discriminatory treatment has been maintained against countries where there is a complete or substantially complete monopoly of trade, and where all prices are fixed by the state; on the other hand, the applicant was required to meet the criteria for a 'market economy'. Therefore, the problem was how to define a 'non-market economy', or

14. Zhao Weitian, *The Legal System of WTO* (Changchun: Jilin People's Press, 2000), pp. 206–207.

15. *Ibid.*, p. 218.

how to identify the traditionally planned economies which are in transition now. However, the GATT and the WTO did not have specific criteria for distinguishing a 'market economy' from a 'non-market economy'. Even in early 1998, the European Union, in view of China and Russia's market-oriented reform process, no longer adhered to the original distinction between 'market economies and non-market economies' and shifted to a more pragmatic 'case by case' basis for dealing with this issue. The multilateral trading system still lacked specific criteria for identifying non-market economies, which made China and Russia's WTO accession negotiations more difficult. In China's WTO accession negotiations, both the United States and the European Union refused to grant China the market economy status despite the fact that China's market developed much faster than that of Russia.<sup>16</sup> Ironically, in mid-2002, both of them respectively granted Russia full market economy status, although Russia still had not obtained WTO membership at that time. So it is a political decision rather than an economic conclusion.

There were three provisions in *The Protocol of China's Accession to the WTO* that were very unfavorable to Chinese foreign trade: (1) 'Price Comparability in Determining Subsidies and Dumping' (non-market economy provisions) for 15 years after China's accession to the WTO (which means that China would be treated as a non-market economy until the end of 2016); (2) 'Specific Products Safeguard Mechanism' for 12 years after China's accession to the WTO (this means other WTO members can take special safeguard measures against Chinese exports, as the Obama Administration did in the Tyre case in 2009); and (3) 'Special restrictions on textile goods' for eight years after China's accession to the WTO (which expired at the end of 2008). These provisions allowed other WTO members to adopt discriminatory measures against China, including such anti-dumping and countervailing investigations in which China is treated as a non-market economy.

The non-market economy provisions, first formulated to deal with eastern European countries in the 1960s and 1970s, had a clear and comprehensive expression in *The Protocol of China's Accession to the WTO*. In contrast to a market economy, where the costs and prices are based on market competition, the costs and prices in a non-market economy are not determined by market competition. Therefore, the prices or costs in a surrogate country will be used as the basis for calculating the normal value of production in a non-market economy. Theoretically, the approach of a surrogate country is appropriate. However, in reality it provides possibilities for manipulation.

The non-market economy status creates two uncertainties for China. First, the GATT and the WTO regulations do not stipulate any procedure or criteria for classifying countries into market or non-market economies. The vagueness of the application procedures and the WTO decision-making mechanism therefore created opportunities for the contracting parties to manipulate the process and to impose restrictions at their own discretion. Moreover, major members of the WTO have very different criteria for what constitutes a non-market economy, which is very unfavorable for those countries that are judged to be non-market economy countries.

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16. Heritage, *Index of Economic Freedom*, (2010), available at: <http://www.heritage.org/index/explore?view=by-region-country-year>.

Second, the choice of a surrogate country in anti-dumping and countervailing duty cases involving a non-market economy is not clearly defined. The primary problem which NME countries encounter is the use of the surrogate country to calculate 'normal values'. In other words, the home market prices or production costs reported by firms in market economies instead of home market prices and the costs reported by the alleged dumpers will be applied to determine if dumping exists. In the same kind of trade disputes, the WTO members may choose different surrogate countries. For example, the EU selected Singapore as a surrogate country in its anti-dumping investigations on Chinese color televisions in 1998, but the US chose Indian prices as the basis of reference in a similar anti-dumping case against Chinese color TVs in 2004. Such an approach is not conducive to China's transition process from a non-market economy to a market economy.

Moreover, the non-market economy status provides anti-dumping authorities in the investigating country with considerable discretion in choosing a surrogate country as the basis for assessing prices and exchange rates. In anti-dumping proceedings, the key point is to determine whether dumping exists and, if so, what the dumping margin is. The lack of transparency of the process of choosing surrogate countries thus provided opportunities for importing country enterprises to manipulate the dumping margins.

In addition, the negative impact of the non-market economy status is not confined to members of the WTO. Although the NME status was first applied to the contracting parties of GATT, it has been widely applied to non-GATT/WTO members too. For example, Europe and the United States also used this methodology in dealing with trade relations with non-GATT/WTO members. Due to the reasons outlined above, non-market economy countries could easily become victims of anti-dumping measures, and China has become the most vulnerable one in recent years.

The non-market economy provisions exerted a negative impact on China's foreign trade in more ways than one. First, China could easily become the victim of anti-dumping and countervailing practices by other WTO members. According to statistics from the Chinese Ministry of Commerce, from the first anti-dumping case by the European Economic Community (EEC) against China in August 1979 to 30 June 2003, 33 countries and regions initiated 518 anti-dumping investigations against US\$20 billion worth of Chinese products, covering over 4,000 commodities such as chemicals, textiles, agriculture and electrical products. Since 1992, China has become the largest target of anti-dumping lawsuits. According to WTO statistics, from 1995 to June 2003, global anti-dumping cases against China reached 324, accounting for 14.19% of the total number of cases in the world. During the same period, China was involved in a total of 232 anti-dumping investigations, accounting for 16.55% of the world's total. This ratio is between three and five times higher than that of China's share in world trade. Overall, the foreign anti-dumping action against China has become a major threat to the development of China's foreign trade. Of course, there are many other reasons, such as an imbalance of bilateral trade, market access and even domestic political disputes, for the growing anti-dumping proceedings against China, but non-market economy status is one of the most important reasons because China is always an easy target in those anti-dumping

cases. As a transition economy and a non-market economy country, China is very vulnerable to excesses in anti-dumping proceedings by other countries.

Second, the NME designation made China more vulnerable to the imposition of high anti-dumping margins. In international anti-dumping proceedings, Chinese companies are often subject to the highest tax rate. For example, in the US color TV anti-dumping cases, Chinese and Malaysian enterprises were both affected. However, while Malaysian enterprises were exempted halfway, Chinese enterprises were charged an anti-dumping rate of as much as 78% in the final determination in May 2004.

Third, the NME status also increased the costs for Chinese enterprises in anti-dumping investigations, as they not only have to prepare a variety of materials to respond to the AD investigation, but they also need to demonstrate a positive process and the progress of China's market development reform to the outside world. This is a very difficult and bitter process, yet the Chinese enterprises had to adjust themselves to this process in order to win market economy status and reduce losses. In determining the dumping margin, Chinese enterprises can use the actual cost of these enterprises and domestic sales price data to evaluate the dumping margin, rather than take the price of similar enterprises in other countries instead. To deal with the anti-dumping lawsuit, Chinese enterprises had to pay high costs, for instance, a lighter factory in Wenzhou spent RMB1 million in responding to the European Union's anti-dumping lawsuits. And it is no surprise that the cost of litigation will be sky-high. It is reported that total litigation costs may reach as high as hundreds of millions or even billions of RMB a year.<sup>17</sup>

### China's options for seeking market economy status

China's trade surplus would likely be treated as a big problem by its trading partners, and China may suffer the NME for a while yet. In order to analyze the reasons behind the development of China's trade, we should have a sound understanding of China's trade surplus (See Table 3). To a certain extent, China's expanding trade surplus is the combination of international division of labor and industrial transfer and reorganization of production. This includes the transfer of production and manufacturing bases as well as the transfer of production links from multinational corporations (MNCs) to Chinese domestic enterprises. During this process, the multinational corporations turn China into a 'world factory', but the two ends of the production links remain abroad. Foreign-invested firms gain a large portion from China's surplus in its trade with trading partners. Because a great part of exported products are manufactured goods, processed or assembled in China's coastal areas with materials and parts supplied by foreign firms, China gains only labor costs (usually under 10% of a product's value). Also, foreign-invested firms play an increasingly important role in the development of China's exports, but the profits they gain are mobile and are not reflected in the trade data.<sup>18</sup> China has been the most desirable developing country destination for foreign direct investment (FDI) since the

17. Wang Zixian, 'China's WTO accession: evaluation and prospect', *China Economic Times*, (21 March 2003).

18. The Ministry of Commerce of China, *Almanac of China's Foreign Economic Relations and Trade* (Beijing: China Statistics Press, 2003), p. 91.

early 1980s. By the end of 2006, China actually had a total of US\$685.4 billion in FDI, 70% of which came from East Asian countries and regions, such as Hong Kong, South Korea, Japan, Singapore and Taiwan. Businesses in those countries and regions transfer production bases to mainland China, together with their huge trade surplus with the US and the EU. Hence, those trade surpluses are counted in China's trade surplus. In other words, the large volume of Chinese exports reflects the global and regional division of production and China's comparative advantage in labor-intensive products.

There is no doubt that among all members of the WTO, China has the most complex identity. Whether measured in overall economic developments, or for the purpose of safeguarding its own interests, China should uphold the status of a developing country. This is because as a developing country, China could enjoy developing countries' special and differential treatment in the international economic system. At the same time, this identity could gain broader political and diplomatic support from developing countries. However, China is a unique developing country as its economic system is under ongoing transformation and its economy is experiencing rapid development. As a rapidly rising developing country, China may face fierce competition from other developing countries in terms of foreign trade and the attraction of FDI. In some specific areas, this competition could be quite keen. Therefore, when China sought to define its identity in the WTO, it concentrated on its practical interests and acted with prudence and caution, and tried not to alienate other WTO members or to create factions in the organization.<sup>19</sup> This special identity makes China a bridge across the North–South divisions.

China takes full advantage of the legitimate rights endowed by the multilateral trading system to strengthen the protection of domestic industries. Since the first anti-dumping investigation in 1997, China had carried out 27 anti-dumping investigations by 2001, 22 of which had resulted in the imposition of anti-dumping measures, thus effectively protecting the legitimate rights and interests of Chinese domestic products and enterprises. From 2002 to 2004, 76 anti-dumping cases were filed and 63 ended up with anti-dumping measures.<sup>20</sup> This shows that after China's WTO accession, China placed greater stress on the use of WTO-related measures to protect its domestic industries. Of course, this does not exclude China's intention of using AD to retaliate against other WTO members who frequently use similar measures against China. At the same time, China actively responded to foreign anti-dumping suits against Chinese products. In 2002, among the five concluded anti-dumping cases in the United States, the Chinese side won 80%.<sup>21</sup> In the case of *US steel safeguard measures*, China used the WTO dispute settlement mechanism for the first time and successfully won the case, forcing the US to abolish the restrictions. These attempts are only the beginning of making use of WTO rules. China needs to further strengthen its capacity in this area and provide effective protection to its domestic industries.

China has been trying to persuade other WTO members to abolish the non-market economy status for China in their domestic anti-dumping laws through diplomatic

19. Jin Liqun, *China: One Year into the WTO Process*, Address to the World Bank, (22 October 2002).

20. Bown, 'China's WTO entry', p. 61.

21. Wang Zixian, 'China's WTO accession'.

means. *The Protocol of China's Accession to the WTO* allows the importing WTO member to terminate China's non-market economy status earlier than the 15-year period. China could negotiate with each WTO member to grant China market economy status under its domestic law or the relevant provisions of its anti-dumping law. Moreover, WTO provisions do not prescribe regulations regarding the granting of market economy status. WTO members can decide whether or not to grant China market economy status in accordance with their domestic law or trade policies toward China. Hence, China has sought to persuade WTO members to grant China market economy status through diplomatic negotiations. From 2004 to 2005, China managed to persuade 51 countries, including New Zealand, ASEAN countries and African countries, to recognize its market economy status through diplomatic efforts.

Seemingly an economic issue, the non-market economy status is essentially a political issue. The United States' specified the criteria for determining an NME to include 'the extent to which the currency of the foreign country is convertible into the currency of other countries' and 'the extent to which wage rates in the foreign country are determined by free bargaining between labor and management'. The EU would only grant market economy status to China after China fulfills the following four requirements: (a) exchange rate conversions are carried out at the market rate; (b) decisions of firms regarding prices, costs and inputs, including technology and labor, output sales and investment, are made in response to market signals, reflecting supply and demand, and without any significant state interference, and costs of major inputs substantially reflect market values; (c) firms have one clear set of accounting records which are independently audited in line with international accounting standards and are applied for all purposes; and (d) the firms concerned are subject to bankruptcy and property laws which guarantee legal certainty and stability for the operation of firms.<sup>22</sup> Although European standards are not consistent with the US standards, they are difficult enough for China to handle. It looks like it is an economic problem only, and as long as China complies with the above criteria, the United States and Europe would grant China market economy status. However, neither the US nor the EU criteria rest on quantifiable indicators, which increases the element of arbitrariness in the process of NME determination. The United States and the European Union have already used the non-market economy status as a bargaining chip to deal with China in a political way. This made it especially difficult for China to have a clear timetable in its negotiations with the EU and the United States.

Indeed, both the US and the EU have flexible standards for determining what constitutes a (non-)market economy. Before the 1990s, non-market economies referred to socialist countries. Since the 1990s, eastern European countries have been removed from the non-market economy list. In 1998, the EU trade policy made major adjustments so that China and Russia were no longer 'purely non-market economies'. In 2002, the US and the EU granted Russia market economy status following the 9/11 attack, when Russia accommodated itself to the US and EU requirements in terms of

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22. Hu Jinxin and Ma Ji, 'On NME issue: EU and the US use AD against Chinese firms', *Theory [Lilun]* no. 7, (2002), pp. 107–110.



energy supply and counter-terrorist operations. Romania and Bulgaria were granted market economy status in 2003 because of their support for the Iraq war. As a matter of fact, while both China and Russia are transitional economies, China's economic liberalization index and the degree of market economy development are much better than those of Russia.<sup>23</sup> However, due to the rapid growth of China's exports, differences in ideology and competition, it is unlikely that the US and the EU will give up their bargaining chip easily.

While the ostensible purpose of the non-market economy status is to maintain fair trade practices, the process of determining what constitutes a non-market economy is essentially discriminatory. Following the protests against the WTO in Seattle, multilateral trade negotiations have been stalled. Both the Doha Round and Cancun negotiations met with great difficulties. The difficulties experienced in multilateral trade negotiations in turn provided an impetus for countries to accelerate bilateral negotiations and the process of regional economic integration; the latter carries considerable incentives for trade protectionism. Having reaped the benefits of the early harvest, developed countries now advocate fair trade for trade protection purposes. In light of this background, China's bid for market economy status will likely be protracted.

China's market economy status depends on whether China could make some compromises in its strategic interests. Without a win-win game plan, the US and the EU could keep this issue at a technical level and continue to raise new technical difficulties with China. Only when the two sides reach a compromise on the strategic interests can China's market economy status be recognized. Otherwise, China will have to wait until the expiration of that provision in 2016.

## 7. Conclusion

In short, as a condition of accepting China into the WTO, the United States and other developed countries maintained the discretion of imposing non-market economy status on China's exports. China objected to this as a violation of the MFN principle. As a precondition that China was forced to accept in order to join the WTO, the non-market economy status has undermined the objectives of China's WTO accession and China was often discriminated against after it became a member of the WTO. The distinctive principle of a liberal trading order is non-discrimination. That means equal treatment under the agreed rules. China makes this point when it faces higher barriers to WTO membership than did other countries at a comparable stage of development. The United States and other developed countries make this same point when they claim that China has not yet met the common standards for WTO membership. Regarding this criticism, China has its own argument. China has lower barriers for imports than other centrally planned economies that were admitted to the GATT many years ago. The United States and other developed countries want to apply a non-market economy status to

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23. Heritage, *Index of Economic Freedom*, (2003), available at: <http://www.heritage.org/index/explore?view=by-region-country-year>.

China, and thus place such limits on exports from China as have never been applied to any other country.

Even after its WTO accession, China's unfair trade environment has not changed fundamentally. However, due to various efforts, there have still been remarkable achievements made in China's foreign trade.

If China's full incorporation into the world trading system is managed well, it seems likely that the reforms . . . will be seen as another watershed event contributing strongly to the modernization of China and its full integration into the world economy.<sup>24</sup>

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24. Margaret M. Pearson, 'China's integration into the international trade and investment regime', in Elizabeth Economy and Michel Oksenberg, eds, *China Joins the World: Progress and Prospects* (New York: Council on Foreign Relations Press, 1999), p. 168.