AEGIS EUROPE

# China's Market Economy Status: the Commission proposal to change the anti-dumping methodology for Non-Market Economy countries

## AEGIS EUROPE position

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**Key messages:**

- **Ensure automatic application of a "non-standard" anti-dumping methodology to imports from countries which do not fulfil the EU's market economy criteria**
- **Reports must lead to a Commission's determination that significant distortions exist in countries where non-market situations prevail**
- **EU industry must have no burden to prove significant distortions in non-market economies or other non-market situations**
- **Third country and/or international prices and benchmarks must be used for all factors of production whenever market economy criteria are not met**
- **Ensure that the WTO leaves the door open to the further application of non-market economy methodologies, and align the EU non-standard dumping calculation methodology with that of the US also in order to coordinate the WTO defence**

## Introduction

On 9 November 2016, the European Commission presented a proposal to introduce into the Basic Anti-dumping Regulation a new methodology to calculate dumping margins with regard to imports from WTO countries where the market is significantly distorted. This would apply to imports from countries such as China, which up to now have been identified as non-market economies (NMEs), i.e. countries which have not yet fulfilled the EU's five market economy criteria, as well as from others where market distortions linked to State intervention mask the true extent of dumping practices.

This proposal of the Commission is intended to address the request made by the European Parliament in the resolution of 12 May 2016 on China's Market Economy Status (MES).

AEGIS Europe supports the Commission's objective of a greater alignment of the EU anti-dumping methodology with that of the US, the replacement of the current analogue country methodology for WTO members, and the maintenance of effective trade defence measures.

However, in our view, the Commission's legislative proposal fails, in its present form, to meet two of the Parliament's key demands, namely:

1) *"Until China meets all five EU criteria required to qualify as a market economy, the EU should use a non-standard methodology in anti-dumping and anti-subsidy investigations into Chinese imports in determining price comparability, in accordance with and giving full effect to those parts of Section 15 of China's Accession Protocol which provide room for the application of a non-standard methodology."*

   In other words, any new methodology applicable to imports from China and other NMEs must ensure that until these countries meet the EU's five market economy criteria, their distorted costs and prices are not used to determine normal value, and the Commission and EU producers have no higher burden of proof than under current legislation.

2) *"…to coordinate with the EU's major trading partners […] on how best to ensure that all provisions of Section 15 of China's Accession Protocol to the WTO that remain in force after 2016 are given full legal meaning under their domestic procedures."*

   In other words, there must be a closer alignment with the methodology applied by the US and other major trading partners to imports from China. This in turn implies that there must be close coordination in WTO dispute settlement procedures involving the interpretation of the effect of the expiry of subparagraph 15(a)(ii) of China's WTO Accession Protocol, in order to ensure that the WTO leaves the door open to the further application of Non-Market Economy methodologies.

By putting all WTO members on an equal footing, the text as it stands gives no certainty that countries such as China are not *de facto* being granted MES. Instead, it is critical that the EU treat countries that have not demonstrated to the EU that they meet the EU's market economy criteria differently from countries that do. This would truly align the EU with the USA, Japan and many other major EU trading partners, which continue to use different methodologies for countries not meeting market economy criteria, as allowed for example by the provisions of Section 15 of China's WTO Protocol of Accession which remain in force today.

Considering the above and the fact that the matter has already been referred by China to the WTO, AEGIS Europe urges the European Parliament and the Council to carefully scrutinize the Commission's proposal and to substantially revise it in order to ensure legal certainty and to protect EU industry and EU jobs against illegal dumping, while at the same time taking into account the broader international context and especially the need to closely coordinate with our main trading partners at WTO level.

AEGIS Europe's key priorities are highlighted below with some suggestions for action.

## 1. Ensure automatic application of a "non-standard" anti-dumping methodology[1] to imports from countries which do not fulfil the EU's market economy criteria

The Commission proposal radically alters the functioning of the EU anti-dumping system with regard to WTO Members that have not shown they meet the EU's five market economy criteria. The proposal not only removes the names of specifically-identified NME countries, it:

1) removes entirely the distinction between market and non-market economy countries;

2) does not make any reference to nor provide any link with China's Protocol of Accession to the WTO;

3) does not make reference to the five criteria used by the EU up to now to determine whether a country is a market economy or a non-market economy (NME); and,

4) makes the use of domestic prices and costs of NME producers the general rule in application of Article 2(1) of the Basic AD Regulation (i.e. creating the risk of *de facto* grants of MES to all NME countries which are WTO Members).

[1] A non-standard methodology is a methodology to calculate normal value in anti-dumping investigations which is **not** based on the generally applicable provisions of Art. 2.2 of the WTO Anti-Dumping Agreement.

It is understood the main reason behind this choice was the intention to lower the risk of an immediate legal challenge at the WTO. However, to lower the risk of an immediate challenge, and to put the EU on the same footing as the US, it would be sufficient to stop naming specific countries as NMEs in the EU anti-dumping legislation. The Commission proposal unnecessarily goes much further than this, and entirely removes the objective distinction between market economies and NMEs (a distinction which remains, for example, in the US legislation).

In this regard, the proposal's entire elimination of the distinction between market economies and NMEs does not remove the risk of a WTO challenge: on 12 December 2016, China presented a request for consultations at the WTO, and on 10 March 2017 circulated a request for the establishment of a panel, making it clear that the request also targets any changes made to the EU Basic Anti-dumping Regulation pursuant to the legislative processes initiated by this proposal (for more details on this WTO dispute see here). Chinese officials have also publicly indicated China does not consider the Commission's proposal to be WTO-compatible.

Moreover, the Commission proposal introduces the vague concept of "significant distortions", a concept which is new in relation to both EU and WTO law (it is not defined in the WTO Anti-Dumping Agreement nor referred to in China's WTO Accession Protocol) as the trigger for applying the new anti-dumping methodology.

This approach raises multiple legal concerns:

1) With no reference to the distinction between market and non-market economies, and the use of Article 2(1) of the Basic Anti-dumping Regulation as the general rule to calculate dumping margins, the proposal risks resulting in a *de facto* grant of MES to NME countries that are members of the WTO.

2) In particular, the proposal fails to take into account that Section 15 of China's Protocol of Accession continues to require that China demonstrate that it meets the importing country's market economy criteria before being entitled to have Chinese prices or costs used to determine the normal values of Chinese exporting producers.

3) The Commission's proposal builds on the new concept of "significant distortions", whose existence is to be established on the basis of several criteria (the new Article 2(6a)(b)). However, those criteria do not clearly correspond to the five criteria that have always been used by the EU to identify a country as a market economy, and this invites a claim that they are too vague and arbitrary.

4) In particular, the concept of "significant distortions" risks to be considered an example of "particular market situations" (ex Art. 2.3 of the Basic Anti-Dumping Regulation) and to be applied as a cost-adjustment provision under the standard anti-dumping

methodology. This would imply *inter alia* the application of the restrictions of recent WTO decisions on this matter[2].

5) Finally, without a clear reference to the long-established five market economy criteria, the Commission's proposal would create an unnecessary risk in relation to:

   i. WTO dispute settlement: a WTO ruling could allow the continued use of a NME methodology in relation to imports from NME countries but find the new EU "non standard" methodology to be in violation of WTO obligations on the grounds that there is no clear link with Section 15 of China's WTO Accession Protocol via the market economy criteria referred to there (i.e. the market economy criteria of the importing WTO Member at the time of China's accession to the WTO)[3].

   ii. Decisions by the European Courts: European Courts could judge that the new methodology, which does not make use of the market economy – NME distinction and which is entirely country-neutral, can be evaluated for compliance with WTO rules in application of the *Nakajima* case-law, and therefore that measures adopted using the new methodology could be annulled – with retroactive effect – on the basis of a violation of WTO rules. However, as clearly shown by the recent ECJ decision on the *Rusal Armenal* case, this risk is not present with regard to the EU's current NME anti-dumping methodology, precisely on the grounds that it presents the market economy – NME distinction, a framework for distinguishing among countries which is not based on the WTO Anti-Dumping Agreement.[4]

***AEGIS Europe recommends that the Commission proposal be amended as follows:***

- ✓ ***Ensure that until such time as non-market economy countries, such as China, can demonstrate fulfilment of the EU's five market economy criteria, the normal values of producers in those countries is not determined on the basis of their prices and costs.***

- ✓ *This requires that* ***the Basic Anti-dumping Regulation continue to make express reference to the EU's five long-established market economy criteria****, as allowed by the remaining portions of Section 15 of China's WTO Accession Protocol, and so as to reduce uncertainty and arbitrariness.*

[2] For more details on ongoing WTO disputes regarding cost adjustments, see for instance here and here.
[3] As explicitly mentioned in Section 15, Paragraph (d) of China's WTO Accession protocol, available here.
[4] See, in particular, para 50 of the *Rusal Armenal* decision, available here.

## 2. Reports must lead to a Commission's determination that significant distortions exist in countries where non-market situations prevail

The elimination of both the existing list of non-market economy countries and the entire market economy – NME distinction from the EU legislation means in practice that the Commission would decide on a case-by-case basis – in relation to the existence of "significant distortions" – whether or not to apply the new methodology. This new system would significantly increase the Commission's margin of discretion in individual anti-dumping cases whether or not to start from NME countries' prices and costs. In addition, the burden of proving the existence of "significant distortions" would lie with the Commission and, at the stage of the complaint, with the EU industry, as the proposal puts no proof burden on the NME country or NME producers.

The Commission proposal aims to mitigate this evidentiary burden by introducing reports (the new Article 2(6a)(c)) that "may" be issued, "where appropriate" by "Commission services" about one or another country or sector. These reports would in effect serve as a collection of evidence of "significant distortions". However, the proposal provides no clarity as to which countries or sectors would be included, how these reports (and any revisions) would be adopted, when the first reports would be issued and how regularly they would be updated, what their legal status would be, and whether or not the Commission must draw conclusions in relation to the distortions identified in the report. In particular, while the proposal would allow stakeholders to comment once a report is published, there is no mechanism for stakeholders to provide prior input, nor for the European Parliament and Council to have a prior say over the content of the report and/or its adoption or revision.

More generally, the new arrangements of the Commission proposal – focused on "significant distortions" rather than the long-established set of market economy criteria – indicate a clear shift of the burden of proof towards the EU to justify the application of the new methodology to non-market economies, creating a paradox: while even the European Commission acknowledges that the Chinese economy (and those of other NMEs) does not operate according to market principles, and thus still fails to meet the EU's long-established market economy criteria, the burden of proving the existence of "significant distortions" is placed on the EU.

Further, this necessarily implies that the burden of proof will be on the complaining EU industry when it presents a request for initiation of an investigation, and this is essentially confirmed by subparagraph (d) of new paragraph 2(6a)[5]. Thus, on a case-by-case basis, the complaining EU industry would have to provide sufficient justification for disregarding local NME prices and costs when calculating dumping margins in the complaint, and to the extent a Commission report has been issued with regard to the country or sector in question, the complaining EU industry could make use of that report to help discharge its burden of proof.

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[5] *"The Union industry may rely on the report referred to in point (c) for the calculation of normal value when filing a complaint."*

Such an unclear wording about the issuance of the reports and their content, use and value would lead to major uncertainty in the procedure, making the EU system much less certain than the US system in which complainants can confidently rely on the official government designation of, for example, China as a non-market economy, without the need to bring forward any proof regarding distortions in the exporting country in order to have the NME methodology applied.

AEGIS Europe believes that the main function of these reports should be to assess conclusively which countries or specific sectors operate according to market principles, with a clear reference to the EU's five existing market economy criteria, and not merely to mitigate the evidentiary burden on complainants, as the burden of proof must lie clearly with exporting producers to justify the use of their prices and costs.

In addition, to provide a clearer transition from the present arrangements, and to reinforce the evidence of significant distortions with regard to non-market economies and economies in transition, there should be a reference to prior reports and evidence from investigations the Commission and third country authorities have already carried out (or will have carried out following the issuance of a given report) concerning the non-fulfilment of the market economy criteria.

***AEGIS Europe recommends that:***

- ✓ ***The proposal is amended to ensure that reports will address the fulfilment (or absence thereof) of the EU's market economy criteria**. In addition, the revision of a determination based on one of these reports should be required only upon receipt of a duly documented request clearly demonstrating the fulfilment of the market economy criteria.*

- ✓ ***The Commission presents a draft of these reports prior to the adoption of any changes to the current methodology**.*

- ✓ ***Reports are to be adopted following consultation of the European Parliament and Council**.*

## 3. EU industry must have no burden to prove significant distortions in non-market economies or other non-market situations and third country and/or international prices and benchmarks must be used for all factors of production whenever market economy criteria are not met

It is widely recognized that China is not yet a market economy. The current EU anti-dumping legislation clearly reflects this fact: under present rules, it is up to Chinese exporting producers under investigation to prove that market economy conditions prevail in order for the normal value to be constructed under the standard market economy methodology, i.e. starting from local prices and costs (Article 2 para. 1 to 6, of the EU Basic Anti-dumping Regulation). If they cannot prove this, the non-market economy methodology ("analogue country") is applied (Article 2(7) (a), EU Basic Anti-dumping Regulation).

In contrast, the proposal of the Commission (new Article 2(6a)(a)) places no burden on exporting country producers to justify the use of their prices and costs :

*(a) In case it is determined, when applying this provision or any other relevant provision of this Regulation, that it is not appropriate to use domestic prices and costs in the exporting country due to the existence of significant distortions, the normal value shall be constructed on the basis of costs of production and sale reflecting undistorted prices or benchmarks. For this purpose, the sources that may be used include undistorted international prices, costs, or benchmarks, or corresponding costs of production and sale in an appropriate representative country with a similar level of economic development as the exporting country, provided the relevant cost data are readily available. The constructed normal value shall include a reasonable amount for administrative, selling and general costs and for profits.*

Indeed, the Commission's proposal makes clear that the new arrangements would start from local producer prices and costs and then move away from them once the existence of "significant distortions" has been established[6]. This follows the framework of the standard WTO Anti-Dumping Agreement provisions regarding cost adjustments (Art. 2.2 of the ADA), which place the burden of proof on the EU side and not on exporting country producers.

In other words, the risk is that, rather than introducing a true "non-standard" methodology, the Commission proposal is applied as an embellishment of the general WTO framework for the normal value determination, which starts from the use of domestic prices and costs. The new proposal allows the Commission to move away from the domestic prices and costs in particular

[6] See, *inter alia*, whereas (4): "*It is further appropriate to recall that costs should normally be calculated on the basis of records kept by the exporter or producer under investigation. However, where there are significant distortions in the exporting country with the consequence that costs reflected in the record of the party concerned are artificially low, such costs may be adjusted or established on any reasonable basis.*"

circumstances, but this is precisely the approach of the standard WTO methodology for normal value calculations. A proper “non-standard” methodology would ignore domestic prices and costs from the start, and do so automatically for each factor of production, based on the fact that a particular country does not have a full market economy (i.e. prices and costs are systematically distorted and none are fit in principle to be used for the purpose of calculating the normal value).

**AEGIS Europe is therefore concerned that anti-dumping measures resulting from the application of the new methodology would be less effective than measures adopted today: the vagueness of the proposal makes it impossible to guarantee that measures applied on the basis of the new anti-dumping methodology would reflect the real level of dumping of EU imports from NME countries.**

This would undermine the EU industry’s legitimate interest in having effective measures to address unfair competition from illegally dumped imports. Hundreds of thousands of EU jobs are at risk here, and this legal uncertainty would only discourage investment by industry in the EU, leading manufacturers to produce outside the EU. It would also make it highly questionable whether SME’s would still be able to lodge complaints in the future, while the EU itself recognises that SME’s provide more than 70% of jobs within the EU.

Indeed, the fact that the Commission proposal does not clearly introduce a new non-standard methodology to calculate normal value, nor introduce a “factors of production” methodology as applied in the US, has critical implications, both for the complaining EU industry and during an investigation of imports from an NME country.

With regard to complaints by EU industry, the reports to which the proposal refers do not adequately address this issue. Indeed, because a report would by definition examine an entire economy or at least an entire sector, it is unclear to what extent complainants would need to bring forward further evidence of distortions with regard to the specific product which is the subject of a given complaint. Thus, the proposed rules would create a significant risk that EU industries, and particularly SMEs, would be handicapped in bringing forward complaints about dumped imports from China. This is in stark contrast with the practice of the EU's main trading partner, the US, as well as with the text of the remaining provisions of Section 15 of China’s WTO Accession Protocol. There is no justification for asking EU producers to go through an even more burdensome procedure, requiring them to show distortions for the cost of each production factor.

The issue of burden of proof is also critical for the conduct of an investigation and the establishment of the Commission's findings. In a situation where the burden of proof is on the exporting country producers to justify the use of their prices or costs, their failure to carry their burden means that the Commission would simply make use of third country prices or costs or international benchmarks for each factor of production, without any need to demonstrate individual cost factor distortions.

Also, there must be a meaningful burden on the exporting country producers, to demonstrate not only that a given cost reflects market economy involvement, but that it is reliable for use in the construction of the normal value. For example, in the US, the Department of Commerce applies a three-part reliability test where the burden is on the NME producers to bring forward sufficient information to justify the use of their own costs individually.

AEGIS believes it would also be appropriate to allow an entire sector or industry to obtain the use of local NME producer prices or costs for all producers of that sector or industry by clearly demonstrating that the entire sector or industry operates under market economy conditions.

***AEGIS Europe therefore recommends that:***

- ✓ *At least* ***with regard to imports coming from countries that have not yet completed the transition towards a market economy, the Commission should apply the new "non-standard" methodology by default and refer directly to third country costs or international benchmarks for each factor of production*** *or for the product concerned as a whole, without regard to local prices or costs.*

- ✓ *In those cases,* ***any individual NME producer would continue to have the opportunity to demonstrate that its cost for a given factor reliably reflects market economy prices*** *and thereby have that cost used in the dumping calculation.*

- ✓ *In addition, from now on, not only individual producers but* ***also an industry or sector from countries which have not yet completed the transition towards a fully-fledged market economy should be given the possibility of demonstrating that it operates according to market economy principles****, and thereby to obtain the use of local producer prices and costs in the calculation of normal values.*

## 4. Ensure that the WTO leaves the door open to the further application of non-market economy methodologies, and align the EU non-standard dumping calculation methodology with that of the US also in order to coordinate the WTO defence

The EU's major trading partners, the US and Japan, have publicly stated that they see no need and are taking no steps to change their legislation with regard to the treatment of China in anti-dumping investigations.

The Commission has stated that its proposal would align the EU with the US system, but – as indicated above – that is not clearly the case. Indeed:

1) The US NME methodology is applied following a determination that a country is a non-market economy as defined by law, whereas under the Commission proposal the new methodology would apply to countries found to have "significant distortions", a new undefined term.

2) The US NME methodology refers directly to third country prices for each factor of production, and allows the use of local NME producer prices or costs only when they are shown to reliably reflect market economy conditions.

At the same time, the fact that China considers both the US and EU to be in violation of WTO obligations with regard to same basic issue (interpretation of the effect of the expiry of 15(a)(ii)) makes coordination of their WTO defence essential.

***AEGIS Europe believes that:***

- ✓ ***The Commission's proposal should be amended with regard to the trigger for applying the new methodology and with regard to its application, in order to truly align it with the US system***.

- ✓ ***Coordinating the WTO defence with the US is essential for the EU***

  i. *to put up the best defence possible of its existing legislation (and thus avoid changing more than is necessary under WTO rules),*

  ii. *to maximise the chances for all WTO Members, including the EU, of being able to make continued use of the remaining provisions of China's WTO Accession Protocol, and*

  iii. *to minimise the risk of deflections of trade that could result from divergent approaches.*

- ✓ ***The EP and the Council should use all tools at their disposal to ensure the Commission operates in this regard under public scrutiny***.

AEGIS Europe is hopeful that WTO judges will ultimately recognise that the anti-dumping provisions which remain in China's Accession Protocol continue to provide a basis for other WTO members not to have to refer to distorted Chinese prices and costs, and we hope that this message will be echoed by EU policy-makers who care about EU industry and EU jobs.

## 5. Non-cooperation should lead to the non-application of the lesser duty rule (LDR)

The Commission proposal addresses all situations where "significant distortions" are established for a given country or sector, including countries which have not yet fulfilled the EU's five market economy criteria, as well as others where market distortions linked to State intervention mask the true extent of dumping practices.

Given the danger posed to EU producers by imports from countries where State intervention is causing these distortions, and the number of EU jobs at risk in anti-dumping investigations of these imports, AEGIS believes that it is particularly important to take care to dissuade non-cooperation by exporting producers from those countries. To accomplish this, the anti-dumping duties imposed on exporting producers which do not provide full cooperation should reflect the full margin of dumping and not be limited to the injury margin. In other words, the lesser duty rule (LDR) should not be applied in the determination of the anti-dumping duty to be imposed on non-cooperating exporting producers from countries or sectors for which significant distortions have been established.

***AEGIS Europe recommends that the legislative proposal be amended so as to:***

- ✓ *Require the Commission to sanction non-cooperation by any producer in a country or sector in which significant distortions exist by establishing the anti-dumping duty imposed on that producer to reflect the full margin of dumping and not limited to the injury margin.*

## Conclusion

There is a clear and undeniable need to retain effective anti-dumping measures to address the dumping that results from China and other NMEs' systemic price distortions. These distortions are significant and are no accident: they are inherent to planned economic systems and continue despite NME countries commitment to remove them upon their accession to the WTO.

AEGIS Europe wants to play a constructive role in the EU decision-making process, and we encourage the European Parliament and the Council to take the appropriate time to carefully address all the pending issues which have been highlighted, especially when other major trading partners have expressed their determination to stand by their existing rules, and clarification regarding the effect of the expiry of subparagraph 15(a)(ii) of China's WTO Accession Protocol will come soon from the WTO dispute settlement process.

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