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The U.S.-China Economic and Security Review Commission has posed two of the most important questions facing the international trading community today: is China a market economy, and if it is not, is the United States nonetheless required to treat it as one? How these questions are answered will affect billions of dollars in trade and millions of jobs. In this case, the answers are actually quite clear. China satisfies none of the criteria for a market economy as enunciated by the United States, the European Union, or Canada. Nor do the international obligations of the United States require it to treat China as a market economy when it is not. Any decision to extend market economy treatment to China when China is not in fact a market economy would have severe negative consequences for the U.S. economy and the entire world trading system.

Is China a Market Economy?

A useful starting point in assessing whether China is a market economy is the stance of the Chinese government itself. The Constitution of the People's Republic of China states explicitly that "{t}he State-owned economy, namely, the socialist economy under ownership by the whole people, is the leading force in the national economy. The State ensures the consolidation and growth of the State-owned economy." A recent statement by the State Council, the highest administrative organ of the Chinese government, highlights the extent to which various levels of government in China interfere in the operation of the economy:

> Some local governments have excessively sought after speedy development, relying on attracting investment. They have provided land at discounted prices, tax reductions or exemptions, resources at discounted prices and other methods to attract business and investment, enabling repetitive investments and expansions in capacity. At the same time, market reforms of resource factors have lagged behind. Policies, regulations, standards, environmental protections and other guidance and restrictions have been weak. Investment mechanisms and administrative methods have been imperfect. Oversight, investigation, and enforcement have been insufficient. This has led to distortions in the prices of the factors of production, an insufficient market environment of fair competition, an inability of market functions to effectively play their role, no smooth channels for the exit of backwards capacity, and incessant intensification of the contradictions of overcapacity.[1]

The legal question of whether China should be treated as a market economy for antidumping purposes is a matter of national law. Three of China's major trading partners – the United States, the European Union, and Canada – follow a generally similar approach to this issue. Significantly, each has determined that China is not a market economy.

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[1] Guiding Opinions of the State Council on Resolving the Contradiction of Serious Industrial Overcapacity, Guofa (2013) No. 41.

U.S. Criteria for "Market Economy"

Under U.S. law, the decision whether a country must be treated as a market or nonmarket economy for antidumping purposes is assigned to the Commerce Department. In assessing whether China (or any other country) is a market economy, the Commerce Department considers six factors, including whether the country's currency is convertible; whether wage rates are the result of negotiation between management and labor; restrictions on foreign investment; the extent of government ownership of the means of production; and the extent to which the government controls the allocation of resources. The Department may also consider any other factors it considers appropriate.

In 2006, the Commerce Department conducted a detailed review, and concluded that China was not a market economy. Examination of the most recent evidence confirms that the Department's earlier determination remains valid, and establishes that China does not satisfy *any* of the criteria for a market economy.

1. *Currency convertibility*: In its 2006 assessment, the Commerce Department found that China controlled the value of its currency, the RMB, through significant restrictions on both the interbank foreign exchange market and on capital account transactions. The most recent report by the International Monetary Fund on China's currency policies notes the Chinese government continues to exert tight control over the RMB's exchange rate. The U.S. Treasury Department has reached similar conclusions.
2. *Wages*. The Department concluded in 2006 that wages in China were largely set as the product of negotiations between management and labor. However, the Department also noted that there no independent trade unions in China; that strikes are prohibited as a matter of law; and that workers are not able to freely move within the country. This limits the extent to which market forces influence the formation of wages. This situation has not changed since 2006.
3. *Foreign investment*. The Department found in its 2006 assessment that the Chinese government exerted substantial control over foreign investment, and in particular tended to direct forward investment towards export-oriented sectors of the economy. China continues to regulate foreign investment closely. Certain key sectors, including financial services, remain either closed to foreign investors or available only under tightly controlled conditions.
4. *Government ownership of the means of production*. The Department found in 2006 that the Chinese government intended to maintain or even increase its control over certain key areas – "pillars" – of the Chinese economy. The Chinese state continues to own a substantial portion of the Chinese economy. Two recent studies estimate that state-owned entities account for approximately 50 percent of Chinese GDP. The Chinese state owns many of the largest companies in China. Indeed, the twelve largest companies in China, by market capitalization, are all state-owned. State-owned enterprises dominate a number of key sectors in the Chinese economy, including petroleum, mining, telecommunications, utilities, transportation, and a number of industrial sectors, including the steel and automotive industries. Indeed, state ownership of some sectors appears to have increased since 2006. State ownership is especially dominant in the banking sector. Even where the Chinese government has indicated a willingness to reduce the extent of formal state ownership, it has also

expressed its intention to increase political supervision of corporate affairs through, for example, an expanded role for Chinese Communist Party supervisory bodies embedded in Chinese firms, both private and state-owned. Thus, even if formal state ownership is reduced, state supervision and control will remain.

5. *Government allocation of resources*. The Department concluded in 2006 that "the PRC government, at all levels, remains deeply entrenched in resource allocation." The Chinese government continues to play the central role within the Chinese economy in the allocation of resources. The Chinese government uses the financial sector, and especially the mammoth state-owned banks, as a major means of implementing its policy decisions. Banks are subject to legal rules requiring them to provide loans "according to the needs of the national economy." In particular, they are required to provide credit to "encouraged" projects and to give priority to support for certain industries. SOEs are the chief beneficiaries of the system, with the government using the state-owned banks to direct low-cost credit to them. As a result of these policies, SOEs have a privileged position within the Chinese economy.
6. *Other factors*. The Commerce Department cited a number of other factors in its 2006 determination as being relevant, including trade liberalization, the rule of law, and corruption. The Office of the U.S. Trade Representative has described China's adoption of the rule of law as "incomplete," and noted that the implementation of anti-monopoly laws in particular has been problematic. Corruption remains a pressing issue. China's implementation of a true rule of law – a prerequisite for a functioning market economy – remains unfinished.

The EU Criteria for "Market Economy"

Like the United States, the EU applies a number of criteria to determine whether a country is a market economy. These indicators include whether firms make decisions based on the market, rather than as the result of government control or influence; convertibility of currency; the existence of effective legal framework for the conduct of business and for the proper functioning of a free-market economy; and the presence of a genuine financial sector. The EU last examined this issue fully in 2008, when it determined that China was not a market economy. The EU repeated this conclusion in 2011.

A comprehensive recent study examined each of the EU criteria for market economy treatment in detail, and concluded emphatically that China is not a market economy under the EU standards.[2] As the discussion above showed, the Chinese government exercises enormous influence over the allocation of resources within China. Given government control over the financial sector, and especially the role of the large state-owned banks in that sector, China cannot be considered to have a "genuine" financial sector. Moreover, the rule of law in China, especially with respect to corporate governance and the conduct of business, remains incomplete.

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[2] Taube and Schmidknoz, *Assessment of the normative and policy framework governing the Chinese economy and its impact on international competition* (2015), http://www.eurofer.org/Issues&Positions/Market%20Economy%20Status%20-%20China/articles/MES%20China%20Study_Taube_Executive%20summary-25June15__F.pdf ("*Aegis China Study*").

The Canadian Approach

Canada follows a somewhat different approach. In every antidumping investigation of Chinese products, the Canada Border Services Agency ("CBSA") examines whether "domestic prices are substantially determined by the government of that country and there is sufficient reason to believe that they are not substantially the same as they would be if they were determined in a competitive market." If the determination is affirmative, then CBSA will not use actual Chinese prices and costs.

Canada has consistently determined that the Chinese government does influence prices to the extent that they cannot provide a reliable basis for dumping calculations. Among the factors CBSA has identified are

- Chinese government policies and regulations concerning the product, including policies specifying participants in the industry, production levels, and technology
- State ownership of enterprises producing the product under investigation;
- Measures limiting the export of the product under investigation;
- Direct government control over prices for key inputs used in the production of the product under investigation;
- Government purchases of the product; and
- Government restrictions on the use or supply of inputs.

Economic Analysis

Under any of these three approaches, the only possible conclusion is that China is not a market economy. Economists have reached the same conclusion from an empirical perspective. Derek Scissors of the American Enterprise Institute, for example, stated in testimony before the House of Representatives Committee on Foreign Affairs in July 2015 that over the last decade the Chinese government has made no real progress towards increasing the role of the market in the Chinese economy.[3] Prof. Scissors singled out the state's domination of the Chinese financial system – its ability to "without legal or political delay, order the strongest institutions to save the weakest" – as an especially important characteristic. Because the Chinese government has ordered the state-owned banks to lend to state-owned enterprises in priority sectors of the Chinese economy, favored industries such steel and aluminum have built up capacity independently of any commercial considerations, with negative consequences for the rest of the world. Prof. Scissors also noted the regulatory protection and other benefits given SOEs, which "means the private sector is simply not allowed to succeed in the two dozen industries that SOEs dominate."

Conclusion

[3] D. Scissors, *China's Stall*, available at https://www.aei.org/publication/chinas-stall/.

Whether U.S., EU, or Canadian law is applied, China is not a market economy. Economists have reached the same conclusion. The Chinese state continues to control the allocation of resources and to influence or even set prices through a variety of mechanisms, including its domination of the financial system, as well as through direct and indirect ownership of individual enterprises. Most tellingly, the Chinese government itself does not describe China as a market economy, and has indeed committed itself to (so-far unimplemented) reforms that would increase the market's role in the Chinese economy, while still allowing the state to play a decisive role.

Is the United States Required to Treat China as a Market Economy?

China claims that the United States is obligated by the terms of China's Protocol of Accession to the World Trade Organization to treat China as a market economy in antidumping investigations after December 11, 2016. This claim is unsupported by the actual language of the Protocol and is contrary to the underlying purpose of the relevant provisions of the Protocol.

I have addressed this issue in great detail in a paper entitled "China Can Still Be Treated as a Nonmarket Economy After 2016," a copy of which is attached. As the paper explains, when China joined the World Trade Organization in 2001, many WTO members expressed strong concerns about how the anti-dumping laws would apply to China. The continuing role of the Chinese government in the economy meant that members could not rely upon prices or costs in China in anti-dumping investigations of Chinese product. In response, China agreed in Article 15 of its Protocol of Accession to the WTO that allow countries to base dumping comparisons on alternative methodologies using something other than Chinese prices or costs. First, however, China committed under Article 9 of the Protocol to allow "prices for traded goods and services in every sector to be determined by market forces." If China fulfilled this obligation of Article 9, it would remove any doubt that Chinese prices and costs were a reliable basis for dumping calculations, so that the alternative methodologies allowed under Article 15 would not be necessary. Article 9 therefore creates the context within which Article 15 should be interpreted.

Article 15 of China's Protocol of Accession provides that the WTO Antidumping Agreement applies to dumping investigations of China, subject to the other provisions of Article 15. Under the WTO Agreement, WTO members are generally required to base dumping comparisons on the home market prices and costs of the individual producers of the product under investigation. Paragraph 15(a), however, states that WTO members may base dumping comparisons involving Chinese products on either Chinese prices or costs or using a methodology employing something other than domestic Chinese prices or costs. The latter approach is commonly referred to as "nonmarket economy country treatment," while the use of domestic prices and costs (the normal situation under the WTO Antidumping Agreement) is often termed "market economy treatment."

Under the WTO Antidumping Agreement, the investigating WTO member would normally make this decision – whether to base dumping comparisons on Chinese prices and costs or on something different – on a producer-by-producer basis. The subparagraphs of paragraph 15 establish two exceptions to this rule. Under subparagraph 15(a)(i), if the Chinese producers can show that an entire industry operates under market conditions, the investigating WTO member must use Chinese prices and costs for all dumping comparisons involving that industry, regardless

of the experience of individual members. Subparagraph 15(a)(ii) establishes the converse – that if the Chinese producers cannot make such a showing, the WTO member can apply nonmarket economy treatment to the entire industry, regardless of the experience of individual producers.

Under the second sentence of Paragraph 15(d), the exception under subparagraph 15(a)(ii) expires on December 11, 2016. After that date, WTO members cannot automatically apply nonmarket economy treatment to an entire Chinese industry. The normal rules of treaty interpretation establish that this language must be interpreted according to the plain meaning of the words. This means that *only* subparagraph 15(a)(ii) expires in 2016. The language in the rest of Article 15 remains in effect.

When read in conjunction with the WTO Antidumping Agreement, the language of the chapeau authorizes the United States to continue to apply nonmarket economy treatment in antidumping investigations of Chinese products, but requires the United States to provide an opportunity for Chinese producers to show that they individually, as well as an industry, operate under market economy conditions. If a producer can make that showing, the United States would be required to use its domestic prices and costs. Under current U.S. law and procedure, individual Chinese producers already have this opportunity. Consequently, no change is required in U.S. law or practice after December 11, 2016.

Any interpretation of Article 15 as requiring market economy treatment for China after 2016 would have the perverse effect of rewarding China for not fulfilling its other obligations under the Protocol. It is clear that China has not satisfied this commitment, and that the Chinese government continues to assert control over prices in many different sectors of the Chinese economy through a variety of measures, as the Canadian authorities, for example, have repeatedly determined. Requiring other WTO members to use Chinese prices in dumping calculations, so allowing Chinese products to avoid the imposition of antidumping duties, would remove a major incentive for China to fulfill its commitments under Article 9.

The conclusion that the United States will be required to treat China as a market economy after December 11, 2016 is also contrary to the underlying purpose of Article 15. As noted above, Article 15 was put into place precisely because the Chinese government's influence over prices in China prevented those prices from serving as a reliable basis for dumping calculations. Forcing other WTO members to use Chinese prices and costs in dumping calculations would create exactly the situation the remaining provisions of Article 15 were intended to prevent.

Had the negotiating parties intended to require all WTO members to accord China market economy treatment after December 11, 2016, they could easily have done so by either specifying that outcome explicitly, or by requiring the expiration of Paragraph 15(a) in its entirety. Significantly, the Protocol does exactly this in the first sentence of Paragraph 15(d), which specifies that, if China establishes under the national law of another WTO member that it is a market economy, Paragraph 15(a) will be terminated with respect to that WTO member. Similarly, Article 16 of the Protocol of provided that the entire article would expire after 12 years. That the second sentence of Article 15 does not contain a similar provision is strong evidence that the parties who negotiated the Protocol did not intend for the entire paragraph to terminate in 2016, so that

WTO members could continue to apply nonmarket economy treatment to China so long as they did so on an individual basis.

In sum, under existing U.S. law, the Commerce Department can determine whether individual Chinese industries or producers qualify for market economy treatment. The Commerce Department can accord market economy status to some industries but not others. Under current U.S. law, both Chinese industries and individual Chinese producers are able to argue that they operate under market conditions, and are therefore entitled to the use of their domestic prices and costs in dumping comparisons. No changes in U.S. law are necessary to comply with the remaining requirements of the Protocol after December 11, 2016.

How Would Market Economy Status for China Affect the U.S. Economy?

If market economy treatment were extended to China, the Commerce Department would be required to use Chinese prices and costs. Because of the various ways in which the Chinese government intervenes in the economy, those prices and costs would generally be well below what they would be in a true market economy. As a result, dumping investigations of Chinese products would generally result in low or even zero margins.

A recent report entitled *Assessment of the Probable Economic Effects on NAFTA of Granting Market Economy Status to China* calculates that the extension of market economy treatment to China would result in a loss of up to 595,000 jobs in the United States.[4] Certain industries, including steel, would be especially affected. The report estimates that the extension of market economy treatment to China would result in a 10 percent decrease in U.S. steel production, and a decline in demand for American-made steel of more than $10 billion. Other industries would doubtless experience similar effects. David Autor of the Massachusetts Institute of Technology has recently published further evidence showing that, contrary to what was expected under classical economic theory, increases in imports from China have had lasting negative effects on employment in the United States, effects that reverberate through the entire U.S. economy.[5]

A decision by other countries to provide China with market economy treatment, for any reason other than that they have determined under national law that China is a market economy, would have significant negative effects for the United States. Because the Chinese government would be able to manipulate prices within China to avoid the imposition of antidumping duties, Chinese exports to countries granting it market economy treatment would almost certainly increase dramatically. Increased Chinese exports would negatively affect the U.S. economy in two ways. First, these exports would displace U.S. exports to the relevant countries. Second, countries subject to such an increase in imports from China would increase exports to the United States of products that could no longer compete against dumped (but unpenalized) imports in their home market. The end result would be a general deterioration of the world economy as China was able to compete on unfair terms.

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[4] This report is available at http://www.steelnet.org/new/20151110a.pdf.

[5] D. Autor, D. Dorn and G. Hanson, The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade, available at http://www.ddorn.net/papers/Autor-Dorn-Hanson-ChinaShock.pdf.

This result would be amplified through various broad trade agreements, including the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership. These agreements would allow China to dump products in foreign countries. Those products could then, through a variety of mechanisms, be re-exported to the United States and sold as products of the importing country. In this way, the treatment of China as a market economy by other countries would allow China to evade the dumping laws of the United States even if the United States continued to consider China a nonmarket economy country. To prevent this outcome, the U.S. negotiators should insist that the TTIP include additional benefits for the United States sufficient to offset such an outcome should the EU grant market economy status to China.

Granting China market economy status would give it special and indeed unique treatment. The Chinese government could continue to influence or even set prices in a myriad of ways, so ensuring that Chinese products would be subject to low or even no dumping duties, regardless of their behavior. This would give China a huge advantage in international trade. It would also remove a major incentive for China to enact real market-based reforms. Such a result would be directly contrary to the intent underlying China's entire Protocol of Accession, in which China committed to allowing the market to set prices.

Conclusion

China is not a market economy. Whether the criteria considered are those under U.S., EU, or Canadian law, the results are the same. Nothing in the international obligations of the United States requires it to treat China as a market economy absent such a finding under national law. Treating China as a market economy when it is not one would have a significant negative impact on the U.S. economy, and would give China a strong and unearned advantage in international trade. It would remove a major incentive for China to implement market-based reforms, and allow it to ignore the commitments it made in its Protocol of Accession to allow prices to be set by market forces.