Financial Times (May 12, 2016)

China's flawed case for market economy status

Beijing needs to reform more if it is to enjoy full WTO privileges


©Bloomberg

The road ahead: will China be given 'market economy status'?

Tension over trade between Europe and the US on one side and China on the other has been high and rising in recent months, not least because of the frothy protectionist rhetoric emanating from the US presidential primaries.

It is an awkward time for Brussels, Washington and other capitals to make a decision on whether to accord China "market economy status" (MES), which could allow yet more cheap Chinese imports to enter their markets.

The European Parliament meets to discuss the issue on Thursday and is likely to be strongly against. How much impact its views will have is unclear: the issue is complicated by the dense legal language of the rules governing the matter. What is obvious is that the real solution is for China to go much further in reforming its economy to prevent state-led distortions having a global impact.

The award of MES would make it harder for the outside world to impose antidumping duties on imports from China. It would require trading partners to compare prices in their own market with those in China's domestic economy when calculating if they are priced unfairly low. Currently, governments are entitled to select prices in a third country as a comparator, enabling them to pick and choose one that backs up their case.

The third-country provision has long been subject to abuse, and introduces an arbitrary and unfair element in a policy regime that needs clarity and equity. But that does not necessarily imply that MES should be granted.

Attaining market economy status has been one of Beijing's main goals in international economic diplomacy since it joined the World Trade Organisation in 2001. Only a few countries such as Australia and South Africa have so far acceded, in the context of wider trade deals with China with concessions on both sides.

But Beijing has been much keener to lobby for MES than to reform its own economy to attain it on merit. Most countries, reasonably enough, have concluded that China does not meet the criteria whereby its lending and production decisions are substantially made without state direction.

Beijing argues that its accession agreement to the WTO in 2001 provided for it to be granted MES in 15 years. This interpretation, which until a couple of years ago was widely treated as correct, has been increasingly challenged by trade lawyers who argue that it is based on the misreading of an ambiguously worded section in the agreement. Beijing has threatened to take the matter to the WTO's dispute settlement process, which seems as good a way as any of dealing with that particular legal issue.

It is difficult to chart a clear way out of this tangle. It is hard to argue that China, particularly given the massive distortions from its state-directed lending, is a market economy. At the same time, if the legal arguments in favour of automatic granting of MES prevail, it will be a serious blow to the rule of law in the international trading system if the big economies continue to withhold such designation.

The best outcome would be for the EU and other large economies to tighten and clarify their antidumping regimes rather than relying on the arbitrary rules governing non-market economies. Another option would be to grant China MES but introduce protection for vulnerable sectors.

Whatever tactics the EU and US choose, they must try to nudge China further down the path to genuinely liberalising its economy, a journey on which it has made much less progress than it promised when it first joined the WTO.