CHINA AND THE NON-MARKET ECONOMY TREATMENT IN ANTI-DUMPING CASES: CAN THE SURROGATE PRICE METHODOLOGY CONTINUE POST-2016?

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Abstract: In December 2001, China joined the World Trade Organization (WTO) after 14 long years of arduous negotiations. One of the most debated issues during the accession negotiations was the treatment of China as a non-market economy — an economy where costs and prices are not dependent on market forces of demand and supply. This classification has resulted in WTO Members resorting to a differential treatment of Chinese imports in anti-dumping investigations, especially with the use of the “surrogate country” — a third country which is at the same level of economic development — for the determination of Chinese home market cost or prices for comparison purposes. The use of this method against Chinese products stems from art.15(a)(ii) of China’s Accession Protocol to the WTO. While the second sentence of art.15(d) of China’s Accession Protocol prescribes an expiry date for the use of non-Chinese costs and prices, there are enough indications at different places in art.15 to support the continued application of the surrogate country method. It is within this framework that this article evaluates the text and context of China’s Accession Protocol. It is argued that the expiry of art.15 subpara.(a)(ii) does not alter the scenario prevailing before 11 December 2016. At best, subpara. (a)(ii) is a mere tautological expression, whose expiry is inconsequential in the light of an indirect authorisation to use surrogate prices in subpara.(a)(i). The article argues that irreconcilable differences exist among the multiple strands of legal interpretation of art.15 and may require an adjudicative decision at the highest level, which could perhaps lay this controversy to rest.

Keywords: China; accession protocol; anti-dumping; non-market economies; surrogate method; normal value; price comparison; WTO

I. Introduction

“When is China Paraguay?” is part title of an article by Professor William P Alford explaining the operation of anti-dumping investigations against non-market economies. The authors thank the reviewer for his comments and are extremely grateful to Professor Anton Cooray for the insightful comments and suggestions which have significantly improved this article.

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The reference to Paraguay is because of the reliance of the United States Department of Commerce (USDOC) on prices in Paraguay in its anti-dumping investigation on natural menthol against China in 1981. As Alford’s title of the article suggests, NME treatment reflects a certain type of country replacement, base shifting and significant amount of arbitrariness and random selections in the use of benchmark prices for comparison in anti-dumping actions.

Anti-dumping duty is a duty imposed by an importing country to offset the differences between the normal value (technical nomenclature for the home market price) and the export price of a product. China was not the only country that was treated as an NME when Alford’s article was published. A large number of communist countries were subject to this treatment in anti-dumping investigations (especially during 1960–1995) on the presumption that in those countries excessive state interference rendered the domestic prices extremely unreliable for most commodities.

NMEs constitute a major problem in international trade law, especially in anti-dumping law. To find out whether the domestic sales are below cost, all anti-dumping investigations require a domestic reference price, which is formally known as the “normal value”. This will help to determine whether there is price discrimination between the domestic price and the export price of the same goods. In market economies (which operate on market principles), the price discrimination is established on the basis of comparison between the export and domestic price. However, NMEs are typically centrally planned economies, and the domestic or even export prices in these economies could be established by the State or could be State directed. In other words, it is assumed that market principles of demand and supply are not at work in NMEs to such an extent that often the sale price does not reflect what should be its fair price. In an NME, policies including production, investment and pricing need not be subject to commercial considerations and could be often controlled or mandated by the State.

In an NME, the determination of a domestic reference price is challenging as the State-controlled economic system can distort the sale price of products or the costs of inputs. In the case of China, a solution to this problem was set out in art.15 of the China’s Protocol of Accession, 2001 (Protocol of Accession) which

2 “Anti-dumping, Natural Menthol from the People’s Republic of China; Final Determination of Sales at Less Than Fair Value”, 46 Fed Reg 24614 (Department of Commerce, 1 May 1981).
4 Other NME countries include Albania, Bulgaria, Czechoslovakia, Hungary, Korea, Mongolia, Poland, Romania, Soviet Union and Vietnam.
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allows the use of a methodology that is not based on a “strict comparison with domestic prices and costs in China”. However, the Protocol of Accession does not prescribe a price comparison methodology that could be followed by World Trade Organization (WTO) Members in case of NMEs.

To find a replacement for domestic prices and costs, WTO Members look at functional market economies to compute what is likely to be the domestic price of the product under investigation by making a comparison with another country. This is done by looking at the cost of production of the same product consuming the same amount of inputs, including labour and energy, in a selected third market economy called a surrogate country. In fact, the process of finding a surrogate country — a market economy at the same level of economic development with significant producers of comparable merchandise — could be endless often resulting in arbitrary selections. In many ways, it is the boundless possibility of arbitrary selection that makes this concept attractive to anti-dumping users.

The surrogate country approach gained popularity after the United States conducted an anti-dumping investigation against Electric Golf Carts from Poland (a centrally planned economy at the time) on the basis of analogue costs in Canada (used as the surrogate country in this case). Interestingly, Poland did not have golf courses and consequently any golf cart sales and Canada did not produce any golf carts. The US Treasury had only the data for carts that were similar to golf carts and had to work hard to construct the data for Polish golf carts. The use of this methodology demonstrates that there is no reason to believe that the prices or costs gathered or extrapolated from a particular market economy adequately reflect and represent the comparative advantages of the NME in question.

However, as Alford had identified, the problems of applying anti-dumping duties to NMEs was fairly well recognised decades ago. While importing countries had no incentive to discipline the concept and the former socialist/communist countries that acceded to the General Agreement on Tariffs and Trade (GATT)/WTO often remained at the mercy of key importing Members for admission to the multilateral trading regime, there have been few attempts to reform this methodology. Furthermore, NME as a concept had the potential of slowly slipping into oblivion with most of the command and control economies widely embracing capitalist-oriented economic policies in the last three decades.

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6 See, for example, Tariff Act of 1930, 19 USC, s.1677b(c)(4).
7 In the United States, although there is a preference for collecting information from a primary surrogate country, oftentimes, information could be collected from more than one country depending on a variety of factors. See Timken Roller Bearing Co v United States 341 US 593 (1951).
8 The term “anti-dumping users” has been used in this article to refer to those countries which impose anti-dumping duties.
In this regard, the fall of the Berlin Wall and the transition of a number of East European countries to market economies was a major development in the late 1980s and early 1990s. By the time the WTO was established in 1995, the list of NMEs had come down substantially. However, the two major economies that had remained outside the WTO and had to bear the brunt of anti-dumping actions were China and Russia.\(^\text{10}\) China’s accession negotiations to join the WTO lasted more than 14 years, and when China was finally admitted, WTO Members retained the ability to treat China as an NME for a period of 15 years for the purpose of anti-dumping determinations — an issue that has turned extremely contentious in the recent months. On the other hand, Russia also underwent a long period of negotiations but received market economy status at the time of its admission to the WTO.

11 December 2016 was China’s 15th anniversary of WTO accession. On 12 December 2016, China requested consultations with the United States and the European Union (EU) under the WTO dispute settlement mechanism.\(^\text{11}\) China claimed that henceforth WTO Members would be required to terminate the use of the surrogate country method in anti-dumping proceedings against Chinese exporters and producers.\(^\text{12}\) A Panel was established to look into the complaint against the EU,\(^\text{13}\) but no Panel has been established in relation to the complaint against the United States. Considering the intensity and number of anti-dumping actions against China, any conclusion reached by the WTO on this dispute will have serious ramifications for international trade. It is thought that products worth roughly US$100 billion, which is seven per cent of China’s exports to G-20 economies, were subject to anti-dumping measures or some other types of trade barrier.\(^\text{14}\) Therefore, the economic consequences of the outcome in this dispute are immeasurable. The US Trade Representative Robert Lighthizer recently noted that the NME matter is “without question the most serious litigation matter” the United States has been engaged with at the WTO.\(^\text{15}\)

This article seeks to examine the controversy involving the use of the surrogate country method against China in anti-dumping proceeding. Section II discusses

\(^{10}\) While the WTO Members negotiated a special provision on China, no such provision is included in the Protocol of Accession of Russia.


\(^{12}\) Ibid.

\(^{13}\) The WTO panel was established on 3 April 2017.


the legal basis of the surrogate country method against China and the details of its application. Section III examines the provisions of Protocol of Accession and the permissible interpretations of the Protocol of Accession. This section provide a detailed analysis of the legal arguments and counterarguments of art.15 of the Protocol of Accession. Section IV is devoted to an examination of the practice of the key users of anti-dumping in relation to China, and the implications of EU — Biodiesel, a recent WTO case, which many argue, could determine the future of the surrogate price methodology. Section V offers some conclusions.

II. Dumping and NME Status

Anti-dumping is a mechanism to deal with “dumping”, which is said to occur when an exporter introduces goods in the markets of the importing country at a price less than that of the like product in the exporter’s domestic market. The price of the product in the domestic market of the exporter, in the ordinary course of trade, is often referred to as the “normal value”. The concept of “ordinary course of trade” is quite important here. A product may not be sold in the “ordinary course of trade” if sufficient quantities of the product are not sold in the domestic market; if the home market sales take place among related parties or affiliates; or in situations where the home market does not constitute a viable market for comparison, etc. In such cases, normal value can also be based on the price of the product when sold to a third country or on the basis of cost of production plus the selling, general and administrative expenses as well as a reasonable estimation of profits (i.e., “constructed normal value”). Although the first option is the preferred option, there is also prevalent use of the “constructed normal value” method. If the price discrimination causes “material injury” to the domestic industry in the importing country, the authorities have a right under WTO law to impose anti-dumping duties to the “extent necessary to counteract the dumping that is causing injury”.

The WTO Agreement on Implementation of art.VI of the GATT (“Anti-dumping Agreement”) places strong emphasis on the use of domestic costs and prices of the producers. However, the domestic costs and prices can be used only when records used to ascertain them are reliable and maintained in accordance with standard accounting practices. This requirement has inherent disadvantages in the case of an NME exporter. In fact, the use of domestic costs and prices was a contentious issue even in the early days of the GATT. To address these concerns, a special provision, viz art.VI(b) was inserted in the GATT after the

16 The policy reasons underlying dumping include curtailing price discrimination and protection of domestic industries from unfair competition, by discouraging excessively low pricing of imported goods.
17 Anti-dumping Agreement (n.3) art.2.2.
18 Ibid., art.2.4.2.
20 Anti-dumping Agreement (n.3) art.2.2.1.
industry producing the like product. The surviving parts of art.15 could still form the context and inform the operation of art.2.2 of the Anti-dumping Agreement in relation to China.

What is likely to happen in the future is the selection of a method, which may involve the use of Chinese costs and prices on a case-by-case basis. As previously illustrated, the constructed normal value method, which India has used in several cases in the past, could be an alternative approach. Even the United States has used such an approach in a number of cases. 108 Under this “mix-and-match” approach, if the producer in an NME can establish that the inputs were purchased at market-oriented prices, the actual prices might be used without resorting to surrogate value. 109 The significance of this approach is that it limits the arbitrariness in the selection of a surrogate economy.

V. Conclusion

The use of the surrogate methodology against Chinese exporters in anti-dumping investigations post-2016 has attracted conflicting legal opinions. The language of Protocol of Accession is as ambiguous as it could be. In view of conflicting legal opinion, a political solution to this conundrum may not be easy, especially given the vast number of countries employing NME methodology against China.

This article has argued that the expiry of para.(a)(ii) of art.15 of the Protocol of Accession need not make the use of surrogate methodology totally inapplicable in the future. The expiry of this paragraph does not mean the prohibition of such a practice, especially when subpara.(a)(i) permits a default choice of non-Chinese costs and prices — an indirect term for surrogate country values. Again, the Second Ad Note of art.VI of the GATT 1994 permits the use of a surrogate country methodology, although the thresholds in the situation are fairly rigorous. It is important to note that in view of the surviving provisions of art.15 of China’s Protocol, the burden of establishing that the market economy conditions exist in the concerned sector or industry is still on the Chinese exporter or producer. This burden has not shifted to the WTO Member conducting anti-dumping investigation against Chinese producers or exporters.

Notwithstanding the argument that the surrogate country methodology does find application even after December 11, 2016, an explicit selection of a market economy third country and the use of this methodology in all future anti-dumping actions seems quite unfair to China. What is likely to happen in the future is that a

number of countries will shift to the use of Chinese costs and prices in developing constructed normal values, as far as possible, on the basis of a finding that prices of a number of inputs and utilities in China are market determined. This approach is consistent with the recent panel and Appellate Body findings in EU — Biodiesel. This case has not expressly ruled out the use of out-of-country costs and prices in determining constructed normal value.

The constructed normal value approach will also obviate the need for an explicit selection of a surrogate country in anti-dumping actions involving China. However, the constructed normal value method can be used only on a case-by-case basis. This is also true with the “particular market situation” mentioned in art.2.2 of the Anti-dumping Agreement. A more appropriate remedy would be to shift towards countervailing duty actions to address situations dealing with artificially low prices of inputs caused by state intervention.