Europe and China: The uneasy truce – Trump, WTO, market economy status

Monday 31 July 2017, by HANKE Jakob, PARAVICINI Giululia, VON DER BURCHARD Hans (Date first published: 31 May 2017).

The world's biggest exporting nation and the world's biggest trade bloc have pulled back from a tit-for-tat tariff war, for now.

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One year ago, Europe was charging toward a trade war with China.

Spurred on by some of the Continent's biggest companies, the European Parliament and the Italian government, Brussels was drawing up battle plans for what looked like an inevitable collision with the emerging Asian power.

At issue was Beijing's demand that it be granted "market economy status" at the World Trade Organization — a talismanic designation that would give China greater leeway to swamp European markets with subsidized steel, textiles and chemicals.

Twelve months on, both sides have resisted firing the opening salvo. It would be premature to say that the EU-China showdown over the market economy designation has been permanently averted. But when Chinese Premier Li Keqiang comes to Brussels for a high-level summit on Thursday and Friday [1], he will be able to take advantage of an uneasy, fragile truce.

For now, the world's biggest exporting nation and the world's biggest trade bloc have pulled back from the mutually assured destruction of a tit-for-tat tariff war.

China interprets WTO rules to mean that the rest of the world should have started treating it as a market economy from December 2016.

Donald Trump has had a big diplomatic impact. Though both the Europeans and Chinese avoid naming the U.S. president, his brand of bellicose protectionism has clearly left both sides rattled and worried that they may have to team up to carry the banner of global free trade.

The two sides still have plenty over which they can bicker; Europe and Bejing differ on a host of issues, from mercantile disputes about access to each other's strategic industries to fundamental disagreements over respect for human rights. In these disputes, one of China's most effective pressure points has been its threat to put restrictions on Germany's treasured car industry [2].

But, for the moment at least, the two sides seem to be searching for common ground. As German Foreign Minister Sigmar Gabriel put it on a trip to the People's Republic last week: "In times in which others pivot to nationalist isolation and advance protectionist tendencies … China and Europe stand for an open global trade order and for multilateralism."

Market economy meltdown

The test of this would-be new Old World order is whether the two sides can make the ceasefire hold. Mutual antipathy toward the new U.S. administration may have helped prevent an immediate clash, but it's done nothing to address the underlying disagreements, which are likely to dominate Li's visit to Brussels.

Indeed, the cessation of hostilities hinges on a highly experimental, legalistic Brussels fudge over market economy status that has yet to be tested. Aimed at appeasing both Beijing's leaders and Europe's Sinophobe manufacturers, the solution the EU has come up with has the potential to ultimately please neither while simultaneously infuriating Washington.

It is impossible to exaggerate the importance of market economy status in China, and it is easily the most sensitive issue in its relations with the EU. The designation has long been one of Beijing's most coveted political goals, and the ruling Communist Party regards it as a defining confirmation of its transition from Maoism to superpower status.

China interprets WTO rules to mean that the rest of the world should have started treating it as a market economy from December 2016.

The EU's big problem with doing so is that, in practical terms, market economy status makes it harder to slap retaliatory duties on Chinese goods dumped beneath the price of production. That could spell disaster for EU firms, ranging from bicycle manufacturers to makers of solar panels.

In 2015 and 2016, many leading European companies urged the European Commission not to cave in to China's demands. Italy became the Continent's chief defender of traditional industry, with Trade Minister Carlo Calenda repeatedly warning Europe not to "unilaterally disarm" by recognizing China's market economy status. And in May last year, the European Parliament voted by a thumping 524 to 28 majority not to do so.

Unfortunately for the Commission, it quickly found it difficult to say "no" to Beijing, as its lawyers largely agreed that under WTO rules China should automatically be granted market economy status at the end of 2016.

Meanwhile, the EU was, perhaps unsurprisingly, politically divided on the issue. Free-traders such as the U.K. and Sweden warned that penalizing low-end imports from China would simply ramp up the cost of raw materials used in Europe's factories higher up the value chain.

Ultimately, the Commission proposed an imaginative — but worryingly untested — compromise. In November, it announced it would simply scrap the legal distinction between market economies and non-market economies and roll out a new anti-dumping methodology that dealt with all countries equally.

The Commission has said the new approach will provide European industries with the same level of protection. The obvious danger: No one has any idea whether it will work.

The old strategy was straightforward. Under WTO rules, if a regulator suspected a non-market economy such as China of dumping goods in Europe, it could use a comparative price of the same products from a third country with market status and set duties to retaliate. That will no longer be possible.

Instead, the Commission will draw up country reports for certain trading partners, listing whether its factors of production — like electricity and land prices — are unfairly discounted and to what extent. Those reports will become the new basis for anti-dumping calculations.

As one senior Commission official familiar with the dossier put it: “We succeeded in turning a binary problem into something more gray.”

Shades of gray

That ambiguity might thread the diplomatic needle with Beijing, but it could also mean that Brussels has exchanged a trade war with China for a diplomatic shoot-out with the United States.

Washington does not accept China’s claim to market economy status and intends to stick with the old-style methodology of basing retaliatory duties on comparative prices from third countries.

China has filed a suit against the EU and put pressure on the U.S. in the WTO for not immediately dropping their old anti-dumping strategy in December. As far as the U.S. is concerned, the EU has set a very unhelpful precedent.

“The EU thinks this is a China-EU issue, but this is going to become an EU-U.S. issue,” said Alan Price, a leading American trade attorney at Wiley Rein. “By dropping its main pressure point against China, the EU risks further encouraging overproduction and depressing worldwide prices.”

The Commission will also have to endure friendly fire from European manufacturers skeptical of its new methods.

Milan Nitzschke, a solar industry executive who heads Brussels’ largest anti-China lobbying group AEGIS, predicts that there will be a “rude awakening” as European industries and politicians realize that the new methodology will probably lower their defenses.

“We are rushing because of political pressure from Beijing, not because of legal necessities,” he said.

Emmanuel Maurel, a French Socialists & Democrats lawmaker in the European Parliament, also criticized the EU’s approach.

“I understand the need for the EU to align with its WTO obligations,” he said. “But the Commission’s text, whose language is vague, is surrounded by so many blind spots, so many ambiguities that I severely question the effectiveness of the future system if it is not deeply amended.”

“The reality is that the Chinese don’t want any methodology that allows us to impose anti-dumping duties” — Commission official

For now, however, there is little opposition in Brussels to the Commission’s methodology. The 28 countries in the European Council have rallied around the Commission proposal with only minor modifications. And even Parliament is now sensing that it is too late to insist that the EU dig in and stick with the old anti-dumping rules.

Salvatore Cicu, an Italian European People’s Party lawmaker who is the rapporteur on the market economy file, admitted that it had become clear that “there is no real alternative.”

The EU’s main priority is to ensure that its new anti-dumping methodology is “WTO-proof” — able to survive the challenges from China’s lawyers that are sure to come.

Beijing complains the new rules will still allow Brussels to use international prices in assessing duties. “The new method is simply another way of carrying on the previous practices,” the state-run news agency Xinhua wrote in an editorial.

As one Commission official complained, “The reality is that the Chinese don’t want any methodology that allows us to impose anti-dumping duties.”

HANS VON DER BURCHARD, GIULIA PARAVICINI AND JAKOB HANKE

Jacopo Barigazzi contributed reporting.

P.S.

* Politico. 5/31/17, 2:04 PM CET Updated 6/1/17, 7:27 PM CET: http://www.politico.eu/article/europe-and-china-the-uneasy-truce-market-economy-export/

Footnotes

[1] http://www.consilium.europa.eu/en/meetings/international-summit/2017/06/01-02/

[2] http://www.politico.eu/pro/china-turns-screws-on-german-cars-to-swing-eu-trade-policy/