

PB 16-24 Should the United States Recognize China as a Market Economy?

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China's accession to the World Trade Organization (WTO) in 2001 came after lengthy negotiations. More than 160 WTO member countries granted nondiscriminatory tariff treatment to China's exporters. For its part, China agreed to carry out numerous steps to open itself to global trade and investment markets. In return for its agreement to abide by certain rules that normally govern a market economy, China was led to believe that trading partners like the United States would officially revoke its nonmarket economy (NME) status in December 2016.¹ For China, the practical consid-

1. In February 2000, for example, then-US Trade Representative Charlene Barshefsky told the House of Representatives' Ways and Means Committee that "China's WTO entry will guarantee our right to continue using our current 'non-market economy' methodology in anti-dumping cases for 15 years after China's accession to the WTO" (Charlene Barshefsky, testimony during the hearing on the US-China bilateral trade agreement and accession of China to the WTO, Committee on Ways and Means, House of Representatives, 106th Congress, Second Session, February 16, 2000, www.gpo.gov/fdsys/pkg/CHRG-106hhrg67129/html/CHRG-106hhrg67129.htm). See also Gary Clyde Hufbauer and Cathleen Cimino-Isaacs, "The Outlook for Market Economy Status for China," Trade and Investment Policy Watch blog,

eration of such a step was that its exporters would stop facing a special type of trade restriction in 2016.

The battle is about to begin over whether the United States and other countries will deliver on their earlier implicit promise.

The first policy concern for the United States is whether to begin treating China as a market economy makes it too difficult to stem the flow of low-priced imports. The second and more complex issue involves how to address the fact that China, while making tremendous strides over the last 15 years, has nevertheless not completely transformed into a transparent, market-oriented economy. In fact, China's subsequent domestic transformation introduced new and unexpected challenges to international cooperation over trade policy that pose a systemic threat to the WTO.

A change in China's nonmarket economy status that reduced the size of applied antidumping duties may result in only a modest increase in imports.

The heightened politics of the decision is putting the US-China relationship at risk.

This Policy Brief examines whether a change in China's nonmarket economy (NME) status reduces the US government's access to special trade policies to address imports from China in a way that might result in a sudden surge in imports from China. The answer is likely no, due to a recent US policy decision to begin use of countervailing duties (CVDs) against China. Most US antidumping duties applied against China since 2007 have been accompanied by a simultaneous CVD. A change in China's NME status that reduced the size of applied antidumping duties may thus result in only a modest increase in imports.

April 11, 2016, Peterson Institute for International Economics,
Washington.

Table 1 Factors the US Department of Commerce must consider in identifying a country as a nonmarket economy

Factor	Legal language
Currency	(i) the extent to which the currency of the foreign country is convertible into the currency of other Countries
Wages	(ii) the extent to which wage rates in the foreign country are determined by free bargaining between labor and management
Inbound foreign direct investment	(iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country
Other inputs	(iv) the extent of government ownership or control of the means of production
Price controls and output	(v) the extent of government control over the allocation of resources and over the price and output decisions of enterprises
Anything else	(vi) such other factors as the administering authority considers appropriate

Source: Omnibus Trade and Competitiveness Act of 1988, from which the legal language quotes directly. The “administering authority” in factor (vi) is currently the Department of Commerce.

A US political decision not to negotiate a solution to the NME issue with China is nevertheless likely to have economic consequences. The most benign outcome has China filing a formal grievance with the WTO, which, after two or three years of litigation, the United States could lose. At that point continued US failure to resolve China’s NME status could result in China being legally authorized to retaliate by raising its tariffs on US exports.

More immediately, China could impose costs on the United States by retaliating outside of the rules. China first engaged in such behavior in 2009 by repeatedly imposing WTO-inconsistent antidumping duties against US exporters in response to its discontent over US trade policy decisions. At its peak in 2011, China’s antidumping covered 8 percent of total US goods exports to China, adversely affecting billions of dollars of US auto, poultry, specialty steel, and agricultural products. A resumption of trade hostilities could threaten these and other major US export sectors.

CHINA’S 2001 WTO ACCESSION PROTOCOL

China’s protocol of accession included a specific provision allowing existing WTO members to treat China as an NME in antidumping investigations. The legal question (not addressed here) is whether this provision expires automatically after 15 years (as of December 11, 2016). Article 15(a)(ii) of China’s accession protocol (WTO 2001) contains the language explicitly permitting other WTO members to treat China as an NME in their antidumping investigations. The controversy arises in part because Article 15(d) then indicates that “the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession.”

The unsettled legal question is how to interpret the remaining elements of Article 15 if Article 15(a)(ii) is removed. Are WTO members permitted to continue to treat China as an NME in antidumping investigations as before, or must they stop? Do the remaining provisions somehow

create an intermediate scenario, in which a country can still use NME techniques in dealing with China, but the burden of proof for justifying China as a NME shifts to the country affected by China’s actions? The focus of this Policy Brief is on the implications of different potential policy decisions the United States and China might undertake.

Under US law, the Department of Commerce must take various factors into consideration in determining whether a trading partner is an NME (table 1). Based on its assessment of these factors, the United States currently treats China as an NME.²

While the formal analysis below is limited to the United States, it is not the only country for which the China NME issue is important. The European Union and Japan similarly treat China as an NME under their antidumping laws, as do several major emerging economies. Many of the same import-competing manufacturing sectors in these countries, for example, face the same concerns as the US industries described below.³

2. In December 2005, Chinese respondent firms in a US anti-dumping investigation asked the Department of Commerce to reevaluate China’s NME status. The department accommodated the request, issuing memos in May and August 2006 updating its rationale for continuing to apply NME methodologies to China. The first memo (Department of Commerce 2006a) focused on distortions in China’s banking sector; the second (Department of Commerce 2006b) provided a more comprehensive explanation of each of the US statutory factors for NME designation listed in table 1.

3. For a discussion of non-US use of antidumping against China and the NME issue, see Chad P. Bown, “China’s Market Economy Status and Antidumping: A \$100 Billion, \$10 Billion, or \$1 Billion Dispute?” Trade and Investment Policy Watch blog, June 8, 2016, Peterson Institute for International Economics, Washington.

US LAW ON ANTIDUMPING AND COUNTERVAILING DUTIES

How Does the United States Apply Its Antidumping Law?

Under US antidumping law, the government investigates whether a foreign firm is selling its product in the United States at a price that is less than fair value (LTFV) and whether those imported sales injure the import-competing US industry.⁴ The US International Trade Commission conducts the injury investigation; its process is largely unaffected by the NME issue described here and is therefore not examined below. The Department of Commerce conducts the separate and independent dumping investigation. The trading partner's NME status directly affects its procedures.

In general, Commerce's dumping determination relies on one of three methods to establish the LTFV benchmark: (a) the price in the exporter's home market for the foreign firm's sales of the same good, (b) the price in a third-country market in which that exporter sells the same good, or (c) a constructed value of the exporting firm's costs.

Commerce's historical concern for exporters from NMEs like China is that the data used to construct the LTFV benchmark could be misleading where supply and demand forces are not at work. That is, observed NME "prices" of final goods under methods (a) or (b) or of factor inputs like labor or capital under method (c) may not be reliable indicators, because they could lead to a downward bias in the LTFV benchmark, which could make it less likely to find evidence of dumping. To address this concern, a new approach was developed that provides Commerce with flexibility to rely on price data from "surrogate" countries to construct an LTFV benchmark in investigations involving exporting firms from NMEs.

Consider an example. Suppose Commerce is asked to investigate whether imports from a Chinese company that produces steel pipes were dumped into the US market.⁵ Because China is an NME, Commerce needs to identify a

4. This Policy Brief does not address the fact that some types of normal, profit-maximizing behavior (without predatory intent or effect) can satisfy the legal definition of dumping described below. Examples include international price discrimination and behavior by large fixed-cost industries whose short-run production decision involves whether the market price covers average variable (not total) costs. Blonigen and Prusa (2016) survey the economics literature on dumping and antidumping. Bown and Crowley (2013b) present evidence that some US antidumping use can be understood as a short-run "escape"—from otherwise low levels of US import tariff protection—in the face of bilateral import volume surges.

5. This example is loosely based on a 2007 antidumping and countervailing duty investigation of circular welded pipe from China, described in the panel report of the US antidumping and countervailing duties dispute with China (WTO 2010).

surrogate country. The surrogate must be a market economy (so that information from input and output prices are meaningful), be at a comparable level of economic development as China, have domestic production in the industry being investigated, and have data that are relatively accessible, so that proxy measures of the Chinese firm's costs under method (c) can be developed.

Suppose India is selected as the surrogate country. To perform the calculation, Commerce would take the quantities of the inputs used to make the pipe (hours of labor, units of raw material, etc.) provided by the Chinese company and multiply them by the prices of the inputs using Indian data.⁶ If the price of the Chinese pipe sold in the US market is less than the constructed measure of the Chinese steel pipe firm's cost (the fair value benchmark), Commerce would find that the Chinese firm had dumped. The size of the applied antidumping duty (the "dumping margin") is the difference between the constructed LTFV benchmark and the US import sales price.

If China is not an NME, Commerce would have to rely on data provided by the Chinese steel pipe firm on its actual costs, the price of the good sold in China, or the price of good sold in a third market. From China's perspective, NME status provides Commerce with excessive discretion, making it more likely to find evidence of dumping and higher dumping margins than if China were treated as a market economy.

How Does the United States Apply Its Countervailing Duty Law on Imports from China?

US law allows the government to investigate whether a foreign firm that is selling its product in the United States has been subsidized, and whether those subsidized imports are injuring import-competing US producers. In broad terms, a subsidy is defined as a financial contribution from the government (or any public body) of a trading partner to a foreign firm that confers a benefit to that firm. If the US industry is injured and there is evidence that the injury was caused by subsidized imports, the United States can impose a CVD equal to the subsidy rate.

The Department of Commerce conducts CVD investigations. In the mid-1980s, it made the decision not to conduct CVD investigations on imports from NMEs. In 2006 it reversed that decision with respect to China and began investigating petitions alleging subsidized imports

6. Commerce would also add in profit, factory overhead, as well as selling, general, and administrative (SG&A) expenses, constructed based on the ratio of these components of costs to the costs of the other inputs in India.

from China.⁷ Beginning in 2007 the US argued that it could apply its CVD law because it was possible for Chinese firms to receive the equivalent of government subsidies.

The United States' argument for the reversal was that although China had made steps toward becoming more market oriented overall, important nonmarket economic forces remained.⁸ In some areas of the economy, for example, the Chinese government or Chinese Communist Party continued to interfere. Government officials or party members were taking leadership positions on company boards; this allowed them to implement industrial policy set out at the national or regional level, including through holding companies such as the State-Owned Assets Supervision and Administration Commission of the State Council (SASAC). The United States also alleged that state-owned enterprises (SOEs) had not been fully phased out of certain sectors in China, including banking and hot-rolled steel, a key input for many downstream steel products, as well as petrochemicals. It also alleged that China underpriced some commercial rents.

To see how a CVD investigation works, consider a Chinese steel pipe manufacturer alleged to have had access to implicitly subsidized inputs. The pipe is a downstream steel product made from cheap hot-rolled steel bought from a Chinese SOE, the loans to finance the operation were provided by a Chinese state-owned commercial bank at below-market interest rates, and the pipe factory was constructed on land that did not require market-based rents. The US government argued that these implicitly subsidized inputs conferred a benefit to the Chinese firm in its pipe production.

To determine the size of the subsidy, the Department of Commerce developed methods analogous to the surrogate country approach it used in antidumping determinations. However, instead of drawing the proxy information from a single surrogate country, it used multiple methods. As a surrogate for the Chinese price for the hot-rolled steel input,

Commerce relied on the world market price for hot-rolled steel. Instead of actual land rents paid by the Chinese firm, it turned to land prices from Bangkok, Thailand. Instead of interest rates at Chinese state-owned commercial banks, Commerce used a regression analysis of inflation-adjusted interest rates in 33 lower-middle-income countries to construct a benchmark interest rate for the firm's costs of borrowing. This approach allowed Commerce to construct a measure of the Chinese firm's costs to reveal the size of the implicit subsidy, which would determine the CVD it could apply if the International Trade Commission also found evidence of injury caused by the subsidy.⁹

Commerce began to use such an approach in CVD investigations of imports from China in 2006, with the first CVDs applied in 2007. China has subsequently challenged certain procedural elements of the new US approach through formal WTO dispute settlement, with mixed legal decisions.

Commerce has continued to use these methods to investigate whether imports from China are unfairly subsidized. It has received more than 50 petitions since 2006, imposing CVDs in roughly 75 percent of the completed investigations. Investigations have covered steel products, chemicals, tires, wood products, and even solar panels and wind towers. Almost all CVD investigations involving imports from China have been conducted simultaneously with antidumping investigations.

US IMPORTS FROM CHINA AND IMPORTS AFFECTED BY ANTIDUMPING AND COUNTERVAILING DUTIES

China's exports to the United States stood at roughly \$500 billion in 2015. They are almost four times higher than they were immediately before China joined the WTO, in 2001 (figure 1).

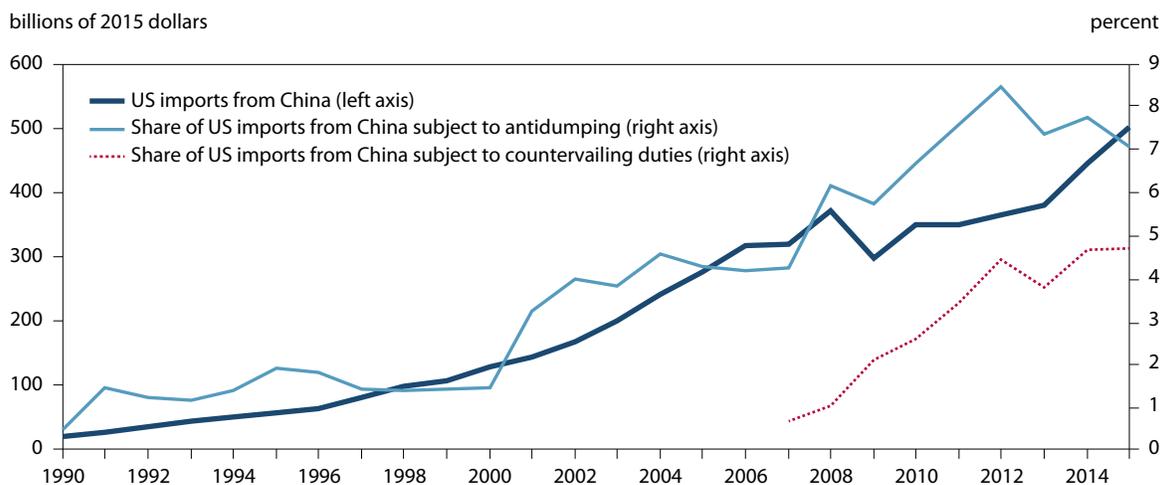
At the same time as China's exports to the United States were growing rapidly, the United States was imposing antidumping import restrictions on an increasingly large share of those imports. On a trade-weighted basis, less than 1.5 percent of China's total goods exports to the US were subject to a US-imposed antidumping import restriction in 2000. By 2015 US imposed antidumping import restrictions affected roughly 7 percent (about \$35 billion) of China's

7. In November 2006, the department initiated its first CVD investigation on imports from China, deviating from a long-held practice of not considering NMEs under CVD law, its practice since a 1984 decision (*Georgetown Steel*). The 2006 investigation involved imports of coated free sheet paper from China. It was conducted in parallel with an antidumping investigation. This investigation is important historically because it was the first US CVD investigation of China that found subsidies. No CVDs were applied, however, because the International Trade Commission did not find evidence of injury in the final determination.

8. The Department of Commerce's arguments are developed in a series of public memos (Commerce 2006a, 2006b, 2007); see also Smith (2013). Lardy (2014) provides empirical evidence of the declining role of the state in the Chinese economy during the 2000s. Wu (2016) provides an insightful analysis of the conflicts between the evolution of the Chinese economy over this period and the legal disciplines under the WTO.

9. Where both dumping and subsidies are found, so that the Department of Commerce can simultaneously apply an antidumping duty and a CVD on the same product, the size of the duties must be adjusted to avoid double-counting of, say, the subsidy in the amount by which the firm was found to have priced below LTFV. See Prusa and Vermulst (2013) for a discussion of this issue.

Figure 1 US goods imports from China and bilateral import share subject to antidumping and countervailing duties, 1990–2015



Note: Shares are trade-weighted import coverage ratios, following the methodology in Bown (2011). The United States first applied a countervailing duty to imports from China in 2007.

Source: Data in Bown (2016) and six-digit Harmonized System trade data from UN Comtrade, made available through World Integrated Trade Solution (WITS).

annual exports to the United States.¹⁰ The significant uptick after 2007 is consistent with research indicating that import restrictions tend to increase during macroeconomic slowdowns—e.g., the Great Recession—and periods of sharp appreciation of the real exchange rate.¹¹ To the extent that China believes that its exports to the United States have been limited because of its treatment under NME status, it is clear why China is concerned about its NME status.

An alternative interpretation of China’s NME status is that it was the price to be paid for the overall benefits of WTO accession. Roughly 93 percent of China’s annual exports of \$500 billion to the United States were not subject to antidumping or countervailing duties in 2015. In exchange for NME status, China received nondiscriminatory tariff treatment—and relatively low and secure access—to the US import market for roughly \$465 billion in annual trade.¹²

Figure 1 also shows the share of US imports from China that is subject to US-imposed CVDs. Since 2007, when the United States imposed its first CVD on Chinese imports, most new US antidumping investigations involving imported products from China have been accompanied by a CVD investigation. The shares of US imports from China that are subject to antidumping *and to* CVDs increased between 2007 and 2015. In addition, there is evidence of a significant reduction in the difference between the two series. In 2007 there was a 3.6 percentage-point gap between the level of US imports from China covered by antidumping and the level of US imports covered by CVDs. By 2015 that gap had narrowed to 2.4 percent.¹³ The implication is that by 2015 more than two-thirds of US imports from China covered by antidumping duties were also covered by CVDs.

10. This estimate is an import coverage ratio and is based on the methodology first developed by Bown (2011). This \$35 billion is not an estimate of how much China’s exports decreased because of US-imposed antidumping import restrictions. Such an estimate requires information on product-level elasticities of the import-responsiveness to import duties and is beyond the scope of this Policy Brief.

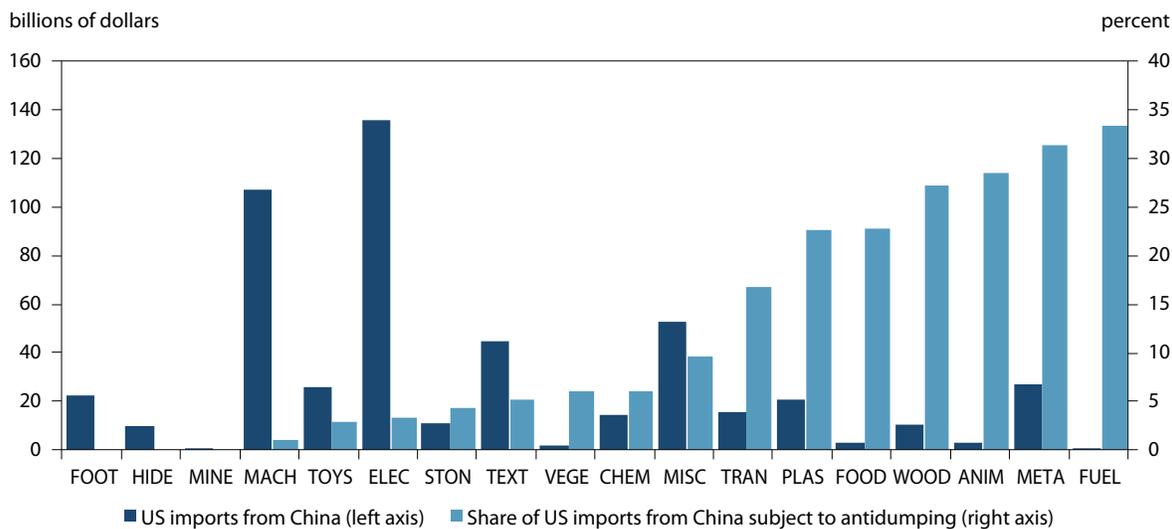
11. See, for example, the analysis by Bown and Crowley (2013a) of the United States’ use of antidumping, CVD, and safeguard measures in 1988–2010, including during the Great Recession.

12. Compare, for example, China’s choice of accepting NME treatment in exchange for being granted most favored nation (MFN) tariff treatment with the choice that Japan accepted when it joined the multilateral trading system in 1955. At the

time of Japan’s entry into the General Agreement on Tariffs and Trade (GATT), more than 50 countries invoked a general GATT exception that allowed them not to apply the same MFN tariff on Japanese imports that they applied to imports from all other GATT members (Bown and Crowley 2016). Many countries continued to discriminate against imports from Japan in this manner until the early 1970s. The United States was an exception; it applied MFN tariffs on Japanese imports, addressing trade frictions with Japan primarily through antidumping and negotiated voluntary export restraints (Bown and McCulloch 2009).

13. Most of the post-2007 applications of new antidumping have been accompanied by new CVDs, but the post-2007 removals of the US antidumping duties on China imposed before 2007 were not accompanied by any removals of CVDs. Recall that a 1984 policy decision (*Georgetown Steel*) meant that the United States did not impose CVDs on imports from China prior to 2007.

Figure 2 US goods imports from China and bilateral import share subject to antidumping in 2015, by sector



Note: Shares are trade-weighted import coverage ratios following the methodology presented in Bown (2011). See appendix table A.1 for industry definitions.

Source: Data in Bown (2016) and six-digit Harmonized System trade data from UN Comtrade made available through World Integrated Trade Solution (WITS).

US imports from China vary widely by sector (figure 2). The largest import sector in 2015 was electronics and electronic machinery (\$136 billion). Figure 2 also documents heterogeneity in the share of bilateral industry-level imports subject to special trade protection. Roughly 31 percent of US imports from China in the metals sector in 2015 were covered by a US antidumping duty, compared to 5 percent of textiles and apparel and 3 percent of electronics and electronic machinery. And there were no US antidumping duties facing imports of footwear or minerals, and very little addressing machinery.

Trade restrictions and import levels are negatively correlated (the correlation is about -0.3). US imports from China tend to be smaller in sectors where there is more antidumping protection (in industries such as metals, wood products, plastic and rubber products, and animal and food products).¹⁴ There is much less US antidumping protection in sectors with high levels of bilateral imports (textiles and apparel products, machinery, and electronics). These sectors cover more than half of US imports from China in 2015 but only about 20 percent of total US antidumping activity against China.

Any change in NME status would affect not only new dumping investigations involving China but also reviews of existing levels of applied duties. The Department of

Commerce will eventually need to determine how the dozens of antidumping duties currently in place would be affected and whether and when they need to be recalculated.

HOW LARGE ARE US ANTIDUMPING DUTIES ON IMPORTS FROM CHINA?

The United States imposes higher antidumping duties on imports from China than on imports from other trading partners (table 2). Across all antidumping cases imposed as of 2015, US duties on China average 81.4 percent—more than 27 percentage points higher than duties on other trading partners (54.3 percent), most of which are treated as market economies. The difference is even larger when controlling for the product investigated (107.3 percent versus 58.0 percent). China would argue that it faces higher duties than other exporting countries because of the surrogate country discretion that NME treatment provides. The United States would argue that China faces higher duties because it is an NME.

The average US antidumping duty imposed on China has increased over time, as the United States began imposing such duties together with countervailing duties in 2007. The average US antidumping duty on China in antidumping cases that were jointly conducted with CVD investigations (96.4 percent) is more than 20 percentage points higher than the average US-imposed antidumping duty imposed without a CVD (72.1 percent).

The separate (and additive) US-imposed countervailing

14. The level of antidumping coverage of fuel products is high, despite the extremely low level of imports, because of import restrictions on foundry coke.

Table 2 US antidumping and countervailing duties applied in 2015

Exporter	Number of cases	Average antidumping duty (percent)
All antidumping cases		
China		
All cases involving China	89	81.4
Cases involving only China	58	67.5
Cases involving China and others	31	107.3
Other trading partners		
All cases involving other trading partners	149	54.3
Cases not involving China at all	93	52.1
Cases involving China and others	56	58.0
Antidumping only (no simultaneous countervailing duties)		
China		
All cases involving China	55	72.1
Cases involving only China	37	69.9
Cases involving China and others	18	76.5
Other trading partners		
All cases involving other trading partners	111	54.4
Cases not involving China at all	64	50.0
Cases involving China and others	47	60.5
Antidumping and countervailing duties simultaneously		
China		
All cases involving China	34	96.4
Cases involving only China	21	63.3
Cases involving China and others	13	149.9
Other trading partners		
All cases involving other trading partners	38	54.2
Cases not involving China at all	29	57.0
Cases involving China and others	9	45.0
All countervailing duty cases		
		Average countervailing duty (percent)
China		
All cases involving China	33	83.8
Cases involving only China	30	79.3
Cases involving China and others	3	128.4
Other trading partners		
All cases involving other trading partners	27	30.7
Cases not involving China at all	25	31.8
Cases involving China and others	2	17.5

Note: A case is defined at the country-product level (one case involving China may be associated with multiple cases associated with other trading partners also being investigated over the same product). The average duty is computed from the simple average of the final duty imposed at the final determination, as reported in the Federal Register; it does not include adjustments for administrative reviews.

Source: Data from Bown (2016).

duty in these simultaneously conducted cases against China is also sizable. The 33 cases with a US-imposed CVD on imports from China had an average CVD of 83.8 percent, in addition to an average antidumping duty of 96.4 percent.¹⁵

Consider the implication of this last comparison. If a US change in China's NME status reduced the size of the average antidumping duty imposed, on average, a large and independently determined US CVD—currently 83.8 percent—would remain in effect. And as figure 1 indicates, an increasing share of US imports from China have also been subject to US-imposed CVD protection—4.7 percent of total US imports from China in 2015—and were thus covered by both antidumping and countervailing duties.

RETALIATION AND CHINA'S POLICY RESPONSE IF THE UNITED STATES DOES NOT CHANGE ITS NONMARKET ECONOMY STATUS

The failure of the United States to come to a political settlement with China over the NME issue could lead to losses of US export revenue and potentially American jobs resulting from China's retaliation.

First, China is likely to file a formal trade complaint with the WTO. Although it may take two to three years for the full legal process to be resolved—a panel report, an appeal, and a period to obtain legal authorization for retaliation—the United States could lose. If the United States did lose and still refused to bring its antidumping procedure into WTO conformity, the WTO could authorize China to retaliate. China would likely be authorized to do so by raising its import tariffs against the United States by an amount equivalent to the estimated annual value of lost Chinese exports to the US market due to NME status.¹⁶ Furthermore, simply letting the WTO litigation simply run its course would place an enormous burden on the rules-based trading system, regardless of how the appellate body decides.

Second, China could engage in WTO-illegal retaliation. By taking matters into its own hands, it could impose

losses more quickly on US exporters in the hope of speeding up US policy engagement.¹⁷ One approach would be to resume an escalation of its own use of antidumping against the United States.

China implemented its own antidumping law in 1997. Although overall US exports to China increased considerably

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around China's 2001 WTO accession; only about 3 percent of US exports were subject to China-imposed antidumping as late as 2008 (figure 3). China's use of antidumping against the United States at the time had been concentrated primarily in the chemicals sector.

Beginning in 2009, China started using antidumping more aggressively against exports from the United States overall and in new sectors. For the first time, China also applied CVDs against US exports it alleged were subsidized.

China triggered antidumping decisions around major US trade policy announcements, such as the 2009 decision on a China-specific safeguard import restriction on tires and the 2010–11 decisions on the WTO dispute settlement activity.¹⁸ It initiated antidumping investigations against US exports in new sectors, such as agriculture (e.g., chicken feet, dried distiller grains) and manufacturing (e.g., high-end specialty steel products, cars, optical fibers).

The share of total US exports to China subject to antidumping duties increased from 3 percent in 2008 to nearly 8 percent in 2011 (figure 3). Those shares fell back to 3

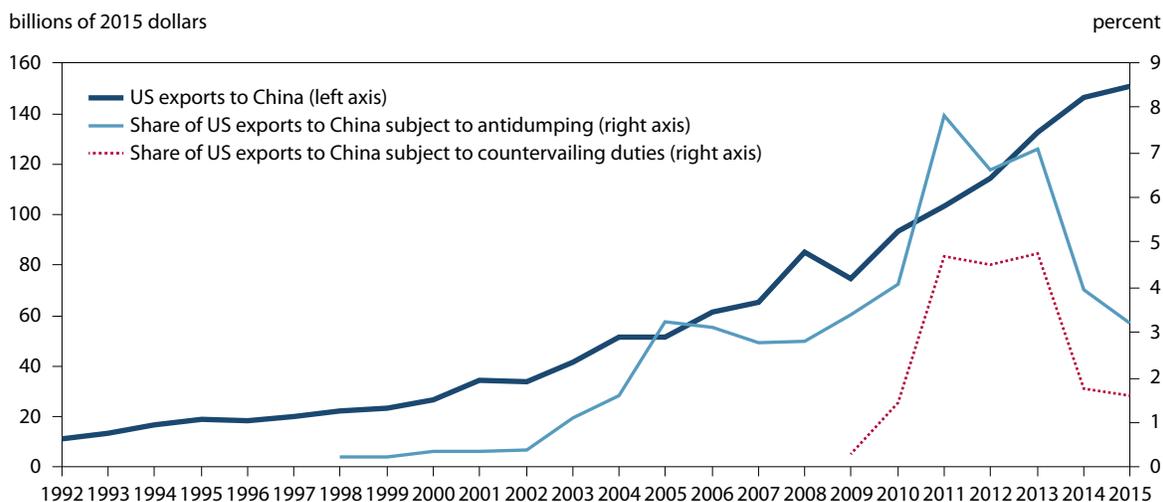
15. The average US-imposed CVD against China is also considerably higher than the US-imposed CVDs on other trading partners (83.8 percent versus 30.7 percent).

16. Such a calculation would require estimates of counterfactual levels of Chinese exports to the United States in products affected by the WTO-inconsistent element of the antidumping restrictions. The task of the WTO would be to use an economic model to identify counterfactual levels of Chinese exports under an assumption that the United States had imposed WTO-consistent levels of antidumping duties instead. Bown and Brewster (2016) describe WTO methods to construct such estimates under a different type of WTO-inconsistent policy, related to a dispute between the United States, Canada, and Mexico over a regulation affecting beef and pork products.

17. China has also shown its willingness to use antidumping to retaliate against the European Union. For example, when the European Union used antidumping against low-end steel fastener imports from China in 2009, China immediately responded with its own antidumping restrictions on high-end steel fasteners from the EU (Bown and Mavroidis 2013). When the European Union initiated an antidumping case against cargo-scanning equipment from China in 2009, China initiated its own antidumping action over X-ray equipment from the EU (Moore and Wu 2015).

18. See, for example, Keith Bradsher, "China Moves to Retaliate against US Tire Tariff," *New York Times*, September 13, 2009; and Norihiko Shirouzu, Sudeep Reddy, and Sharon Terlep, "US-China Trade Spat Escalates to Autos," *Wall Street Journal*, December 15, 2011.

Figure 3 US goods exports to China and bilateral export share subject to antidumping and countervailing duties, 1992–2015



Note: Shares are trade-weighted import coverage ratios, following the methodology in Bown (2011). China first applied a countervailing duty to imports from the United States in 2009.
 Source: Data in Bown (2016) and six-digit Harmonized System trade data from UN Comtrade made available through World Integrated Trade Solution (WITS).

percent by 2015. However, China’s removal of its import restrictions took place only years later, after the WTO ruled China’s policies illegal under formal dispute settlement proceedings.¹⁹

While China’s WTO-illegal antidumping duties were in effect, US companies suffered losses in export revenue. While illegal, a decision by China to return to WTO-inconsistent use of antidumping to address political concerns over NME status would be economically costly for the United States.

POLICY RECOMMENDATIONS

The current political climate is not ideal for the United States and China to convene to address these important issues. The bruising US presidential election of 2016 brought into sharp relief the fact that much of the US population is worried about globalization, including the effect of imports from China on the US labor market.²⁰ China is struggling

with its own slowing growth and a transition toward a more consumer-based and service-oriented economy. This transformation is expected to involve large-scale adjustment out of sectors that employ millions of Chinese workers, including in steel, where China has half of the world’s production capacity.

Nevertheless, the United States and China are at an impasse that requires a political solution. The terms of China’s 2001 WTO accession were silent on the criteria China would have to meet to graduate to market economy status as well as what would happen if China failed to meet them.

Given the impasse, the United States and China should have two main objectives. The first is to develop a more explicit long-term agreement to encourage China’s further market orientation. The second is to establish a process to manage bilateral trade tensions.

The management of near-term trade tensions is likely an easier objective to meet. The United States is increasingly prepared for the day it must stop treating China as an NME in antidumping investigations. It has developed the ability to apply CVDs against implicitly subsidized imports from China when such imports cause injury to US companies. Indeed, US CVDs already cover two-thirds of the imports that antidumping duties address, and the share has been rising over time. This ability is likely to significantly offset any potentially disruptive effect on imports of granting market economy status. Even an immediate removal of all imposed antidumping duties on China—an outcome more extreme than elimination of NME status would necessitate—implies

19. In addition to the US disputes brought to the WTO over China-Autos (DS440), see the US disputes over antidumping in China-Broiler Products (DS427) and China-GOES (DS414). For legal-economic analysis of these three disputes, see Mitchell and Prusa (2016) and Prusa and Vermulst (2014, 2015).

20. The magnitude of the blame placed on China (or trade more generally) for the labor market problems in the United States is excessive; automation and other shocks are more sizable contributors to dislocation. Even the largest estimates put imports from China as causing just 20 percent of US manufacturing job loss since 2001 (for a survey of the evidence, see Autor, Dorn, and Hanson 2016). Nevertheless, even a relatively modest negative impact of imports from China on US labor market outcomes would contribute to the toxic political climate toward trade.

that only 2.4 percent of China's exports, or \$12 billion, would no longer be subjected to these import restrictions.

However, a US-China agreement is needed to clarify the conditions under which the United States could access the surrogate-input methods currently applied to its imports from China under CVD law, without the threat of constant Chinese legal challenge at the WTO. Implementation of such an agreement could be possible through a WTO waiver.

The benefit to China of such a deal would be political: It would eliminate the stigma of NME status. The benefits to the United States would be twofold: it would retain sufficient trade policy flexibility to address future surges in imports, and it would also maintain access to the potential stick needed over the long term to enforce China's commitment to live up to the second objective.

The second and more difficult objective is to come to a durable and mutually advantageous agreement on what it means for China to become sufficiently market oriented. The details of such a deal would be complex and are well beyond the scope of this Policy Brief. However, it is worth identifying some of the most critical elements, especially so as to clarify some of the key issues of interest to the United States.

Most important is the need for increased Chinese transparency. Much of the current tension between China and the United States arises from uncertainty, some of which could be eliminated with more information. Information is needed not only on China's government (direct) subsidies but also that might be used to independently determine whether what the United States alleges to be indirect subsidies are economically meaningful. The United States points to China's explicit plans for industrial policy, the role of the government and Chinese Communist Party officials in firm-level management decisions, and the continued impact of SOEs that provide excessively low-priced inputs to downstream industries. Additional transparency might be a tool that could help to assuage US concerns.

A new US-China agreement could also usefully tackle

related issues. It would certainly require both sides to flesh out more explicit terms under which China would no longer be the target of specially designed import protection policies under antidumping or CVDs.²¹ But it might also address the reality that even in market economies like the United States and the European Union, trade-distorting subsidies continue to exist—e.g., Boeing/Airbus, agriculture—and thus China cannot be held to an unreasonable standard.

Such an agreement also requires earlier and more frequent feedback. Today's impasse flows directly from the decision of the 2001 WTO accession to wait until the 15-year mark to provide China with a formal update. That turns out to have been an unproductive approach to managing long-run cooperation. While there are no signs that it is politically feasible, the most effective approach would be for the European Union and Japan to actually join the United States and negotiate jointly with China over this collection of issues, rather than playing (or being played) off one another.

Finally, a negotiated agreement would have other benefits leaving both the United States and China better off. It might prevent significant Chinese retaliation from taking place outside of WTO rules, which has the potential to be very costly for the US economy and which could lead to a trade war.²² It is likely to be backed by reformers within China who are likely to have an independent economic interest. In addition to reducing trade tensions, an agreement would provide an external commitment device for China to undertake reforms to reduce state involvement in the economy—a move that would improve resource allocation, reduce waste, increase domestic productivity, and thus spur growth.

21. Bown and Crowley (2016, table 6) provide evidence that countries such as Japan and Korea are targeted with foreign antidumping much less frequently today than in the 1990s.

22. See, for example, the simulations for the effect of China's tariff retaliation on the US economy presented in Noland et al. (2016).

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APPENDIX A**Table A.1 Industry definitions and classifications**

Industry	Product	Harmonized System chapters
ANIM	Live animals and animal products	01–05
CHEM	Chemicals	28–38
ELEC	Electronics and electrical machinery	85
FOOD	Animal or vegetable oils and fats, prepared foodstuffs, beverages, tobacco	16–24
FOOT	Footwear	64–67
FUEL	Fuel	27
HIDE	Hides, skins	41–43
MACH	Machinery	84
META	Metals	72–83
MINE	Mineral products	25–26
MISC	Miscellaneous	90–94, 96–99
PLAS	Plastic, rubber	39–40
STON	Stone, glass	68–71
TEXT	Textiles, clothing	50–63
TOYS	Toys and sports equipment	95
TRAN	Transportation equipment	86–89
VEGE	Vegetable products	06–15
WOOD	Wood	44–49