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Will Nonmarket Economy Methodology Go Quietly into the Night?

U.S. Antidumping Policy toward China after 2016

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EXECUTIVE SUMMARY

The use of antidumping measures to protect certain domestic industries may be the most widely abused trade policy instrument worldwide. The U.S. government has been persistent in its efforts to find creative ways to inflate and impose antidumping duties on goods used by American consumers and businesses, occasionally running afoul of the law or U.S. obligations under the World Trade Organization (WTO). But U.S. authorities reserve their most punitive and abusive practices for goods from China.

In those cases, the United States sets antidumping duties using what is called nonmarket economy (NME) methodology. The practice gives license to the U.S. Department of Commerce to ignore Chinese producers' cost and price data and to turn, instead, to estimates for those data that are usually punitive and almost always unrealistic.

Current WTO rules permit the United States to maintain this discriminatory approach, which China agreed to as a condition of its accession to the WTO, but that condition will expire in December 2016. If that deadline passes without the U.S. practice having changed, it will become grossly out of sync with WTO rules. Absent a

major change in the mindset of U.S. trade officials with respect to Chinese treatment in antidumping proceedings, it is unlikely that the United States will bring its policy into compliance.

This paper presents some of the alternative scenarios that might unfold as the 2016 expiration date approaches. There are a number of ways for U.S. antidumping authorities to retain the capacity to discriminate against Chinese exports while claiming to be in compliance with WTO rules. However, those options will almost surely precipitate years of WTO litigation and tit-for-tat retaliation harmful to the U.S. economy and the health of the global trading system.

The policy that would best serve a strong U.S. trade agenda and the American public is to end NME treatment of China by no later than December 2016. China's NME designation currently serves as an excuse for lawless protectionism, which not only inflames trade relations, but imposes enormous costs on downstream U.S. industries and consumers. Nondiscriminatory treatment of Chinese imports would bring U.S. trade policy into compliance with WTO rules while reducing the distorting effect of antidumping measures on the U.S. economy.

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INTRODUCTION

President Obama has an important decision to make between now and December 11, 2016. On that date the United States will no longer be permitted by the rules of the World Trade Organization (WTO) to treat China as a nonmarket economy (NME) in antidumping actions. Ending China's NME designation in U.S. law is the only legal and logical option for the United States. Yet it is also almost certainly not going to happen.

In standard antidumping practice, the U.S. Department of Commerce determines the “margin of dumping” by comparing a producer's U.S. price to “normal value”—the price that the producer charges in its home market or a constructed price based on costs of production. If the imports have injured, or threaten to injure, a domestic industry, a duty will be imposed on future imports in order to offset the dumping.

In an NME investigation, however, Commerce approximates a home market price by quantifying a producer's factors of production (such as labor and material costs) and valuing those factors using prices paid by other producers in a third country. The practical consequences of China's NME designation are that Commerce ignores Chinese producers' own costs and domestic prices when investigating whether to impose antidumping duties. The practice results in higher margins and more uncertainty for both Chinese producers and American importers.

The rationale behind treating NME imports differently is not unreasonable. It makes no sense to compare prices as you would in a normal antidumping investigation if those prices are arbitrarily and independently set by government dictate. But that is not how China's economy works anymore.

Chinese economic reforms that began in 1978 have lifted hundreds of millions of people out of poverty and have enabled China to become one of the great economic powers of the early 21st century. China's path toward liberalization has been a winding one that has not produced—and may never lead to—a pristinely Western-style economic system. Price controls and state ownership remain embedded in cer-

tain industries. But the country, by joining the WTO in 2001, has signaled its intent to be part of the rules-based global economy, and the days of aggressive central planning are long gone.

Unfortunately, the U.S. government does not seem to have noticed any of this. Failing to grasp the nuances of transition, the U.S. Department of Commerce stridently maintains that China is an NME and uses that designation to justify the use of unwarranted and illegal discrimination against Chinese imports in antidumping proceedings. As China's economy liberalizes, U.S. officials raise their expectations for what it must achieve. As the WTO calls out their abusive practices, U.S. officials discover new ways to discriminate.

The U.S. authorities claim that state intervention in China's economic system means the United States does not have to follow WTO rules that generally govern national antidumping practices. But those rules provide an invaluable check against abuse. The idea that China is different is being used to justify limitless discretion and protectionist outcomes.

The history of lawlessness in U.S. practice toward China strongly suggests that the United States will not accept the 2016 deadline in good faith. The U.S. practice already exceeds the bounds of current WTO disciplines and the United States is currently entangled in a tit-for-tat litigation war with China over mutual antidumping abuses. The expiration of China's NME exception in 2016 has the potential to further inflame tensions if the United States does not adopt a more reasonable policy.

There are a variety of ways that Commerce could choose to respond, with different legal and political consequences for each possibility. They have the power under U.S. law to simply ignore the change in WTO rules and continue their current practice. They could also accept China's new status in principle while continuing to use discriminatory methods. Both of those approaches will almost certainly lead to years of litigation and retaliation at the WTO.

On the other hand, there are ways for Commerce to follow WTO and U.S. law while taking into account genuine instances of Chinese

state intervention in a fair way. However, such methods likely will not lead to the high margins Commerce is able to “calculate” under current practices.

Finally, Commerce could simply accept China’s transition toward a market system, drop NME treatment altogether, and rely on anti-subsidy laws to address any remaining distortions. This final option would not only eliminate an unreasonable and abusive antidumping practice, it would also do the most to improve U.S.–China relations and increase U.S. influence in the rules-based global trading system.

NME TREATMENT HAS ALWAYS BEEN LAWLESS AND ILLOGICAL

Under the U.S. antidumping law, domestic industries that have been materially injured because of competition from imports may petition the government to impose special customs duties on products being sold in the United States for less than their “normal value.” Generally, normal value is considered to be the price a product is sold for in the country where it is produced.

The general practice in antidumping investigations, therefore, is to calculate the difference between the price a company charges in its home market and the price it charges in the United States. That difference is considered the “margin of dumping,” which is then offset through the imposition of “remedial” duties.

The principal rationalization for the antidumping regime is that it prevents predatory pricing.² The theory is that a company with significant market power in its home country could sell its product in the United States at a loss in order to drive out competitors, with the goal of raising prices afterward. Antidumping investigations deal with this concern in an especially ham-fisted manner by capturing all forms of price discrimination, not just those indicative of predatory intent.³

Even if one ignores the question of whether “dumping” actually warrants a remedial response, there remain serious concerns about whether the Department of Commerce is capable of making accurate dumping deter-

minations. There are often slight differences in product quality, packaging, or other characteristics that make a direct comparison impossible. Companies may make a great number of sales during the period of review, so Commerce has to average those prices before making a comparison. Investigators also have to deduct market-specific expenses such as shipping and advertising. Antidumping law addresses these difficulties through a smorgasbord of discretionary rules, so that a final dumping determination depends as much on clever lawyering as it does on real-world prices.⁴

To complicate matters further, the United States has long used a method different from that described above when making a dumping determination against goods originating from a country designated as an NME. The rationale for this distinction is that domestic prices set by central planners are not a reliable indicator of normal value because they tell us nothing about the cost of production. Moreover, the domestic price set by planners may have no bearing on the export prices set by a state trading agency.⁵

When dealing with NME imports, Commerce constructs normal value by using the Chinese company’s factors of production, but values those factors using prices paid for the inputs by some other company or companies located in a market economy country at a similar level of economic development.⁶ So, the quantity of inputs such as raw materials, labor, and energy comes from the respondent, but Commerce finds surrogate values to use as prices for those inputs. Put it all together and you have an approximation of what the NME producer’s domestic price would be if it were operating in a market economy.

The practice magnifies Commerce’s discretion, and the uncertainty and abuse it inevitably brings, for products from NME countries.⁷ Differences between the respondent and third party producers, such as production methods, scale of operation, and even the end product itself, provide countless distortions that affect the final dumping margin. Because the Chinese firms cannot know what normal

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value is until Commerce concocts it through surrogate values, it is very difficult for them to avoid antidumping duties.⁸ The result is often a punitive and unpredictable tariff based on fictitious prices and fantastic assumptions.

The fiction lies not only in the prices that Commerce constructs but also in the NME designation to begin with. The Chinese government’s presence in the economy may seem exceptionally overt by Western standards, but state intervention in China is comparable to many other developing countries. The days of micro-managed central planning that justified NME treatment are long gone. The last 30 years have seen unprecedented reforms to liberalize the basic structure of China’s economy so that the vast majority of prices are determined through market-driven supply and demand. To put it plainly, China is not an NME.

Make It Up As You Go

Much of the structure and purpose of modern U.S. trade law was devised through protectionist legislation in the 1920s, a time when there was little concern about trade with centrally planned economies.

The end of World War II, however, saw the beginning of the Cold War and the advent of the global liberal trading system. Just as the U.S. antidumping law came to be governed by international disciplines under the General Agreement on Tariffs and Trade (GATT), Western nations also had to figure out how to apply domestic trade laws to imports from countries where prices were not set by market forces.

At the international level, the result was a broad exception to GATT rules on antidumping. To address imports from Czechoslovakia, then the only GATT member with a centrally planned economy, the parties to the GATT decided in 1955 to adopt an “interpretive note” to Article VI governing antidumping measures:

It is recognized that, in the case of imports from a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State, special difficulties may

exist in determining price comparability . . . and in such cases importing contracting parties may find it necessary to take into account the possibility that a strict comparison with domestic prices in such a country may not always be appropriate.⁹

The effect of this provision on NME antidumping is quite extreme. It seems to permit antidumping authorities to completely ignore international rules on how to determine normal value in antidumping investigations. Whether or not derogation from those disciplines was needed, the result was that NME methodology could be developed without any of the legal scrutiny given to regular antidumping techniques.

It is unfortunate that the GATT contracting parties chose simply to exempt NME antidumping from existing rules rather than craft new rules. Those GATT disciplines, which have been expanded to become the WTO Antidumping Agreement, exist to rein in the national tendency toward discrimination and protectionism. Without that legal discipline, NME antidumping practice has been able to develop in a state of lawlessness. The U.S. experience shows how antidumping authorities freed themselves not only of international rules but of domestic law as well.

Standard U.S. antidumping rules provide investigators with the three ways to come up with normal value that they can compare with the import’s U.S. price to determine a margin of dumping. The first, and preferred, way is to use the price a company charges “in the ordinary course of trade” in its home market. But if the company makes no home market sales, there are two alternatives: the company’s sales to a third country market or a constructed price based on production costs.¹⁰

U.S. authorities, however, decided early on to use another method not authorized by U.S. statute or regulations at that time. Deeming all sales and costs within an NME to be not “in the ordinary course of trade,” they decided that none of the three allowable methods would work well. Undaunted, investigators invented a new method in the early 1960s that used export or home

market sales of a different producer in a different country.¹¹ Although this practice completely ignored the respondent producer's actual prices or production methods, it was a simple methodology to employ once the investigators determined which third country to use.

The fact that this method was used despite not being provided for in U.S. statute or agency regulations shows how NME treatment began with lawlessness. Eventually, antidumping regulations were amended to catch up with agency practice, so that in 1968 they provided for the use of sales by third country producers, either in the third country market or in the United States.¹²

The approach proved not to be feasible in cases where the United States and the NME country were the only places on earth that made the product. In *Electric Golf Cars from Poland*, U.S. investigators had originally used sales from a Canadian producer to provide normal value, but when that company stopped making golf carts, investigators had no source for normal value.¹³ So, not long after codifying its previous practice in official regulations, U.S. authorities began to develop a new, more convoluted and complex practice of using surrogate values and factors of production.¹⁴ By using third party prices to value inputs, investigators were free to use prices paid by companies using the same inputs as the NME producer even if they were not making the exact same product.

Rather than reserve this methodology for cases in which more straightforward approaches were impractical, investigators simply defaulted toward the more complex process in all cases.¹⁵ Indeed, at each step in the evolution of NME treatment, investigators took an approach developed to address a specific problem in one case and turned it into standard practice even when the conditions justifying the new approach were not present.

New Facts Mean New Laws to Ignore

Predictably, the fall of communism in the late 1980s and early 1990s prompted serious scrutiny of NME treatment. It was clear that many countries then treated as NMEs would not be so for long. The economic transition of countries

newly embracing capitalism seemed inevitable. In typical fashion, antidumping authorities succeeded in developing a very complex way of dealing with this transition.

The most significant outcome from this period was an increase in the quantity and sophistication of legal rules governing NME treatment. Through a combination of statutes, regulations, or agency practices, formal transition mechanisms developed that would ease the passage of countries out of NME status as their economies liberalized. Unfortunately, the lawlessness inherent in U.S. NME antidumping policy prevented these mechanisms from serving their intended purpose.

The first major reform to the NME system was the creation of a market economy test. The test based on Commerce's criteria for determining NME status was codified in the Trade Act of 1988 and remains in place today.¹⁶

Once a country is determined to be an NME, the designation remains in force until Commerce revokes it, pursuant to a request from the respondent or foreign government during an antidumping proceeding. Eleven countries in Eastern Europe and the former Soviet Union have been graduated from NME status since the early 1990s.¹⁷ None of the nine former Soviet states that retain their NME designation has been the target of an antidumping investigation in over a decade.¹⁸ Four of those countries—Armenia, Georgia, Kyrgyzstan, and Moldova—are members of the WTO and do not have special provisions in their accession protocols allowing the use of NME methodology. If a petition were filed against imports from any of those countries, Commerce would be required by WTO law to treat them as market economies, but under U.S. law it would first have to conduct the market economy test.

That test requires Commerce to consider the following factors:

1. the extent to which the country's currency is convertible,
2. the extent to which wage rates are determined by free bargaining between labor and management,

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3. the extent to which foreign investment is permitted,
4. the extent of government control of the means of production,
5. the extent of government control over pricing and output decisions, and
6. any other factors considered appropriate.¹⁹

Those factors cover a lot of different aspects of an economy and leave limitless discretion (explicitly with the sixth factor) to the bureaucrats making the decision.

There is no indication as to which factors are more important or what “extent” is needed to justify a classification. What is more, under the law, any decision that Commerce makes as to NME status cannot be reviewed by a court.²⁰ It should be no surprise then that all such decisions are largely political in their outcome.

The most striking fact about this test is that only one of the factors relates to the justification for using NME methodology in the first place. Factor five looks at how pricing and output decisions are made by central planners. If government is not making those decisions, then a company’s own domestic sales should be an adequate indicator of normal value, regardless of whether a country allows unfettered foreign investment or freely floats its currency. If the other factors were dispositive, Commerce could easily find that Japan, Brazil, or almost any developing country was an NME.

Thankfully, U.S. policymakers recognized that NME methodology might be inappropriate even before a country’s economic reforms met the legal and political requirements of the market economy test. They developed transition mechanisms that recognized partial liberalization and rewarded it by scaling back NME treatment.

Commerce’s first attempt at a more facilitating attitude toward economic transition has been called the “bubbles of capitalism” approach. If an NME exporter could show that one or more of its factors of production was purchased from a supplier in a market economy or otherwise under market conditions, Commerce would use the exporter’s own costs for that factor.²¹ This approach resulted in a hybrid of NME

methodology and traditional constructed value, and was used in two cases in 1991.²²

However, in 1992, Commerce abandoned the flexible bubbles of capitalism idea and developed another all-or-nothing approach known as the market-oriented industry (MOI) test.²³ Under the MOI test, a respondent exporter can theoretically avoid NME treatment by proving that its industry as a whole is sufficiently free of government control. The test has three criteria:

1. virtually no government involvement in setting prices or amounts to be produced,
2. typically private or collective ownership of firms in the industry, and
3. market-determined prices for all significant inputs.²⁴

So far, these tests have been a farce. Not only has Commerce denied every challenge from China that it is not an NME, Commerce has refused to acknowledge a single Chinese industry as independent from government control.

The test is not fairly administered. For example, in one case, Commerce cited low import penetration and the existence of export tariffs for some inputs as evidence against the existence of market-determined prices.²⁵ Trade restrictions certainly distort prices, but they are hardly indicative of a command economy.

Just as with the NME test, the MOI test’s factors also do not address the price-comparability problem that justifies special treatment of NME imports. The most difficult factor for antidumping respondents to pass in the MOI test is the requirement that they pay market-determined prices for all significant inputs. Any distortion in input prices is reflected in both home market and export prices. Furthermore, many manufacturers in market economies use inputs whose prices are affected by government policy, especially for electricity and labor—markets that are heavily regulated in the developed Western world.

Resisting the End of Lawlessness

For most former communist countries, the legal minefield of U.S. NME treatment and the

phony transition mechanisms became irrelevant as they were promoted out of NME status. But while former Soviet and other Eastern-bloc countries gained recognition in U.S. law as market economies during the 1990s and early 2000s, China has retained its NME status.

In 2001, China joined the WTO while still being treated as an NME in U.S. and EU antidumping law. Rather than reform its discriminatory practices to conform to WTO rules, the U.S. government insisted that China accept NME treatment despite WTO membership. The result was an exception written into China's accession agreement allowing the United States and other WTO members to use the NME methodology subject to some important limitations.

Paragraph 15 of China's WTO accession protocol reads:

The importing WTO Member may use a methodology that is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product.²⁶

This provision makes a number of important contributions to WTO law. First, it implies that China does not meet the requirements of the 1955 interpretive note that already allowed antidumping investigators to ignore domestic prices in countries with a state-controlled economy. China's accession protocol gave the United States the right to use NME methodology regardless of whether China was in fact an NME. Also, it incorporated the MOI test into WTO law. The provision recognizes that China's economy is in transition and endorses the U.S. practice developed over the previous decade.

China's accession protocol also requires that the United States abide by the outcome of its NME test. Subparagraph 15(d) states that the permission to use NME methodology ends "once China has established, under the national law of the importing WTO Member, that it is a

market economy."²⁷ So, China's accession protocol allows discrimination but does so in a limited way by turning both transition mechanisms—the NME and MOI tests—into WTO obligations.

The unwillingness of U.S. authorities to use those mechanisms in a constructive way will not matter forever because even those mechanisms are transitional. The most important thing to know about the NME provision in China's accession protocol is that it expires in December 2016.²⁸ After that date, the United States will not be allowed to treat China as an NME regardless of whether Commerce thinks its economy, industries, or manufacturers meet the conditions of any test. Vietnam has a similar provision in its WTO accession agreement that expires in 2018.²⁹ After that time, the United States will have no right to use NME methodology against imports from any of its trading partners at the WTO.

NME TREATMENT IN THE 21ST CENTURY

Unfortunately, U.S. antidumping authorities have demonstrated a consistent aversion to logic and law in NME practice. The U.S. government has blindly continued to treat China as an NME despite significant reform and liberalization. Whether or not U.S. law continues to label China an NME, the fact is that China's economy is sufficiently liberalized that domestic prices generally provide adequate evidence of normal value.

Ignoring the Facts

Despite drastic economic reforms and China's WTO membership, the U.S. government uses the arbitrary criteria of the NME test to maintain special treatment of Chinese imports. The United States continues to argue that, because China has not met these criteria, NME treatment of Chinese imports is not subject to WTO rules. The problem is that the criteria of the test are not tailored to address problems that might prevent proper price comparison.

The basic premise of NME treatment makes sense. If domestic sale prices are not

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market-determined but are instead set by central planners, then they may bear no meaningful relationship to export prices.³⁰ But this situation does not exist in China today, nor does the U.S. government claim that it does. When Commerce denied China’s most recent formal request to be removed from the NME list in 2006, it nevertheless noted, “The era of China’s command economy has receded and the great majority of prices are liberalized.”³¹ Despite this general observation, Commerce pointed to a number of systemic and institutional policies that keep China from passing the five-factor test to be graduated from NME status.

Many of the nonmarket aspects of China’s economic policies that Commerce points to are, in fact, common in other countries comfortably recognized as market economies. For example, direct currency controls and limits on capital account transactions are used in various ways throughout Asia and Latin America. Likewise, many countries maintain state-owned monopolies and restrict foreign investment in priority industries. These are not good policies and they certainly distort the proper functioning of markets, but they do not alter the viability of price comparisons in antidumping throughout the entire economy.

Commerce also went beyond the five factors in discussing intellectual property laws, industrial policy in the automotive and steel sector, trade liberalization, and corruption.³² These issues are not especially relevant to the question of whether the Chinese economy operates according to market principles, but they do reflect the priorities of politically powerful U.S. businesses.

The most important criteria for maintaining China’s NME status, according to the Commerce Department, is the prevalence of state-directed financing. China’s government owns the vast majority of the banking sector and is accused of giving preferential credit to state-owned firms or to state-approved activities.³³

Strong government intervention in financial markets does not justify continued use of NME treatment. For one thing, while liberalization of the banking sector may have some bearing on the extent to which China’s economy operates on

market principles, it is irrelevant to the question of whether home market prices for manufactured goods reliably demonstrate normal value. The U.S. government claims that home market prices must be the product of “market principles of cost and pricing structures” in order to be used.³⁴ But it does not adequately consider whether a particular distortion of the market affects home market prices only without also affecting export prices. If the price a company pays for inputs is distorted, that distortion will affect home market and export price, thus leaving home market sales as a reliable benchmark for deciding whether exports are sold at dumped prices.

Even accepting the U.S. government’s characterization of the Chinese economy, the truth is that any distortions caused by preferential financing for state-owned enterprises could be better dealt with through anti-subsidy actions. If the Chinese government is using economic policies or discretionary lending practices to promote exports or to champion state-run industries, these may amount to actionable subsidies under WTO law subject to countervailing duties. They are not, however, such monumental distortions as to negate the functioning of market principles throughout the entire Chinese economy. Indeed, less than a year after releasing the NME memo, Commerce determined under the same factors that China’s economy was now sufficiently liberalized to permit the use of such anti-subsidy measures.³⁵

Ignoring the Law

Antidumping authorities have not only ignored the reality of China’s transition, they have actually increased the level of discrimination. In addition to ignoring the non-NME nature of China’s economy by refusing to utilize the MOI transition mechanism and the NME test, Commerce has invented new ways to defy law and logic in its treatment of Chinese imports. Two practices in particular have been challenged successfully in WTO dispute settlement as going beyond the bounds of the exception established in China’s accession protocol. The U.S. government has not made any serious attempt to comply with those rulings.

Double Remedies. In 2006, Commerce decided to impose anti-subsidy duties on Chinese imports subject to investigations under the countervailing duty (CVD) law. This reversed a decades-old policy of exempting NMEs from CVD actions.

The exemption was itself a rare display of logic in the history of NME treatment. If an economy is so controlled by government that prices were set by central planners, how can you possibly calculate the effect of a particular government bounty on export prices?

The idea that countries subject to NME methodology in antidumping were exempt from the CVD law had a significant effect in the formation of transition mechanisms in the early 1990s. Graduating from the NME designation was not always a good outcome for NME producers because it would then open them up to CVD investigations. One reason why the bubbles of capitalism approach to transition was abandoned by Commerce was that petitioners immediately filed CVD complaints against those producers found to be operating under market conditions.³⁶

Reversing the policy in 2006 caused a host of logical and legal problems. As noted above, Commerce had to decide that China was a market economy and an NME at the same time. The decision showed how U.S. authorities were willing to resort to total nonsense in order to keep China's firms from competing in the U.S. market.³⁷ It also upset the balance worked out in China's WTO accession protocol.

The problem with Commerce's decision was not that China should remain exempt from CVD measures, but that exposing China to CVD liability should have been accompanied by the end of NME treatment in antidumping. Doing so would have given protectionist U.S. industry what they sought: a new tool against Chinese exporters accused of benefiting from unfair subsidies. Maintaining NME treatment gave the protectionists what they wanted without granting Chinese producers the legally and logically necessary recompense.

China successfully challenged the current practice in WTO dispute settlement on the grounds that using CVD measures and

NME-based antidumping duties on the same imports results in the imposition of a double remedy for the same subsidy.³⁸ Concurrent antidumping and CVD measures are not a problem when using traditional antidumping methodology because production subsidies affect both domestic and export prices. But because NME methodology ignores domestic prices and costs, an NME antidumping duty captures both "dumping" and subsidization. Applying a CVD measure on top of the NME antidumping duty double-counts the subsidy.

The policy violated not only WTO rules, but federal domestic law as well. A federal appeals court found in 2011 that U.S. law did not authorize Commerce to impose CVDs on imports from NMEs.³⁹ In another example of illegal NME practices being later codified in law, Congress intervened by amending the law in early 2012, explicitly allowing NME CVD investigations.⁴⁰

In a cursory nod to WTO rules, Congress also directed Commerce to consider on a case-by-case basis whether subsidies had been double-counted and then reduce the antidumping duties accordingly. It is not at all clear how Commerce will do that in a reasonably accurate way that comports with WTO requirements.⁴¹

The entire controversy over double remedies would go away if China were graduated from NME status. Commerce had the opportunity to do that when it added CVD liability in 2006 and Congress could have done it in 2012. If the U.S. government had not been applying NME methodology in antidumping, the use of concurrent antidumping and CVD measures would never have been a problem. Today, double remedies is a systemic feature of U.S. trade remedy practice in violation of WTO rules that U.S. authorities have no serious intention of fixing.

Separate Rates. In addition to applying the CVD law and NME antidumping concurrently, the United States also exceeds the bounds of NME treatment by assigning all NME producers a uniform dumping margin unless they can affirmatively prove that they are not under government control. Chinese firms

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are required to pass the “separate rate” test in order for Commerce to use the firms’ own export prices to the U.S. market. Any producers who fail or do not apply for separate rates are treated as if they are part of a China-wide entity (a sort of “China, Inc.”) and assigned an “entity-wide” rate that, for procedural reasons, is almost always whatever rate the petitioners alleged in their complaint.

Because Commerce invented the separate rates test in the late 1980s, it appears on the surface to be a transition mechanism designed to allow independent companies a reprieve from broader NME treatment. However, before the test was invented, assigning separate rates was the default practice.⁴² The test actually adds a completely new burden onto NME respondents that is difficult, although not impossible, to meet.

Although the test is not as difficult to pass as the industrywide MOI test, it does require that exporters prove a negative. Respondents seeking separate rates must “provide sufficient proof of an absence of government control, both in law and in fact, with respect to export activities.”⁴³

The result for companies that do not pass the test is an antidumping duty that Commerce “calculated” without considering a producer’s domestic prices or its export prices. The idea that such a system could reliably capture real price discrimination, much less predatory price discrimination, is laughable. Moreover, one must wonder how a company could possibly know whether it is “dumping” or alter its behavior to prevent doing so.

Just as with the double remedies, WTO dispute settlement reports have found that the U.S. practice (and its European equivalent) of treating all Chinese and Vietnamese exporters as a single entity, unless they prove otherwise, to be impermissible despite the NME provision of China’s protocol.⁴⁴ Specifically, in a case against the European Union, the WTO Appellate Body stated:

China’s Accession Protocol does not authorize WTO Members to treat China differently from other Members except for the determination of price compa-

rability in respect of domestic prices and costs in China, which relates to the determination of normal value. . . . [I]t does not contain an open-ended exception that allows WTO Members to treat China differently.⁴⁵

This statement from the WTO’s highest judicial body is very important because it completely contradicts the U.S. position on the legal significance of the NME label. Despite judicial clarification that the WTO’s NME exception is limited to normal value comparisons, the U.S. government continues to claim that (and act as if) China’s economic structure justifies a wholesale departure from standard antidumping practices.

Not Making Sense

The official U.S. position in WTO disputes has been unequivocal. The United States has consistently claimed that NMEs present special problems for antidumping investigations and that other countries should be allowed to divert from normal rules in response. To justify its position, the United States has offered specious arguments like this one:

China’s Accession Protocol recognizes the pervasive government interference in the Chinese economy, allowing Members to establish different evidentiary requirements for firms operating in China. Specifically, the Protocol recognizes that, absent a demonstration to the contrary by Chinese producers, government interference will prevent market principles from functioning in the relevant industry producing the product under consideration.⁴⁶

This argument is exceedingly peculiar in that it conflates legal permission with factual reality. The fact that the protocol permits the United States to require a showing of noninterference by Chinese authorities does not in any way prove that such interference exists or is so disruptive as to “prevent market principles from functioning.” On the contrary, it shows that China’s NME sta-

tus is a matter of law rather than fact, which directly undermines the U.S. position.

It has become quite clear that the United States has no intention of complying with WTO rules, despite numerous legal challenges on both double remedies and separate rates.⁴⁷ That defiant attitude reflects longstanding U.S. practice of ignoring WTO condemnation of its trade remedy practices. The most noted example of U.S. defiance has been the decades-long saga over “zeroing,” a practice the United States uses to inflate dumping margins, even in market economy cases, that has been deemed illegal by the WTO over and over again.⁴⁸ NME treatment is poised to become just one more way the United States flagrantly flouts WTO rules on antidumping.

NME TREATMENT IN THE POST-NME ERA

While genuine and complete U.S. compliance with WTO antidumping rules is unlikely, it is unknown at this point exactly what the U.S. government will do when China’s NME exception expires in 2016. The following are four possible scenarios in order from worst to best in terms of compliance with WTO rules:

Willful Ignorance

One possibility is for U.S. authorities to completely ignore the expiration of China’s NME exception. There is no automatic trigger in U.S. law that would end the use of NME methodology. Rather, Commerce has to decide that China is no longer an NME based on the factors in the NME test. As discussed above, the outcome of that test is purely political.

That means the Obama administration currently has the power to end China’s NME designation if it so chooses. The deadline to do so is just before the end of his second term. Stubbornly ignoring that deadline would completely disregard the agreement made when China joined the WTO and would violate international trade rules. But, that fact has not prevented lobbyists and representatives of protection-seeking industries from advocating just such an approach.⁴⁹

Some commentators have begun to present an argument that the permission to treat China as an NME does not actually expire in 2016.⁵⁰ They argue that only one portion of the NME section will expire, and that the remaining portions—which require that countries offer the NME and MOI tests to Chinese producers—are still in effect. The argument, while appealing to antidumping petitioners and their lawyers, is fundamentally lacking because the part that expires is the one provision that expressly permits NME treatment. The fact that everyone has understood for over 10 years, without controversy, that the NME permission would expire at the 2016 deadline also makes it difficult to take seriously a previously unconsidered argument to the contrary.⁵¹

Nevertheless, the U.S. government could choose to press this argument in dispute settlement at the WTO. Based on the WTO Appellate Body’s history of narrowly interpreting the NME exception, it seems unlikely this hypothetical U.S. position would succeed.

Constructed Value

Another more nuanced possibility is that the United States will formally recognize China as a market economy while continuing to use some kind of modified methodology in antidumping investigations. Even without the special procedures of the NME methodology, U.S. law gives Commerce an option for bypassing Chinese companies’ domestic prices.⁵²

One option is for Commerce to decide that “the particular market situation in the exporting country does not permit a proper comparison with the export price or constructed export price.”⁵³ Under U.S. law, such a determination would permit investigators to use an alternative methodology. When Congress implemented the WTO Antidumping Agreement into U.S. law, the accompanying Statement of Administrative Action seemed to contemplate that a particular market situation might prevent proper price comparison “where there is government control over pricing to such an extent that home market prices cannot be considered to be competitively set.”⁵⁴

“Nonmarket-economy treatment is poised to become just one more way the United States flagrantly flouts World Trade Organization rules on antidumping.”

“Even if Commerce determines that Chinese domestic prices are unusable, U.S. and WTO rules specifically provide only two alternative methods for calculating normal value.”

Antidumping authorities could also take the position that domestic sales in an economy like China's are not made “in the ordinary course of trade.” The consequence would be largely the same, as the determination would invoke alternatives to strict price comparison. Those alternatives include using the company's sales in a third-country market or, more commonly, constructed value based on the cost of production. Constructed value is used on a fairly common basis in market economy antidumping cases when, for various reasons (e.g., no domestic sales), domestic prices are unusable.

Commerce considered this approach after Russia was graduated from NME status in 2002. In the official memorandum explaining Russia's graduation, Commerce stated that it would “examine prices and costs within Russia, utilizing them for the determination of normal value *when appropriate* or disregarding them when they are not.”⁵⁵ This caveat was cited in the case of *Magnesium Metal from Russia* when Commerce considered ignoring the actual price paid for energy by a Russian firm on the ground that the Russian energy market was overly regulated and insufficiently competitive.⁵⁶

Interestingly, Commerce claimed legal authority to ignore Russian prices based on the very same argument used to justify NME treatment in the 1950s. Commerce asserted that extensive state intervention meant that domestic transactions were not made “in the ordinary course of trade” and so could be bypassed. Moreover, just as before, Commerce did not explain under what express legal authority it could use a different methodology. Commerce officials simply found that once they had permission under the law to use something other than domestic prices, they then had limitless discretion to adopt a new methodology.⁵⁷

However, the value of this maneuver as a way to get higher margins on Chinese imports is limited. Even if Commerce determines that Chinese domestic prices are unusable, U.S. and WTO rules specifically provide only two alternative methods for calculating normal value—third country prices and constructed value.

Nondiscrimination and Burden Shifting

WTO rules prohibit discriminatory application of antidumping laws. Right now, China's accession protocol expressly permits the use of an alternative methodology, but when that permission expires, the United States will have to treat China the same as all other WTO members. This means that the Commerce Department cannot have a special procedure it reserves for China.

The simplest way around that problem is to place the burden on petitioners to show that China's economic situation prevents proper price comparison with domestic prices. Theoretically, Commerce could employ some of the same NME tests it does now, but with the burden shifted. For example, Commerce could accept submissions from petitioners arguing that the respondents' industry is not market oriented or that a particular Chinese firm is *not* independent of government control. Proving the former would justify the use of constructed value over Chinese prices, while proving the latter would permit Commerce to treat all such producers as a single state-run entity.

Placing the burden on petitioners would enable Commerce to employ a test applicable to imports from all countries but that still disadvantages China in certain cases. If done right, the test should pass muster in WTO dispute settlement because it is nondiscriminatory and relies on an existing mechanism available in all market economy cases.

Ending NME Altogether

While history tells us that U.S.–China trade is likely headed toward years of legal quagmire and diplomatic strife, that future is not inevitable. President Obama has a unique opportunity between now and December 2016 to render the pessimistic predictions moot. Graduating China out of NME status before the deadline, and doing so unequivocally, would do a lot to improve U.S.–China relations and restore U.S. leadership and influence in global trade policy.

Ending NME treatment could do a lot to help mend ties between the world's two greatest trading nations. The sooner the adminis-

tration takes action to end NME treatment of Chinese imports the better, as it would send a message that the United States respects China as an equal partner.

U.S. trade officials and politicians are constantly accusing China of skirting global trade rules. A common refrain is that China's newly acquired status as an economic power entails greater responsibility. Such exhortations ring hollow when the United States continues to treat China as a second-class citizen, especially when that treatment violates fundamental rules of the very system that China is expected to value.

The U.S. officials and businesses eager to address their many complaints about China's trade policy should not underestimate the positive effect ending NME status would have on U.S. leverage over China's trade policies. The NME issue has consistently ranked high on China's foreign economic policy priorities. For example, China has made revoking NME designation a necessary prerequisite for negotiating bilateral free trade agreements.⁵⁸

Ending NME treatment would also go a long way toward reducing the troubling trend of tit-for-tat litigation at the WTO. The WTO's dispute settlement mechanism can be a very effective way to eliminate harmful trade policies and resolve conflicts in a peaceful manner. Unfortunately, both the United States and China have engaged in a practice of retaliatory and strategic litigation where complaints are used as a tool to achieve other policy goals. Abuse of the NME designation has already been used by China as a standby complaint, and this tactic will be even more available if the U.S. government continues NME treatment after the 2016 deadline.

In addition to helping U.S.–China relations, making a genuine good faith effort to bring the United States into compliance with international nondiscrimination rules could do a lot to further U.S. interests in the international trading regime. The United States has a strong interest in maintaining the rule of law in global trade relations. Flouting those rules sends a bad signal to other countries, while U.S. actions to accept

global trade disciplines will strengthen the system. A course correction on the issue of China's NME treatment would send a clear signal that the United States values the rules-based trading system, especially the foundational principle of nondiscrimination. Making that change before the 2016 deadline would show even stronger respect for the law and would do much to bolster America's ability to provide leadership in global trade relations.

Bringing the United States into compliance with trade rules and proving its capacity for leadership would also improve the U.S. government's influence in global trade negotiations. Much of the impasse currently preventing progress in WTO efforts to further liberalize global trade stems from confrontational attitudes between developed countries and emerging economies such as Brazil, India, and China. Neither side trusts the other's willingness to take on new obligations and reforms, and for good reason. Perhaps U.S. officials are not genuinely interested in bridging that divide, but if they are, addressing the NME issue will be essential.

CONCLUSION

The United States has a choice to make. The end of China's NME status in December 2016 will necessitate a change in U.S. antidumping policy. Whether that change is for the better is up to U.S. policymakers. Essentially, the choice is between good faith compliance with global trade rules or stubborn adherence to illegal protectionism.

Unfortunately, history prompts us to expect the latter. The U.S. antidumping practice against NMEs has always stretched the bounds of law and logic. Even as China's economy liberalizes, U.S. authorities at the Department of Commerce have increased their use of discriminatory methods to disrupt legitimate trade and to construct higher margins for Chinese exporters. The United States is already operating outside the bounds of current WTO rules, and tit-for-tat trade litigation and retaliation has already begun. What will hap-

“The United States has a strong interest in maintaining the rule of law in global trade relations.”

“Law and logic are both on the side of ending nonmarket-economy treatment altogether.”

pen when those rules become much stricter?

Commerce has a variety of policy choices it could make, each with different legal and political consequences. The U.S. authorities may simply ignore the new legal landscape and continue to treat China as an NME, or they may acknowledge China's new status but find other justifications under U.S. law to discriminate against Chinese imports. In either of those scenarios, China will rightly challenge U.S. practice at the WTO.

Maintaining some form of discrimination against China within the bounds of WTO rules may be possible. However, designing WTO-compliant tests to gauge the effect of state intervention on domestic price comparability and then applying WTO-compliant methodologies in response may not be sufficiently punitive to attract the interest of antidumping petitioners and investigators.

Law and logic are both on the side of ending NME treatment altogether. Instead of spending years litigating at the WTO, trying to find the least illegal way to discriminate against Chinese imports, the United States should embrace the reality of China's economic transition and WTO membership. Accepting the end of NME treatment even before the deadline would strengthen the U.S. position in the inevitably contentious U.S.–China trade relationship and would provide a much-needed boost to the United States' role as a leader in the global trading system.

NOTES

1. 19 U.S.C. § 1677b (2012).

2. Jacob Viner, *Dumping: A Problem in International Trade* (Chicago: University of Chicago Press, 1923), pp. 239–57.

3. See Brink Lindsey and Daniel J. Ikenson, “Antidumping 101: The Devilish Details of ‘Unfair Trade’ Law,” Cato Trade Policy Analysis no. 20, November 21, 2002.

4. Ibid.

5. Peter Buck Feller, “The Antidumping Act and

the Future of East-West Trade,” *Michigan Law Review* 66 (November 1967): 117–19.

6. 19 C.F.R. § 351.408.

7. See Daniel Ikenson, “Nonmarket Nonsense: U.S. Antidumping Policy toward China,” Cato Trade Briefing Paper no. 22, March 7, 2005.

8. Ibid.

9. General Agreement on Tariffs and Trade, annex I, Ad Article VI.

10. 19 U.S.C. § 1677b.

11. *Fur Felt Hoods, Bodies, and Caps from Czechoslovakia*, 27 Fed. Reg. 6099 (June 22, 1962); *Jalousie-Louvre-Sized Sheet Glass from Czechoslovakia*, 27 Fed. Reg. 8457 (August 15, 1962).

12. Donald L. Cuneo and Charles B. Manuel Jr., “Roadblock to Trade: The State-Controlled Economy Issue in Antidumping Law Administration,” *Fordham International Law Journal* 5, no. 2 (1982): 290–92.

13. 40 Fed. Reg. 25497 (June 11, 1975).

14. See Cuneo and Manuel, pp. 292–95.

15. See Joseph P. Hornyak, “Treatment of Dumped Imports from Nonmarket Economy Countries,” *Maryland Journal of International Law* 15, no. 1 (1991): 27–29.

16. In a formal sense, the United States does not actually have a “list” of NME countries (although Europe does). According to U.S. law, Commerce can determine that a country is an NME at any time, and that determination remains in force and unchallengeable until Commerce revokes it. 19 U.S.C. § 1677(18)(C).

17. Former NMEs include Poland (graduated in 1993), the Czech Republic (1998), Slovakia (1999), Hungary (2000), Latvia (2001), Kazakhstan (2002), Russia (2002), Romania (2002), Estonia (2003),

Lithuania (2003), and Ukraine (2006).

18. Countries currently designated as NMEs are China and Vietnam, as well as nine former Soviet states: Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan.

19. 19 U.S.C. §1677(18).

20. 19 U.S.C. 1677(18)(D).

21. Judith H. Bello, Alan F. Holmer, and Jeremy O. Preiss, "Searching for 'Bubbles of Capitalism': Application of the U.S. Antidumping and Countervailing Duty Laws to Reforming Nonmarket Economies," *George Washington Journal of International Law and Economics* 25 (1992): 691–95.

22. Ibid.

23. See *Sulfanilic Acid from the People's Republic of China*, 57 Fed. Reg. 9409 (March 18, 1992); Robert H. Lantz, "The Search for Consistency: Treatment of Nonmarket Economies in Transition under United States Antidumping and Countervailing Duty Laws," *American University International Law Review* 10, no. 3 (1995): 993–1059.

24. *Chrome-Plated Lug Nuts from the People's Republic of China*, 57 Fed. Reg. 15052 (April, 24, 1992); see also *Import Administration Antidumping Manual*, Chapter 10, p. 32, <http://enforcement.trade.gov/admanual/index.html>.

25. Import Administration, *Issues and Decision Memorandum for the Antidumping Duty Investigations of Certain Coated Paper Suitable for High Quality Print Graphics Using Sheet-Fed Presses from the People's Republic of China* (September 20, 2010), p. 8, <http://enforcement.trade.gov/frn/summary/prc/2010-24184-1.pdf>.

26. "Protocol on the Accession of the People's Republic of China," ¶15, WT/L/432, (November 23, 2001).

27. Ibid.

28. Ibid.; Paragraph 15(d):

Once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of subparagraph (a) shall be terminated provided that the importing Member's national law contains market economy criteria as of the date of accession. In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession. In addition, should China establish, pursuant to the national law of the importing WTO Member, that market economy conditions prevail in a particular industry or sector, the non-market economy provisions of subparagraph (a) shall no longer apply to that industry or sector.

29. "Report of the Working Party on the Accession of Viet Nam," ¶255, WT/ACC/VNM/38 (October 27, 2006).

30. Feller, pp. 117–19.

31. "Import Administration Memorandum, Antidumping Duty Investigation of Certain Lined Paper Products from the People's Republic of China—China's Status as a Non-market Economy," NME memo, August 30, 2006, p. 77.

32. Ibid., pp. 66–80.

33. Ibid., p. 77.

34. Ibid., p. 2.

35. See "Import Administration Memorandum, Countervailing Duty Investigation of Coated Free Sheet Paper from the People's Republic of China—Whether the Analytical Elements of the *Georgetown Steel Opinion* are Applicable to China's Present-Day Economy," March 29, 2007, <http://enforcement.trade.gov/download/prc-cfsp/CFSCChina.Georgetownapplicability.pdf>.

36. Lantz, pp. 1040–41.

37. See Scott Lincicome, "Documenting DOC's

Ample Discretion RE the 'NME' Designation," *lincicome.blogspot.com* (blog), September 11, 2012, <http://lincicome.blogspot.com/2012/09/documenting-docs-ample-discretion-re.html>.

38. See Appellate Body Report, *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (March 11, 2011).

39. *GPX International Tire Corp. v. United States*, 666 F.3d 732 (Fed. Cir. 2011).

40. "An Act to Apply the Countervailing Duty Provisions of the Tariff Act of 1930 to Nonmarket Economy Countries, and for Other Purposes," Pub. L. 112-99, 126 Stat. 265 (March 13, 2012).

41. See James P. Durling and Thomas J. Prusa, "The Problem of 'Double Remedies' in International Trade Disputes and the Economics of Pass-Through," *Tulane Journal of International and Comparative Law* 21, no. 2 (2013): 513-44. See also, Scott Lincicome, "GPX Update: The Fake Pressure to Pass a Bad Bill," *lincicome.blogspot.com* (blog), February 29, 2012, <http://lincicome.blogspot.com/2012/02/gpx-update-fake-pressure-to-pass-bad.html>.

42. Priya Alagiri, "Reform, Reality, and Recognition: Reassessing U.S. Antidumping Policy toward China," *Law and Policy in International Business* 26 (1995): 1068-69.

43. *Import Administration Antidumping Manual*, Chapter 10, p. 4.

44. See Panel Report, *United States—Anti-Dumping Measures on Certain Shrimp from Vietnam*, WT/DS404/R (July 11, 2011); Appellate Body Report, *European Communities—Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China*, WT/DS397/AB/R (July 15, 2011).

45. *EC—Fasteners*, para. 290. This position was echoed by the panel in *U.S.—Shrimp* (Viet Nam), para. 7.251: "We see nothing in [Vietnam's accession commitments] indicating that the interpretation and/or application of any other provision of

the Anti-Dumping Agreement, including Article 9.4, should be modified to accommodate any special difficulties that might arise in a proceeding involving imports from Viet Nam."

46. *EC—Fasteners*, para. 259.

47. See Appellate Body Report, *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (March 11, 2011); Panel Report, *United States—Anti-Dumping Measures on Certain Shrimp from Vietnam*, WT/DS404/R (July 11, 2011); Appellate Body Report, *European Communities—Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China*, WT/DS397/AB/R (July 15, 2011); Panel Report, *United States—Countervailing and Anti-Dumping Measures on Certain Products from China*, WT/DS449/R (March 27, 2014).

48. See Daniel J. Ikenson, "Zeroing In: Anti-dumping's Flawed Methodology under Fire," *Cato Free Trade Bulletin* no. 11, April 27, 2004.

49. See Terence P. Stewart, et al., "Any Change to China's Non-Market Economy Status Must Be Based on the Criteria Specified under U.S. Anti-dumping Law," August 18, 2005, http://origin.uscc.gov/sites/default/files/Research/05_08_18_trade_group_law_postion_paper.pdf.

50. See Bernard O'Connor, "Market-economy Status for China Is Not Automatic," *Vox*, November 2011, <http://www.voxeu.org/article/china-market-economy>; Jorge Miranda, "Interpreting Paragraph 15 of China's Protocol of Accession," *Global Trade and Customs Journal* 9, no. 3 (2014): 94-103.

51. See Folkert Graafsma and Elena Kumashova, "In re China's Protocol of Accession and the Anti-Dumping Agreement: Temporary Derogation or Permanent Modification?" *Global Trade and Customs Journal* 9, no. 4 (2014): 154-59.

52. See Kenneth J. Pierce and Matthew R. Nicely, "Transitioning to China's Market Economy Anti dumping Treatment in 2016," <http://apps.americanbar.org/intlaw/spring09/materials/Transitioning>

to China's Market Economy Antidumping Treatment in 2016.pdf.

53. 19 U.S.C. § 1677b(a)(1)(C)(iii).

54. Statement of Administrative Action accompanying H.R. 5110 (H.R. Doc. No. 316, 103d Cong., 2d sess.) at 822 (1994) [emphasis added].

55. Import Administration, *Inquiry into the Status of the Russian Federation as a Non-Market Economy Country under the U.S. Antidumping Law*, June 6, 2002, <http://enforcement.trade.gov/download/russia-nme-status/russia-nme-decision-final.htm>.

56. *Magnesium Metal from the Russian Federation*, 70 Fed. Reg. 9041 (February 24, 2005).

57. Commerce ended up using actual prices paid for energy by the Russian producer because it had no reasonable way to construct a proper price for energy. It did not resort to the use of surrogate values from a third country producer as it would have in a genuine NME investigation.

58. See Ka Zeng, "Multilateral versus Bilateral and Regional Trade Liberalization: Explaining China's Pursuit of Free Trade Agreements," *Journal of Contemporary China* 19, no. 66 (2010): 635–52.

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