

WTO – MARKET AND NON-MARKET ECONOMIES: the hybrid case of China ¹

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July 2013

INTRODUCTION

The Multilateral Trading System was created in the 1940`s with the GATT, containing clear objectives to liberalize and promote trade as an instrument of economic development. Aiming to become universal, the Multilateral Trading System gave support and incentives to both market and non-market economies (NMEs) to participate in its activities. With the strengthening of the Cold War, however, NMEs left the negotiations leading to General Agreement on Trade and Tariffs (GATT).

During the second half of the 20th century, it was a common perception that the GATT system, along with the OECD, was the club of market economies in contrast to the Council for Mutual Economic Assistance – Comecom – that would be the club of centrally-planned economies. In this sense, GATT rules, tailored for market-economies, did not envisage dealing with the different aspects of NMEs.

Nevertheless, throughout the history of GATT, and especially after the creation of the WTO, the accession and presence of NME countries in the Multilateral Trading System has brought light to the specificities of trade between market and non-market economies.

With the end of the Cold War and the creation of WTO, all economies invited to participate in the Multilateral Trading System negotiated and agreed to the commitment to become market economies, accepting specific rules in their Protocols of Accession, with the objective to participate fully in the Organization.

The case of China, the first major hybrid economy³ containing NME features to accede to the WTO, in 2001, however, attracted attention from other WTO members and reinstated the debate on adequate systemic rules and reforms. The recent accession of Russia and other former centrally-planned economies enhanced the importance of the discussion.

¹ Publicado no *Latin American Journal of International Trade Law*, v. 1, issue 2, 2013, p 765 – 798
http://www.derecho.unam.mx/revista_ldci/index1.html

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³ The Working Party Report on the Accession of China constantly refers to the Chinese economic model as in transition towards a Socialist Market Economy and it signals to the fact that the Chinese economy bears characteristics of both market and non-market economies. WTO, *Report of the Working Party on the Accession of China*, WT/ACC/CHN/49, October 2001, para. 4

When acceding, China committed to undertake several reforms, regarding, e.g., subsidies, management of state-owned enterprises (SOEs), and liberalization of its banking system which would assure a level playing field between China and other economies under the WTO system. This purpose is clearly stated in its Protocol of Accession⁴.

However, there is strong evidence to the effect that, ten years after accession, China still has not completed its transition process. The World Bank has published a study about China where it affirms that the government continues to dominate key sectors and that “close links between the government, big banks, and state enterprises have created vested interests that inhibit reforms and contribute to continued ad hoc state interventions in the economy”⁵.

Furthermore, the report states that

China’s transition to a market economy is incomplete in many areas. A mix of market and non-market measures shapes incentives for producers and consumers, and there remains a lack of clarity in distinguishing the individual roles of government state enterprises, and the private sector. It is imperative, therefore that China resolve these issues, accelerate structural reforms and develop a market-based system with sound foundations in which the state focuses on providing key public goods and services – while a vigorous private sector plays the more important role of driving growth⁶.

In truth, China still relies heavily upon SOEs to implement public policies conceived by the Communist Party. Considering the internal opposition to further liberalization and privatization reforms, some commentators are starting to doubt that China could ever complete its transformation into a full market economy, given the intrinsic political links between the Communist Party, SOEs and the means by which public policies are implemented.

Not only China, but other emerging economies seem to have lost the drive to continue their liberalization processes and to finish their economic reforms. A renewed interest on state developmentalism and a reinforced role of the state in the economy are recent marks of many governments in important emerging and developing countries, arguably inspired by the recent robust economic growth of China and sloppy performance of western economies. The mechanisms through which these governments seek to advance state-led economic growth are well known and were characteristic of NMEs. These NME features impact the Multilateral Trading System in many ways.

⁴ See provisions concerning the liberalization of the Right to Trade (Article 5), Non-Tariff Measures, especially paragraph 3 (Article 7), Price Controls (Article 9) and Price Comparability in Determining Subsidies and Dumping (Article 15) in WTO, *Protocol of Accession of the People’s Republic of China*. WT/L/432, 10 November 2001. Julian Qin refers to these obligations as being “obligations to practice market economy” and “obligations concerning domestic governance”. See QIN, Julia Ya, “China, India and WTO Law”, in SORNARAJAH, Muthucumaraswamy; WANG, Jiangyu, *China, India and the International Economic Order*, Cambridge University Press, 2010, pp 172-173

⁵ WORLD BANK, *China 2030 – Building a Modern, Harmonious, and Creative High-Income Society*. Conference Edition, 2012. Available at:

<http://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf> p. 25

⁶ *Ibid*, p. 25

Since the WTO was not designed to regulate trade practices of NMEs, neither to force them to transform their economies into market ones, the Organization is unable to properly supervise the specificities of international trade between market and NMEs, failing to properly regulate international trade.

Some relevant questions can, thus, be posed:

. Is the WTO an organization created under market economy principles and rules or does it provide rules for both market and NMEs?

. Can it be assumed that, by acceding the WTO, China, Viet Nam and other countries to the WTO committed to transform themselves into market economies, or can two economic systems be allowed?

. Is the WTO properly equipped with mechanisms to allow for fair trade between State-led and Market-led economies?

This article will discuss the systemic challenges of integrating hybrid economies, and their NME features, into the WTO. It will analyze how the Multilateral Trading System has dealt differently with the issue during the GATT and the WTO eras. It will then discuss the relationship between NMEs and the principles and rules of the Multilateral Trading System.

First of all, however, the following section will look into the definitions for NMEs which are available in the context of international trade.

I. DEFINITION OF MARKET AND NON-MARKET ECONOMIES

China joined the WTO in 2001 through its Protocol of Accession, in which the country committed to a series of obligations that should theoretically lead it into a market economy. China's status of NME is also referred to in a few provisions of the Protocol, namely in its Article 15, where concerns are raised about the difficulties arisen from the absence of market economy conditions for the determination of dumping and subsidies. Nevertheless, there is no definition, under the Protocol, of the expression "non market economy". The provisions of Article 15 only presume that China is a NME, but give no further clarifications.

China's Accession Working Party Report, when referring to Article 15 of the Chinese Accession Protocol, states that:

Several members of the Working Party noted that China was continuing the process of transition towards a full market economy. Those members noted that under those circumstances, in the case of imports of Chinese origin into a WTO Member, special difficulties could exist in determining cost and price comparability in the context of anti-dumping investigations and countervailing duty investigations⁷.

⁷ WTO, *Report of the Working Party on the Accession of China*, WT/ACC/CHN/49, October 2001, para. 150

The Working Party thus evidenced some NMEs' effects on the WTO system, especially on the proper functioning of its mechanisms, but did not give a definition of what precisely is deemed to be a NME or a "full market economy". In this context, one can raise the question: what is a market economy and how to define it?

Although the main concern with the concept of NME focuses on dumping investigations, as shown by China's Protocol of Accession, such definition is crucial to shed some light on other NME challenges to the rules of the Multilateral Trading System, and to fully understand the participation of China, as well as that of other NMEs in the WTO.

1. International definitions

There are a diversity of economic parameters and subtle gradations between a centrally planned and a market economy. Hence, the difficulty of legally defining a market economy or a NME. Apart from the United Nations Conference on Trade and Development (Unctad), a legally detailed description has still not been produced among influent international organizations, though there are punctual official statements that, together, form an official structure of what is needed for a country to be considered as a market economy.

Unctad

Unctad defines market economy as "*a national economy of a country that relies heavily upon market forces to determine levels of production, consumption, investment and savings without government intervention*"⁸.

Likewise, Unctad's definition of a NME is as follows:

A national economy in which the government seeks to determine economic activity largely through a mechanism of central planning, as in the former Soviet Union, in contrast to a market economy which depends heavily upon market forces to allocate productive resources. In a "non-market" economy, production targets, prices, costs, investment allocations, raw materials, labour, international trade and most other economic aggregates are manipulated within a national economic plan drawn up by a central planning authority; hence, the public sector makes the major decisions affecting demand and supply within the national economy.

⁸ Unctad's Glossary of Customs Terms, available at <http://www.asycuda.org/cuglossa.asp?term=market+economy>. Last viewed on 31st January 2012.

WTO

The Multilateral Trading System's first discussion on the subject happened during the Review Session of GATT, in 1954-55. Article VI, which contains dispositions on subsidies and dumping matters, was interpreted through the second Supplementary Provision to paragraph 1 (Ad Note):

Ad Article VI

Paragraph 1

2. 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 for the purposes of paragraph 1 (...).(Emphasis added)

Point 2 of the Ad Note refers to the determination of price comparability between market and centrally planned economies. But is it a WTO definition of a NME? Evidence in that sense can be found in the reference to the Ad Note present in Article 15 of the Tokyo Round Subsidies Code, paragraph 1, which states:

Article 15

Special situations

1. In cases of alleged injury caused by imports **from a country described in Notes and Supplementary Provisions to the General Agreement (Annex I, Article VI, paragraph 1, point 2)** the importing signatory may base its procedures and measures either: (...) (Emphasis added)

Through that indirect reference to the Ad Note, the Panel on US – Antidumping and Countervailing Duties (WT/DS/379), paragraph 14.119 declared that:

(T)he predecessor to the SCM Agreement – the Tokyo Round Subsidies Code – contained a provision that **explicitly addressed the concurrent use of NME [non-market economies] methodologies** in anti-dumping investigations, and of countervailing duties, in respect of imports **from NMEs**. Where imports **from non-market economies** were at issue, Article 15 of that Code imposed upon the importing Member a choice between the use of anti-dumping measures or of countervailing duties. (Emphasis added)

The presumption that the inferred Article deals with imports from NMEs can also be found in Paragraph 578 of the Appellate Body's decision on the same case, which states that:

Article 15 of the Tokyo Round Subsidies Code imposed upon an importing signatory a choice between the use of anti-dumping duties and the use of countervailing duties against imports **from NMEs**⁹. (Emphasis added)

The reference to the Ad Note in the heading of Paragraph 1 is explicit, and therefore it seems reasonable to infer that the definition of the Ad Note is, for the Dispute Settlement

⁹ WTO, *US – Antidumping and Countervailing Duties*, Appellate Body Report, WT/DS/379, 11 March 2011, para. 14.119.

Body (DSB), a definition of a NME. This interpretation is confirmed by the Appellate Body in the case EC – Fasteners, in a footnote to its decision:

We observe that the second Ad Note to Article VI:1 refers to a “country which has a complete or substantially complete monopoly of its trade” and “where all domestic prices are fixed by the State”. **This appears to describe a certain type of NME**, where the State monopolizes trade and sets all domestic prices¹⁰. (Emphasis added).

However, the Appellate Body continues:

The second Ad Note to Article VI:1 would thus not on its face be applicable to lesser forms of NMEs that do not fulfill both conditions, that is, the complete or substantially complete monopoly of trade and the fixing of all prices by the State¹¹. (Emphasis added)

This leads to the interpretation that, although the Ad Note provides a definition of a NME, it does not cover the whole meaning of the expression. As the Appellate Body stated, there are other forms of NMEs besides *a country which has a complete or substantially complete monopoly of its trade and where all domestic prices are fixed by the State*. Even though the Ad Note may not be applicable to such other forms of NMEs, they could be recognized as so.

The matter of NME was also addressed in the Agreement on Subsidies and Countervailing Measures (SCM). Article 29 approaches the market economy issue while dealing with time-frame extensions for countries in transition to market economies:

Article 29: Transformation into a Market Economy

29.1 Members in **the process of transformation from a centrally-planned into a market, free-enterprise economy, may apply programmes and measures necessary for such a transformation.**

Article 29.3 determines that countries considered to be in the process of transformation from a centrally-planned into a market-oriented economy (Article 29.1) shall notify the Committee on Subsidies and Countervailing measures of subsidies to which Article 3 of the SCM Agreement would apply. The lack of a legal definition enables WTO Members to decide politically on the matter to some extent. Notifications under Article 29.3 of the SCM Agreement were submitted by countries that were transitioning to a market economy.

The Agreement on Trade Related Intellectual Property Measures (TRIPS) also handles the market economy or NME condition in order to rule over measures that may arise from the transitional situation:

Article 65

Transitional Arrangements

3. Any other Member which is in the **process of transformation from a centrally-planned into a market, free-enterprise economy and which is undertaking structural**

¹⁰ WTO EC – Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China (DS397), WT/DS397/AB/R, Appellate Body Report adopted on 15 July 2011, para. 285, footnote 460.

¹¹ *Ibid.*

reform of its intellectual property system and facing special problems in the preparation and implementation of intellectual property laws and regulations, **may also benefit from a period of delay** as foreseen in paragraph 2. (Emphasis added)

The Anti-Dumping Agreement (ADA) is more cautious. In its Article 2.2, there is a vague concept that is not further explored:

2.2 When there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country or when, **because of the particular market situation** or the low volume of the sales in the domestic market of the exporting country, such sales do not permit a proper comparison, the margin of dumping shall be determined by comparison with a comparable price of the like product when exported to an appropriate third country, provided that this price is representative, or with the cost of production in the country of origin plus a reasonable amount for administrative, selling and general costs and for profits. (Emphasis added)

Paragraph 2.7 of the same Article asserts that its provisions are *without prejudice to the second Supplementary Provision to paragraph 1 of Article VI in Annex I to GATT 1994*. These specific clauses were never discussed in the DSB with a view to determine their relationship, and there is, up until now, no clear definition as to what a particular market situation is, although it seems to have a much wider meaning than a NME, since such a market situation can also prevail in a specific sector of a market economy, e.g. a natural monopoly.

The Agreement on Agriculture in its preamble only points out to a market-oriented agricultural trading system:

Recalling that their long-term objective as agreed at the Mid-Term Review of the Uruguay Round "is to establish a **fair and market-oriented** agricultural trading system and that a reform process should be initiated through the negotiation of commitments on support and protection and through the establishment of strengthened and more operationally effective GATT rules and disciplines". (Emphasis added)

All other agreements of the Uruguay Round are silent on the matter.

World Bank

Like other international organizations, the World Bank has not explicitly defined what a market economy is. However, in its reports and studies, especially on countries in transition to market economies during the 1990s, some standards were defined. Those reports provide an overview of the economy and discuss policy reforms and institutional changes deemed necessary for achieving a quick transition from a centrally planned to a market economy, after some members have applied for membership.

Czechoslovakia had reapplied membership in 1991 and requested the World Bank and IMF's assistance into changing to a market economy. On the country report, the World Bank makes the following statements:

A market economy requires a modern banking system with a clear division of labour

between the Central Bank in charge of monetary policy and bank supervision on the one hand, and the commercial banking sector on the other¹².

The state must play an active role to promote competition and avoid monopolies. The implementation of anti-trust legislation and regulations are the most obvious requirements, but not the only ones. Thus, the state also needs to avoid controls and regulations that may be used to strengthen monopoly powers (for example, controls on the establishment or expansion of economic activities not clearly justified by necessary zoning, health and safety considerations; or the allocation of import licenses for essential-inputs to a favoured group of producers). There may also be a need for a positive program to encourage new entrants in to particular activities¹³.

The World Bank also points at price controls as a relevant issue when assessing the proper functioning of a market economy. Such controls are admitted only in extraordinary circumstances:

(...) (A) market economy cannot function properly without competition and the freedom to set prices and that, eventually, price controls will remain for only few activities, such as natural monopolies like water, electricity, and gas, and social services like health care, as in other market economies¹⁴.

2. National definitions

Complementing the international provisions on market economy or NME, some countries have more specific legal definitions and procedures which often become reference to other countries' domestic legal system.

United States

The United States (US) legal system is based on common law, and some acts are compiled under the US Code (USC). Its Tome 19 treats Customs Duties issues and regulations and defines what a NME is under the Section 771(18) of the Tariff Act of 1930 and, as amended, under 19 USC § 1677(18):

(18) Nonmarket economy country (A) In general

The term “**nonmarket economy country**” means any foreign country that the administering authority determines does not operate on market principles of cost or pricing structures, so that sales of merchandise in such country do not reflect the fair value of the merchandise. (Emphasis added)

(B) Factors to be considered

In making determinations under subparagraph (A) the administering authority shall take into account—

(i) the extent to which the currency of the foreign country is convertible into the currency of other countries;

(ii) the extent to which wage rates in the foreign country are determined by free bargaining between labour and management,

¹² World Bank, “Czechoslovakia: Transition to a Market Economy”, *The World Bank Country Studies*, Washington, 1991, p. xx.

¹³ *Ibid*, p. 43.

¹⁴ *Ibid*, p. 56

- (iii) the extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country,
 - (iv) the extent of government ownership or control of the means of production,
 - (v) the extent of government control over the allocation of resources and over the price and output decisions of enterprises, and
 - (vi) such other factors as the administering authority considers appropriate.
- (C) Determination in effect
- (i) Any determination that a foreign country is a nonmarket economy country shall remain in effect until revoked by the administering authority.
 - (ii) The administering authority may make a determination under subparagraph (A) with respect to any foreign country at any time.

If a country has not been formally designated as a NME, it is presumed to be a market economy. If an interested party alleges that the country is a NME and documents its allegation with respect to each of the factors listed above, the DoC will initiate a formal inquiry to determine whether the country should be treated as a NME or not.

The Title 12 that regulates banks and banking brings, under 12 USC §635, brings the definition of a Marxist-Leninist country:

- (B) Marxist-Leninist country defined.—
- (i) In general.—For purposes of this paragraph, the term “**Marxist-Leninist country**” means any country that maintains a centrally planned economy based on the principles of Marxism-Leninism, or is economically and militarily dependent on any other such country.

As for a market economy, there is a definition under 19 USC §2703a (d), which contains conditions for Haiti to receive economic aid:

- (d) Eligibility requirements
- (1) In general
- Haiti shall be eligible for preferential treatment under this section if the President determines and certifies to Congress that Haiti:
- (A) has established, or is making continual progress toward establishing:
 - (i) **a market-based economy that protects private property rights, incorporates an open rules-based trading system, and minimizes government interference in the economy through measures such as price controls, subsidies, and government ownership of economic assets;**
 - (...)

Regarding the Russian Federation, the United States recognized Russia as a market economy on June 7, 2002¹⁵.

European Union

The European Community had laid down several market economy features a NME producer should have in order to demonstrate that it operates under Market Economy conditions in Art. 7(c) of its Council Regulation (EC) No 384/96. Due to the paradigm change on NME discussion caused by size of China’s economy, the Council Regulation

¹⁵ As provided by Pub. L. 107–246, § 2, Oct. 23, 2002, 116 Stat. 1511

EC 1225/2009 repealed that document and added new and more specific clauses. About NMEs, its legal text determines, on Article 7, that:

(b) In anti-dumping investigations concerning imports from the People's Republic of China, Vietnam and Kazakhstan and any non-market economy country which is a member of the WTO at the date of the initiation of the investigation, normal value shall be determined in accordance with paragraphs 1 to 6, if it is shown, on the basis of properly substantiated claims by one or more producers subject to the investigation and in accordance with the criteria and procedures set out in subparagraph (c), that market economy conditions prevail for this producer or producers in respect of the manufacture and sale of the like product concerned. When this is not the case, the rules set out under subparagraph (a) shall apply.

(c) A claim under subparagraph (b) must be made in writing and contain sufficient evidence that the producer operates **under market economy conditions, that is if:**

- decisions of firms regarding prices, costs and inputs, including for instance raw materials, cost of technology and labour, output, sales and investment, are made in response to market signals reflecting supply and demand, and without significant State interference in this regard, and costs of major inputs substantially reflect market values,
- firms have one clear set of basic accounting records which are independently audited in line with international accounting standards and are applied for all purposes,
- the production costs and financial situation of firms are not subject to significant distortions carried over from the former non-market economy system, in particular in relation to depreciation of assets, other write-offs, barter trade and payment via compensation of debts,
- the firms concerned are subject to bankruptcy and property laws which guarantee legal certainty and stability for the operation of firms, and
- exchange rate conversions are carried out at the market rate. (Emphasis added)

The conditions to be fulfilled by countries acceding to the European Union (EU) shed some further light on the matter. According to the Treaty on European Union, Article 49, any European State that desires to join the European Union shall be welcome to do so as long as it respects the European Union principles stated at Article 6 of the same treaty¹⁶. Also, a broad analysis of the institutional and systemic reforms required for an acceding member to be able to respect such principles will be done by the EU.

In June 1993, during the European Council meeting at Copenhagen, the conditions for countries aiming to accede to the EU were further developed into a series of criteria: the Copenhagen Criteria¹⁷. These criteria list necessary attributes for a country to be able to join the European Union and included “*a **functioning market economy, as well as the ability to cope with the pressure of competition and the market forces at work inside the Union.***”

Concerning the accession of former USSR members, a more specific description relating to acceding countries of Central and Eastern Europe to the EU was outlined¹⁸:

- ii) The European Council welcomed the courageous efforts undertaken by the associated countries to modernize their economies, which have been weakened by 40 years of central

¹⁶ These are the principles of liberty, democracy, respect for human rights and fundamental freedoms, and the rule of law. See EU, *Treaty on European Union*, Maastricht, 7 February 1992, Article 6.

¹⁷ See EU, *European Council Meeting*, Copenhagen, 21-22 June 1993, DOC/93/3.

¹⁸ *ibid*, point 7A.

planning, and to **ensure a rapid transition to a market economy**. The Community and its Member States pledge their support to this reform process. Peace and security in Europe depend on the success of those efforts.

iii) The European Council today agreed that the associated countries in Central and Eastern Europe that so desire shall become members of the European Union. Accession will take place as soon as an associated country is able to assume the obligations of membership by **satisfying the economic and political conditions required**.

Membership requires that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, the **existence of a functioning market economy** as well as the capacity to cope with competitive pressure and market forces within the Union. Membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union. (Emphasis added)

Hence, the EU regards as market economies all its 27 members, including the former socialist states, as expressly declared in their Protocols of Accession. Similarly, the EU established a framework for EU negotiations with the Western Balkan countries (also comprising financing programs): the Stabilization and Association Process¹⁹, to be followed and updated until the countries' eventual accession. The Process has amongst its aims: stabilizing the countries and **encouraging their swift transition to a market economy**.

This kind of EU initiative demonstrates the weight it gives to the existence of a market economy in order for a country to be part of the Union and for it to function properly. There is no single recipe, however, for which reforms are needed in order to achieve a functioning market economy as the EU will work with acceding members in a case-by-case manner, addressing each country's specific needs.

Brazil

Brazil also has specific norms on the matter of determining NMEs in the context of antidumping legislation. The Decree 1.602, dated 23 August 1995, enacts administrative procedures of anti-dumping investigation and states:

Art.7 In finding difficulties in determining the normal value in case of imports from not predominantly market oriented economies, where domestic prices are mainly fixed by the state, the normal value can be determined using the actual amounts incurred and realized by the exporter or producer in question or can be a constructed value of a like product in a third market economy country, or the export price to other countries, exclusive Brazil, or, whenever that is not possible, the normal value can be based on any other reasonable method, including the price paid or price to pay by the similar product on Brazilian market, duly adjusted, if necessary, in order to include a reasonable profit margin.

¹⁹ European Community Commission, *Communication from the Commission to the European Council and Parliament*, Brussels, 26 May 1999, COM(1999)235. See also, European Council, *Conclusions on the Development of a Comprehensive Policy Based on the Commission Communication on "The Stabilisation and Association Process for Countries of South-Eastern Europe*, 2192nd Council meeting, General Affairs, Luxembourg, 21-22 June 1999.

Circular N. 59, dated 28 November 2001, clarifies some provisions of the aforementioned Decree. Article 3.2 defines economies in transition:

3.2 Considering the transformations undergone by several countries with economies that are traditionally non-market orientated economies, which reached the stage of economies in transition having implemented important measures with a view to removing state monopolies and the control and state intervention on domestic prices, the following understanding will be adopted:

3.2.1 The **following countries are considered as economies in transition**: Bulgaria, the Slovak Republic, Slovenia, Hungary, Poland, Romania and the Czech Republic.

3.2.2 As regards the initiation of the investigation involving the countries mentioned in paragraph 3.2.1, the provisions of Article 7 of Decree 1.602, of 1995, shall not apply. However, **if during the investigation it is verified that the market rules do not prevail in the sector** where the producer/exporter under investigation operates, the **provisions of Article 7 may be applied** for the calculation of the normal value. (Emphasis added)

The Circular 59/2001's Article 3 also states:

3.3 For the assessment of the **existence of market economy conditions**, the following elements, "*inter alia*", will be observed:

- (a) the degree of government control over the companies or over the means of production;
- (b) the level of state control over the allocation of resources, over prices and over the production decisions by companies;
- (c) the legislation to be applied in terms of ownership, investment, taxation and bankruptcy;
- (d) the degree of freedom in the determination of wages in negotiations between employers and employees;
- (e) the level at which distortions inherited from the centralized economy system persist in relation to, *inter alia*, assets amortization, other assets deductions, direct swap of assets and payments in the form of debt compensation; and
- (f) the level of state interference on currency exchange operations. (Emphasis added)

In any case, companies from NMEs countries may request market economy treatment for their specific markets, for the purpose of dumping investigations.

The NME treatment of China is under discussion in Brazil. In 2004, Brazil signed the "Memorandum of Understanding on Trade and Investment Cooperation Between the People's Republic of China and the Federative Republic of Brazil", recognizing China as a market economy.

However, such declaration of market economy recognition, to have effect on the domestic legal system, must be internalized, through an act of the Executive Power, specifically through a Circular passed by SECEX of MDIC, as it happened in other instances (Russia, Ukraine, Slovakia, Slovenia, Estonia, Hungary, Latvia, Lithuania, Poland, Czech Republic, Bulgaria and Romania). No Circular on China has been enacted yet, meaning that, for internal purposes, China is still considered a NME.

3. Conclusions

The definition of a NME is imprecise, especially when it attempts to cover multiple economic situations in which a country relies upon different degrees of government interference in its economy. The case of transitional economies is particularly difficult to comprehend. During a transitional period in which the economy will neither be centrally planned nor a market economy, the Government is required to intervene on behalf of the consumer, and anti-competitive behavior may arise from the possible distortions to the market. To assist countries in that endeavor, assistance is granted in the form of special conditions and periods extensions to fully abide by the WTO norms while reforms take place.

From the WTO normative system and Accession Protocols, it can be inferred that the main legal provisions to deal with the presence of NMEs in the WTO are related to the determination of normal value for dumping investigations, and that the supporting treaties are deliberately vague due to the difficulty of regulating such complex economic feature.

This explains why the definitions of NMEs, both under the WTO and several national legislations can only be found in the limited context of dumping investigations. A more comprehensive discussion over the issue was seldom undertaken under the Multilateral System. Nevertheless, as it will be discussed below, NMEs' impact on the WTO system goes well beyond antidumping rules.

II. NMES AT THE MULTILATERAL TRADING SYSTEM

1. The GATT era

At the end of World War 2, nations aimed at creating an international economic framework which would regulate economic relations of all countries, capitalists and socialists. The so-called Bretton Woods system would have included, in addition to the International Monetary Fund (IMF) and the World Bank, an International Trade Organization (ITO).

The founding document for the ITO, the Havana Charter, contained provisions enabling the participation of NMEs in the projected trading system. Nevertheless, both because the USSR decided not to participate in the negotiations and because of the strengthening of the Cold War rivalry, these provisions on NMEs were gradually weakened. In the GATT, initially seen as a provisional agreement to the creation of the ITO, only one of those provisions dealing with NME subsisted: GATT Article XVII, on state-trading enterprises (STEs).

The ITO never came into force and the GATT was the main source of multilateral trade regulation for almost 50 years. It did not concentrate in finding ways to adapt socialist economies to its framework, partly because of its provisional status and also because of the lack of interest of the USSR in the emerging Multilateral Trading System.

Even the applicability of Article XVII to NMEs was questioned: Grzybowski affirms that when the Article binds state-trading enterprises to make transactions solely in accordance with commercial considerations, it theoretically excludes *other motivations, which seems to contradict the basic tenets of economic planning in a socialist country of the soviet type*²⁰.

The first difficulties of applying GATT rules to NMEs arose during the 1950s with the transition of Czechoslovakia, a GATT founding member, towards a centrally-planned economy. One of the first issues brought up was the calculation of dumping margins and the determination of normal value.

Czechoslovakia argued that *no comparison of export prices with prices in the domestic market of the exporting country is possible when such domestic prices are not established as a result of fair competition in that market, but are fixed by the State*²¹. The main problem was that, since the prices inside the country were fixed, they could often be higher than export prices, which led to the determination of dumping by other countries and consequent application of antidumping rights.

Czechoslovakia proposed, thus, an amendment to Article VI, by which, in countries where the domestic prices were fixed by the State, the margins of dumping should be calculated using (i) the “*average comparable price for the like product for export by third countries to the importing country in question in the ordinary course of trade*”, or (ii) in the absence of such price, the average comparable price for the like product for export by the exporting country to third countries, or (iii) the cost of production plus a reasonable addition for selling cost and profit²².

The GATT Contracting Parties did not accept the proposal, but agreed on adding an Interpretative Note on Article VI, affirming that in the case of imports from a country with complete or substantially complete monopoly of trade and where domestic prices are fixed by the State, special difficulties may exist in determining price comparability based on prices practiced on the domestic market, and members may find that such strict comparison may not always be appropriate²³.

In practice, however, the use of a third country, as proposed by Czechoslovakia, became the common alternative methodology and was later explicitly mentioned at the Working Party on the Accession of Poland²⁴.

²⁰ GRZYBOWSKI, K., “Socialist Countries in GATT,” *The American Journal of Comparative Law*, v. 28, n. 4, Autumn, 1980, p 548.

²¹ GATT, *Article VI – Proposals by the Czechoslovakia Delegation – Revision*, W.9/86/Rev.1, Review Working Party II on Tariffs, Schedules and Customs Administration, Contracting Parties Ninth Session, 21 December 1954, W.9/86/Rev. 1

²² *Ibid.*

²³ GATT, *Report of Review Working Party III on Barriers to Trade other than Restrictions or Tariffs*, Contracting Party Ninth Session, L/334, 1 March 1955.

²⁴ GATT, *Report of the Working Party on the Accession of Poland*, 23 June 1967, L/2806, p. 3, §13

The transition of Czechoslovakia (to a NME) also brought difficulties in the application of Article XV:6. The provision deals with the membership of the contracting parties at the International Monetary Fund, stating that parties that fail to join the Fund shall enter into special exchange arrangements with the CONTRACTING PARTIES. The Article aimed to avoid parties to adopt exchange rate policies incompatible with the rules of the multilateral financial system that could impact on international trade.

Czechoslovakia claimed that a country with complete monopoly of foreign trade could change the par value of its currency without affecting international commercial transactions and without impairing any concessions made under the GATT. Thus, a waiver from the obligations under GATT Article XV:6 was accorded to the country²⁵.

The case of Czechoslovakia is relevant because it shows that its transition to a centrally planned economy was never regarded, neither by other contracting parties, nor by itself, as incompatible with its obligations in the Multilateral Trading System. The parties considered the need to adjust some of the rules, in order to adapt to the particularities of centrally planned economies, but the core of the system would remain intact.

The second NME acceding to the GATT, Yugoslavia, was already a centrally planned economy. In that case, GATT contracting parties formally requested from Yugoslavia some changes in its commercial policies, in order to make it able to participate in the GATT.²⁶

The 1959 Decision on relations with Yugoslavia affirms that *the government of Yugoslavia is not at present in a position to assume all the obligations involved in accession to the General Agreement*²⁷. Parties agreed, thus, that Yugoslavia would endeavor, in the development of arrangements affecting its commercial policies, to move progressively toward a position in which it can give full effect to the provisions of the General Agreement²⁸.

Yugoslavia did not become a market economy, but it undertook some important changes which allowed its provisional admittance to the GATT in 1962²⁹. Such reforms included: the elimination of state intervention in the activities of individual enterprises and business decision-making; the adoption of customs tariffs; the promotion of a reform in the pricing system, allowing free pricing for a range of commodities and removing certain price limits for basic industries; and the decentralization of investment resources, reducing the role of government in investment financing.

²⁵ GATT, *Waiver granted to Czechoslovakia of the provisions of Article XV:6 (Decision of 5 March 1955, SR.9/45, Contracting Parties Ninth Session, 18 March 1955.*

²⁶ GATT, *Report of the Working Party on the Accession of Yugoslavia, , L/2562, 24 February 1966.*

²⁷ GATT, *Decision on Relations with the Federal People's Republic of Yugoslavia, L/986, Contracting Parties Fourteenth Session, 16 May 1959.*

²⁸ *Ibid.*

²⁹ GATT, *Provisional Accession of Yugoslavia, L/1939, Contracting Parties Twentieth Session, 13 November 1962.*

Finally, in 1966, despite the fact that Yugoslavia clearly was yet a NME, it acceded to the GATT³⁰. It can however be argued that the entry of Yugoslavia under “market conditions” owed more to political than economic reasons, to reinforce Yugoslavia’s non-alignment with the USSR and thus further restrain soviet influence over the region³¹.

The following NME to accede to the GATT was Poland, in 1967. Its accession contrasts with Yugoslavia’s, because some special provisions were devised for application to Poland that differed from the obligations of all other GATT contracting parties. No change was requested from Poland’s economic system; this time the adaptation lied on the rules applicable to the country.

The adjustments proposed by Czechoslovakia were also applied to Poland³². Regarding the application of the Interpretative Note to Article VI:1, the Working Party Report acknowledged the possibility of using the surrogate country methodology (the construction of the normal value based on the prices of the same product produced in another country), which was not expressly foreseen in the Note.

Since Poland did not have any customs tariff, its concessions were based on import commitments: Poland committed to increase the total value of its imports from the territories of the contracting parties by no less than 7% per annum. Also, to counter any sharp increase on imports of Polish products under non market conditions, a specific safeguard mechanism was created.

Furthermore, members were permitted to maintain quantitative restrictions against Poland, even if these were inconsistent with GATT Article XIII, provided that the discriminatory element of the restriction was not increased and was progressively relaxed.

The accession of Poland became a model for future NME accessions. In the case of Romania, which acceded in 1971, the only significant difference was in its Schedule of Commitments, where it committed to “*increase its imports from the contracting parties as a whole at a rate not smaller than the growth of total Romanian imports provided in its Five-Year Plans*”³³. This provided some flexibility to its obligations on imports, if compared to Poland.

The accession of Hungary, in 1973, presented a few more differences: the country already had a customs tariff and had recently undertaken a reorganization of the central management of its economy, which, according to Grzybowski, would have introduced

³⁰ GATT, *Report of the Working Party on the Accession of Yugoslavia*, L/2562, 24 February 1966.

³¹ See POLOUEKTOV, Alexander, “*The Non-Market Economy*” *Issue in International Trade in the Context of WTO Accessions*, Unctad/DITC/TNCD/MISC.20, Unctad Report, 9 October 2002, p. 39.

³² GATT, *Accession of Poland*, L/2851, 19 September 1967, para. 8; and GATT, *Accession of Poland Report of the Working Party*, L/2806, 23 June 1967, para. 13

³³ GATT, *Protocol for the Accession of Romania to the GATT*, BISD § 18S/5 (Eighteenth Supplement, Twenty-Seventh Session, 1969-1970), April 1972

market relations³⁴. The economic changes did not alter the planned character of the country's economy, but it allowed Hungary to negotiate concessions under a tariff base. Nevertheless, it remained subject to quantitative restrictions and special safeguards by other contracting parties. It also reserved its position with respect to Article XV:6 and was subject to the application of the Interpretative Note on Article VI³⁵.

The GATT made, therefore, only few adaptations in order to accommodate NMEs into its framework, but it never fully closed itself to the participation of such countries. According to Jackson, as the sole "offspring" of the failed ITO, the GATT attempted to accommodate different market structures, not only NMEs, but also countries with different levels of industrial development and with policies of economic development not fully consistent with market oriented principles³⁶.

The accessions of Poland, Romania and Hungary show the range of adjustments allowed in GATT rules.

These adjustments were referred by Jackson as the "interface principle". The idea was to create mechanisms that would mediate between the different economic structures, providing rules to reduce the incompatibilities among them³⁷. The negotiations of quotas instead of tariffs and the creation of specific safeguard mechanisms in NMEs accessions to the GATT are vivid examples of that approach.

But Jackson also stresses that the NMEs participating in the GATT system were relatively small and the accession of China or the USSR could create much more significant impacts, demanding either a more complex interface system or a decision to revert GATT to being a forum designated primarily for market oriented economies³⁸.

2. The WTO era

With the collapse of communist regimes in Eastern Europe, a number of countries were willing to promote significant economic reforms towards a market oriented economy. Their accessions triggered a change of direction in how the Multilateral Trading System approached NMEs: instead of adapting WTO rules to integrate NMEs, the main concern was to promote a more efficient transition of such economies.

Interestingly, the accession of Yugoslavia to the GATT became the main reference in that new approach, to a certain degree. In the same way as Yugoslavia had been required to undertake reforms such as the adoption of customs tariff, the transition economies had to

³⁴ GRZYBOWSKI, K., "Socialist Countries in GATT," *The American Journal of Comparative Law*, v. 28, n. 4, Autumn, 1980, p 549

³⁵ GATT, *Report of the Working Party on the Accession of Hungary to the GATT*, BISD § 20S/3-8 (Twentieth Supplement, Twenty-Ninth Session, 1971-1972), January 1974, p. 3, § 18.

³⁶ JACKSON, John H., *Restructuring the GATT System*, Royal Institute of International Affairs, London, 1990, pp. 81-82

³⁷ *Ibid*, pp. 84-85..

³⁸ *Ibid*, p. 82.

promote economic reforms in a much deeper way than the ones required during GATT era to be granted membership in the WTO.

Acceding members, such as Mongolia, Bulgaria, the Kyrgyz Republic, Latvia, Estonia, Albania, Croatia, Georgia, Lithuania and Moldova, were required to commit to obligations in the fields of: foreign exchange; state ownership and privatization; pricing policies; trading rights; subsidies; industrial policy; state-trading enterprises and transparency³⁹.

The WTO agreements provided a few rules specifically devoted to transition economies (e.g., Article 29 of the SCM and Article 65 of TRIPS), mostly granting them more time to enforce their obligations, but there were no material changes in the WTO rules in order to allow a better participation of these economies.

A different approach to the integration of NMEs into the Multilateral Trading System was also a consequence of the evolution of the System itself over time. With the successful GATT rounds of negotiation, tariff levels had been significantly reduced and non-tariff measures had become the major perceived obstacle to trade liberalization. The WTO extended its scope to measures once considered of domestic competence, bringing the organization's influence into domestic policy making.

The position of WTO members vis-à-vis the transition process from non-market to market economy evolved from “adaptations and incentives” to “obligations”, since NMEs practices became incompatible with a more integrated Multilateral Trading System. The interface principle was no longer sufficient to allow the functioning of the rules: new members were required to undertake deep economic reforms towards a market oriented model in order to fully comply with WTO rules.

3. The accession of China to the WTO

The Chinese accession in 2001, and Viet Nam's accession in 2007, followed this new pattern, and represent interesting examples of the new approach.

China was the first large NME to integrate the WTO system. While other NMEs had little weight in international trade and, thus, any distortions to competition could be easily overlooked by other members, China had a much larger economy, which could cause greater impact on other members' economies. The accommodation of China in the system would necessarily be more complex than other NMEs, as every NME feature could give rise to disruptions in other markets.

In its accession process, China committed: to accord non-discriminatory treatment at the procurement of inputs and goods and in respect of the prices and availability of goods and services supplied by governmental authorities; to liberalize the availability and scope of the right to trade; to refrain from taking measures to influence or direct state-trading

³⁹ POLOUEKTOV, Alexander, “*The Non-Market Economy*” Issue in International Trade in the Context of WTO Accessions, Unctad/DITC/TNCD/MISC.20, Unctad Report, 9 October 2002, p. 26.

enterprises, except in accordance with WTO Agreements; to allow prices for traded goods and services in every sector to be determined by market forces; to eliminate export subsidies on agricultural products, amongst others.

China's Protocol of Accession⁴⁰ also has provisions on: a progressive elimination of quantitative measures imposed by other members that are incompatible with WTO Agreements; the application of transitional specific safeguards; the use of alternative methodology for the determination of normal value in the calculation of dumping margins; a special safeguard for textiles; special methodologies for identifying subsidy benefits.

In one hand, China's Protocol has a series of obligations that should lead China towards a market oriented economic system, an essential feature for the smooth functioning of the WTO system. On the other hand, the Protocol contains interface mechanisms, some of provisional character, similar to those used for NMEs during the GATT era.

4. Conclusions

The failure to establish the International Trade Organization (ITO) led to a lack of specific trade rules applying to international trade between planned and market economies. Article XVII of the GATT dealt with only a minimal spectrum of the challenges posed by the subject. The process of accession of NMEs to the GATT, during the subsequent years, put on view some of these challenges and how they were dealt with in the protocols of accession – mainly through buffer mechanisms and import obligations.

As the Multilateral Trading System gradually changed its focus, from import tariffs to non-tariff barriers, and started to supervise internal policy measures from its members in order to guarantee a level playing field, so did the adaptations required for the accession of NMEs. With the creation of the WTO, there was a substantial change in the nature of obligations imposed on acceding NME countries in order to preserve the well functioning of the system. They now focus on a systemic approach, requiring deep economic changes and an adaptation of the development model of the acceding NME.

III. IMPACTS OF NMEs ON THE WTO SYSTEM

The shift in the treatment of NMEs when acceding to the WTO attempted to respond to the practical difficulties brought by competition on the international market with products from NMEs, whose weight in some economic sectors can have an important trade impact. The Economist highlighted some of the fears of market economies:

Another concern is the impact of the model on the global trading system (...). Ensuring that trade is fair is harder when some companies enjoy the support, overt or covert, of a national government. Western politicians are beginning to lose patience with state-capitalist powers that rig the system in favor of their own companies. For emerging countries wanting to make

⁴⁰ WTO, *Protocol of Accession of the People's Republic of China*. WT/L/432, 10 November 2001.

their mark on the world, state capitalism has an obvious appeal. It gives them the clout that private-sector companies would take years to build⁴¹.

In light of these concerns and considering the impact that the Chinese accession has had to the Multilateral Trading System, it is worth analyzing what exactly are the trade rules and instruments that are not adapted or would not be fit to deal with trade from NMEs

1. Impacts on Multilateral Trading System instruments

First of all, it is important to stress that, after the end of the socialist block and the gradual transition of planned economies to market-oriented ones, it is hard to determine, today, a whole economy as planned or as NME. Nevertheless, one can identify “forms of NMEs”⁴² with different levels of government interference in the economy. This central planned interference can attain different levels and might indicate NME features that may cause difficulties in the application of WTO rules. It is also interesting to indicate that these features are not exclusive to socialist or transition economies, being identifiable, albeit in lesser levels, in western market economies in different moments of their history⁴³.

During the GATT period, the contracting parties were mainly concerned with two aspects of NME inconsistencies with the Multilateral Trading System: governments had the monopoly of international trade; and internal prices were fixed by the government.

The monopoly of international trade dictated that import tariffs. The inadequacy of import tariffs was overcome by import commitments from acceding NMEs. This solved the immediate problem of market access but could not be extended to all acceding members since it created another market distortion by forcing artificial levels of import rather than regular market forces to dictate trade between the contracting parties⁴⁴.

The real problem underlining the initiative was how to reconcile market access negotiations and obligations with the state control of market decisions. The multilateral negotiations were based under the premise that, apart from the barriers to trade imposed by countries, economic agents would be free to seek products from whichever market offered the best prices and conditions. The fact that imports were actually centrally decided undermined this principle and was irreconcilable with the dynamics of multilateral negotiations.

In fact, the GATT already acknowledged the difficulties brought by import control by the State, through import monopolies. Its Article II.4 establishes that:

⁴¹ The rise of state capitalism, *The Economist*, 21 January 2012. Available at: <<http://www.economist.com/node/21543160>>. Viewed at: 27 January 2012.

⁴² See WTO, AB, *EC – Definitive Anti-Dumping Measures on Certain Iron or Steel Fasteners from China* (DS397), WT/DS397/AB/R, AB Report adopted on 15 July 2011, para. 285, footnote 460.

⁴³ HUANG, Chien, “Non-market Economies Accessions to the WTO: An Empire is Rising?”, *ISA Annual Convention*, San Francisco, CA, March 23-26, 2008, p. 17

⁴⁴ POLOUEKTOV, Alexander, “*The Non-Market Economy*” *Issue in International Trade in the Context of WTO Accessions*, Unctad report, 9 October 2002, UNCTAD/DITC/TNCD/MISC.20, p. 10.

If any contracting party establishes, maintains or authorizes, formally or in effect, a **monopoly of the importation** of any product described in the appropriate Schedule annexed to this Agreement, *such monopoly shall not*, except as provided for in that Schedule or as otherwise agreed between the parties which initially negotiated the concession, **operate so as to afford protection on the average in excess of the amount of protection provided for in that Schedule**. The provisions of this paragraph shall not limit the use by contracting parties of any form of assistance to domestic producers permitted by other provisions of this Agreement. (Emphasis added).

In this sense, the GATT sought to restrain the domestic market protection afforded through import monopoly to the limits established in each party's Schedule of Concessions. These, however, translated market access obligations into import tariffs. It is thus hard to imagine a practical and efficient way to translate the market access granted through a given bound tariff rate into import obligations. Considering these difficulties, an Interpretative Note to Article II.4 was adopted stating that:

Except where otherwise specifically agreed between the contracting parties which initially negotiated the concession, the provisions of this paragraph will be applied in the light of the provisions of Article 31 of the Havana Charter.

The relevant part of Article 31 of the Havana Charter for this analysis is its Paragraph 5 that requires the contracting party that has imposed an import monopoly over a product to import and offer for sale *such quantities of the product as will be sufficient to satisfy the full domestic demand for the imported product*. This interpretation has been confirmed by two GATT panels⁴⁵. Once again, the definition of what would satisfy *the full domestic demand for the imported product* is hard to establish.

In any case, the direct reference of the Interpretative Note to Article II.4 to an Article of the Havana Charter highlights the difficulties imposed by the non-creation of the ITO for the purpose of integrating NMEs in the Multilateral Trading System. The Havana Charter had a whole section – Section D: State Trading and Related Matters – dedicated to dealing with such issues. It is interesting to note that during the GATT Review Session of 1954-55, the Review Working Party on Other Barriers to Trade considered proposals for amending the state trading provisions of the General Agreement either by consolidating them or by adopting Articles 29-31 of the Havana Charter, but these proposals failed to gather unanimous approval and were abandoned.

Another reaction to state monopoly of international trade was the possibility of contracting parties to apply special safeguards, specifically aimed at imports from the acceding NME countries. Also, the existing quantitative import restrictions could be maintained regarding these countries as long as they were progressively relaxed, although no final term was provided. The justification was the fear that, due to the weight of the State when compared with individual enterprises, a decision by a NME country to export

⁴⁵ GATT, *Japan – Restrictions on Imports of Certain Agricultural Products*, L/6253, Panel Report adopted on 2 February 1988, BISD § 35S/163, paras. 5.2.2.1-5.2.2.2 and the three parallel Panel Reports on *Republic of Korea - Restrictions on Imports of Beef*, L/6503, L/6504, L/6505, adopted on 7 November 1989, BISD § 36S/202, 234, 268

a particular product would cause considerable damage to some sectors of market economy countries. The competition of private owned enterprises with state backed ones was considered unfair and would justify these “buffer” mechanisms. In this sense, in order to promote a fair competition between members of The Multilateral Trading System, a separation between state and private producers would be required.

GATT Articles

There are many challenges in applying the Multilateral Trading System rules, as they are, to NMEs. Some of them are highlighted here.

Article XVII of the GATT regulates the participation of SOEs in the economy of the contracting parties so as to limit potential negative effects on fair trade between private and SOEs. It states that:

1. (a) Each contracting party undertakes that if it establishes or maintains a state enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges,* **such enterprise shall**, in its purchases or sales involving either imports or exports, **act in a manner consistent with the general principles of non-discriminatory treatment** prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

(b) The provisions of subparagraph (a) of this paragraph shall be understood to require that **such enterprises shall**, having due regard to the other provisions of this Agreement, **make any such purchases or sales solely in accordance with commercial considerations**,* including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

(c) **No contracting party shall prevent any enterprise** (whether or not an enterprise described in subparagraph (a) of this Paragraph) **under its jurisdiction from acting in accordance with the principles** of subparagraphs (a) and (b) of this paragraph.

Article XVII establishes the principles under which *all* enterprises should operate. In this sense, it seeks to obligate SOEs to act as private enterprises so as to afford the enterprises of other contracting parties adequate competition opportunity, guaranteeing fair trade. Although answering theoretically to the challenges posed by competition between private and SOE, subsequent practice has shown the difficulties in analyzing whether purchases by SOEs have been made *in accordance with commercial considerations*⁴⁶.

It is worth noting that the GATT did not regulate government procurement and Article XVII.2 extends this to government procurement made through SOEs. In this sense, another challenge is that one must separate purchases made for government purposes from those made in *regular commercial* trade while analyzing whether these have

⁴⁶ The cases *Korea — Various Measures on Beef* and *Canada — Wheat Exports and Grain Imports*, in the WTO, both demonstrated the difficulties in analyzing the *rationale* behind SOE import decisions and of the proof of whether they acted in accordance with commercial considerations..

respected commercial considerations. Article XVII.3 seems to acknowledge these challenges and the potential damage to fair trade of the abuse of SOEs, stating that:

3. The contracting parties recognize that enterprises of the kind described in Paragraph 1 (a) of this Article might be operated so as to create serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce such obstacles are of importance to the expansion of international trade

The solution proposed was that countries counting with SOEs should negotiate special agreements to limit or reduce the obstacles posed by SOEs. These special agreements demonstrate the exceptionality of state-controlled production in the Multilateral Trading System. Also, it is interesting to note that the Interpretative Note paragraph 3 of Article XVII makes reference to the special agreements made under Article II.4, which in turn refers to the dispositions present in the Havana Charter. Yet again the dispositions of GATT were considered insufficient to deal with NME features and the recourse to the non-adopted Havana Charter has been deemed necessary. The extent and economic presence of SOEs in NMEs further enhance the challenges posed by the subject and indicate the insufficiency of GATT rules to discipline competition between private and SOEs⁴⁷.

The second aspect of NMEs highlighted during GATT time was the fixing of domestic prices by the State. This problem was mainly linked to the difficulties in determining normal value in anti-dumping investigations and the Ad Note to Paragraph 1 of Article VI of GATT was considered as a suitable arrangement. Nonetheless, the fact that internal prices were not determined by market forces, but rather by the government, made it hard to guarantee any level of market access for certain products deemed as “sensitive” by each NME country. If the government decided, due to policy options, that, for instance, the price of a good should not surpass a determined level, it would be, in practice, impeding any imports of that product in higher prices than the one established. This problem, keen in the case of NMEs, was already highlighted by the GATT, in its Article III.9 that states:

The contracting parties recognize that internal maximum price control measures, even though conforming to the other provisions of this Article, can have effects prejudicial to the interests of contracting parties supplying imported products. Accordingly, contracting parties applying such measures shall take account of the interests of exporting contracting parties with a view to avoiding to the fullest practicable extent such prejudicial effects.

Although this practice has been used several times in Western countries considered to be market economies, the extent of its use and the economic justifications regarding NME practices brings further challenges to the implementation of the National Treatment principle.

Exchange rates

⁴⁷ In light of the creation of the WTO, an Understanding on the Interpretation of Article XVII of the GATT 1994 was adopted. It sought to enhance transparency in SOE matters and created a working party to review notifications and counter-notifications in the subject. However, no substantial modifications to the discipline of Article XVII were promoted and the WTO provided no further development in the subject.

Besides the issues above already highlighted in the accessions of NME during GATT time, it is possible to identify other challenges posed by the presence of NME in the Multilateral System, considering its present structure and legal order.

The control over exchange rates and the constraints on free currency convertibility has been indicated as of particular concern regarding some NME. The manipulation of exchange rates can be detrimental to imports both by its impact on tariffs as for the difficulties for economic agents to deal in international trade⁴⁸. GATT Article XV is the logical reference to deal with this issue, along with the surveillance of the IMF. Nevertheless, this subject is under much debate nowadays and an effective remedy against exchange rate manipulations is still under discussion. This brings unpredictability to the whole system, but is of particular concern regarding NMEs.

Subsidies

The practice of subsidies in NME also presents special difficulties related to the inherent relationship between the source of the subsidies – the government – and their main beneficiaries – SOE. The rules present in GATT Article VI and in the SCM do not solve all these specificities, making it difficult to identify mechanisms that would allow for a clear separation between subsidy beneficiaries and benefactors.

It is worth recalling that the reason why subsidies might be considered negative in the context of international trade is that they are governmental stimulus to direct resources to a particular sector of the economy. In this sense, the government would be influencing in the allocation of resources that would otherwise be directed to whichever sector of the economy presented better comparative advantages and better efficiency. If one considers that a NME feature would be precisely the allocation of the resources of the economy by the government, the very concept of subsidies may not fit properly to this reality. Nonetheless, the surveillance and discipline of subsidy programs is an important part of the functioning of the Multilateral Trading System and it would be to the detriment of the system's coherence to exclude NMEs from it.

Finally, the control over investments decisions/planning in NME can raise other kinds of challenges, which the narrow legal basis of the WTO in the subject would not be apt to resolve.

2. China's obligations

The accessions of NMEs to the WTO have produced much more debate and specific obligations to the acceding country than those during GATT. One can argue that this is due to the change in the nature of WTO obligations compared to those of GATT – being much more concerned today with policy aspects of members' international trade. Nonetheless, the accession of some countries to the WTO, deemed to be NME, have

⁴⁸ THORSTENSEN, Vera, MARÇAL, Emerson, FERRAZ, Lucas, (2011) - *Impacts of Exchange Rates on International Trade Policy Instruments: The Case of Tariffs*, Journal of World Trade, v. 46, i. 3, 2012

entailed especial obligations, reproduced in their respective Accession Protocols⁴⁹. These obligations can serve as indications of which aspects of their economies were considered to be in conflict with the legal and economic order of the WTO.

The analysis of the Protocol of Accession of China and of its Working Party Report offer some indications of the structural economic adaptations required of a NME in order to integrate itself in the Multilateral Trading System. Some key obligations are highlighted next.

Uniform administration of WTO rules over the territory

Under Article 2.A of the Accession Protocol, China must apply WTO rules in a uniform manner over all its territory, including border trade regions and minority autonomous areas, special economic zones, open coastal cities, economic and technical development zones. This is relevant since the planned-economy development model created several special zones in which trade rules could vary substantially. The uniform application of trade rules represents a considerable adaptation from this model.

Rule of Law

Article 2.C and 2.D requires the establishment of an official journal and of a judicial system, impartial and independent, with possibility of appeal. These two requirements can be interpreted as being necessary to implement the rule of law in China. These obligations relate to the manner by which obligations are negotiated, monitored and implemented in Western countries. In this sense, these obligations are considered imperative in order to adapt the Chinese system to the legal functioning of the WTO.

Non-discrimination – foreign capital and individuals

The Protocol of Accession, in its Article 3, establishes the obligation of China to concede national treatment for foreign individuals, enterprises and foreign-funded enterprises. Although this obligation extends to all WTO members, it has a special meaning for NME, since it implies that all foreign individuals and enterprises shall be free to participate in the economy of the country, at the same rate as nationals. This has particular implications to the treatment conceded to foreign capital in NMEs.

Right to Trade – monopoly of international trade

The right to trade and the monopoly of international trade by the State are main concerns for the well functioning of the Multilateral Trading System. In this regard, China WPR states that:

⁴⁹ It is worth noting that WTO members have expressly considered China to be “in the process of transition towards a full market economy”. WTO, Report of the Working Party on the Accession of China, WT/ACC/CHN/49, 1 October 2001, p. 29, para. 150.

80. Some members of the Working Party noted that China was in the process of liberalizing the availability of the right to import and export goods from China, but that such rights were now only available to some Chinese enterprises (totalling 35,000). In addition, foreign-invested enterprises had the right to trade, although this was restricted to the importation for production purposes and exportation, according to the enterprises' scope of business. Those members stated their view that such restrictions were inconsistent with WTO requirements, including Articles XI and III of GATT 1994, and welcomed China's commitment to progressively liberalize the availability and scope of the right to trade so that within three years after accession all enterprises would have the right to import and export all goods (...) ⁵⁰.

Articles 5 and 8 of the Protocol of Accession dealt with this subject. In order to conduct international trade *in a manner consistent with the WTO Agreement*, China must progressively liberalize the availability and scope of the right to trade for both its national and foreign individuals and enterprises (Article 5). This adaptation should be done, generally, in three years. Also import and export licensing should be liberalized and a justification by China would be required *for maintaining the restriction or its scheduled date of termination* (Article 8.b).

Price controls

Article 9 of the Protocol of Accession regulates price controls in China. This subject has been of key interest when dealing with NME. Article 9 states that China shall “allow prices for traded goods and services in every sector to be determined by market forces” and provides for the elimination of “multi-tier pricing practices”. In this manner, WTO members sought to address the problem highlighted by Article III.9 of the GATT.

At the time of accession, Chinese representatives recognized that:

52. There were presently three types of prices: government price, government guidance price and market-regulated price. The government price was set by price administration authorities and could not be changed without the approval of these authorities. Products and services subject to government pricing were those having a direct bearing on the national economy and the basic needs of the people's livelihood, including those products that were scarce in China ⁵¹.

Regarding this issue, China WPR states that:

50. Some members of the Working Party noted that China had made extensive use of price controls, for example in the agricultural sector. Those members requested that China undertake specific commitments concerning its system of state pricing. In particular, those members stated that China should allow prices for traded goods and services in every sector to be determined by market forces, and multi-tier pricing practices for such goods and services should be eliminated. Those members noted, however, that China expected to maintain price controls on the goods and services listed in Annex 4 to the Draft Protocol, and stated that any such controls should be maintained in a manner consistent with the WTO Agreement, in particular Article III of the GATT 1994 and Annex 2, paragraphs 3 and 4, of the Agreement on Agriculture. ⁵².

⁵⁰ *Ibid*, p 15.

⁵¹ *Ibid*, p. 10

⁵² *Ibid*, p. 10

China undertook the obligation to terminate, generally, the price control system, and to maintain only those contained at Annex 4 of the Protocol of Accession. In so, China also agreed not to implement price controls in such way as to provide further protection for its domestic market.

Subsidies and Countervailing Measures

Regarding the subsidisation of Chinese economy, the special characteristics of China's development model bring further challenges to the implementation of the SCM Agreement. In this sense, China WPR stated that:

171. Some members of the Working Party expressed concern that the special features of China's economy, in its present state of reform, still created the potential for a certain level of trade-distorting subsidization; this could have an impact not only on access to China's domestic market, but also on the performance of Chinese exports in the markets of other WTO Members, and should be subject to effective SCM Agreement disciplines. (...) The representative of China (...) informed the Working Party of the efforts being undertaken, as part of its ongoing reform process, to reduce the availability of certain types of subsidies⁵³.

Annex 5.A of the Accession Protocol of China brought a list of 22 types of subsidies, 3 of which should be phased out after accession (Annex 5.B). Those are: subsidies provided to certain state-owned enterprises which are running at a loss; the priority in obtaining loans and foreign currencies based on export performance; preferential tariff rates based on localization rate of automotive production.

Also, due to the difficulties in identifying subsidies in NMEs and determining specificity during countervailing duties investigations, Article 10.2 of the Protocol of Accession considered that *subsidies provided to state-owned enterprises will be viewed as specific if, inter alia, state-owned enterprises are the predominant recipients of such subsidies or state-owned enterprises receive disproportionately large amounts of such subsidies.*

State-Owned Enterprises

The rate of participation of SOEs in the economy is considered one of the most important features of NMEs. China undertook the obligation not to allow government interference in SOE commercial decisions, which would be dependent solely upon commercial considerations.

45. The representative of China emphasized the evolving nature of China's economy and the significant role of FIEs and the private sector in the economy. Given the increasing need and desirability of competing with private enterprises in the market, decisions by state-owned and state-invested enterprises had to be based on commercial considerations as provided in the WTO Agreement.

46. The representative of China further confirmed that China would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g., price, quality, marketability and availability, and that the

⁵³ *Ibid*, p. 34

enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions. In addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement. The Working Party took note of these commitments.

Transitional Product-Specific Safeguard Mechanism and Price Comparability in Anti-dumping Investigations

Two “buffer” mechanisms were conceived to address WTO members’ concerns about the impact on their economies of China’s accession to the WTO. The first one is the reference to special rules regarding price comparability in anti-dumping and countervailing measures investigations against imports from China.

As it was the case in other NME accessions, the use of alternative methodologies to calculate normal price during anti-dumping investigations was deemed appropriate considering the difficulties provided by special characteristics of the Chinese domestic market. The lack of normal commercial environment and the high level of State presence in the economy were considered as NME features that would render anti-dumping investigations based on internal prices as impractical.

Although the possibility of using alternative methodologies for normal price determination concerning NMEs already existed under GATT Article VI, through its Ad Note, a new *special and temporary system* was created⁵⁴. Under this new *special system*, provided for in Article 15 of China’s Accession Protocol, there is no need for countries to apply the exception of the Ad Note to China since it would be objectively considered as a NME, for price comparability purposes, for 15 years, i.e. until 2016.

This mechanism had already been previewed in the WPR of Viet Nam⁵⁵ and can be seen as a means to enhance the protection granted through the application of alternative methodologies in anti-dumping investigations against NMEs, especially considering the difficulties by investigating authorities to access relevant data.

The second buffer mechanism is the use of transitional product-specific safeguard mechanism – one general (until 2013) and another specific to the textile sector (no longer in force). This is a common feature of NME accessions to the Multilateral Trading

⁵⁴ The legal basis and the deadline for the applicability of this new system has been the focus of much academic debate recently. See TIETJE, Christian and NOWROT, Karsten, “Myth or Reality? China’s Market Economy Status under WTO Anti-Dumping Law after 2016”, *Policy Papers on Transnational Economic Law*, No. 34, Transnational Economic Law Research Center, December 2011. See also O’CONNOR, Bernard, *Market-economy status for China is not automatic*, VoxEu 27 November 2011. Available at <http://www.voxeu.org/index.php?q=node/7345>. Last access on 01.03.2012 and in GAO, Henry, *If you don’t believe in the 2012 myth, do you believe in the 2016 myth?*, WTO and China, 20 November 2011. Available at <http://wtoandchina.blogspot.com/2011/11/if-you-dont-believe-in-2012-myth-do-you.html>. Last access on 01.03.2012

⁵⁵ See WTO, *Report of the Working Party on the Accession of Viet Nam*, WT/ACC/VNM/48, 11 January 2007, para. 255

System and has been reproduced in the Protocol of Accession of China in its Article 16 and in China WPR Para. 242, respectively.

The transitional element of both mechanisms is proof of political bargain but also of the understanding that such mechanisms would not be needed once the NME features of China that justified them were surpassed.

Transitional Review Mechanism

As a sign of the importance of all the above-mentioned systemic changes required of China, a special transitional review mechanism was provided for in Article 18 of the Protocol of Accession of China. This mechanism would examine China's implementation of its obligations both under WTO agreements and under China WPR and Protocol of Accession. China was subject to annual reviews in the first eight years of its accession and to an additional review by the tenth year (the last one occurred in 2011).

It is worth noting that the transitional review mechanism operated in conjunction with the regular Trade Policy Review Mechanism to which all countries are subject regularly. China is subject to reviews each two years under the regular mechanism (the first was conducted in 2006). The combination of both review mechanism made China's economy as the most scrutinized since its accession, demonstrating the impact of its accession to the Multilateral Trading System.

3. Conclusions

There are several WTO provisions that are not adapted to NMEs. Core principles such as the national treatment, as well as rules on market access, established in GATT Article II, face challenges when applied to NMEs. Furthermore, even Article XVII, created to deal with the issue of state-trading enterprises show itself as insufficient to regulate NMEs and to assure their compatibility with the Multilateral Trading System.

The WTO members, therefore, decided to require new obligations from acceding NMEs, imposing substantial economic changes and eliminating aspects considered incompatible with the multilateral system. Considering all these deep systemic obligations to which China had to adhere before acceding to the WTO, it is fair to argue that WTO members sought to guarantee the adequacy of China's economy to multilateral trading rules by demanding reforms that would curb Chinese NME features. In this sense, Julia Ya Qin states that "*as a result of these obligations, whether China practices market economy is no longer a mere matter of domestic policy; instead, it has become a matter of WTO law*"⁵⁶.

⁵⁶ QIN, Julia Ya, "China, India and WTO Law", in SORNARAJAH, Muthucumaraswamy; WANG, Jiangyu, *China, India and the International Economic Order*, Cambridge University Press, 2010, p 173

IV. IMPLICATIONS OF THE NME ISSUE FOR THE WTO

The present study has analyzed the systemic challenges posed by the integration of NMEs into the Multilateral Trading System. The relationship between market and planned economies has seen an interesting evolution on how the GATT and the WTO dealt with the specificities of trade between the two economic systems. The accession of China has, in this sense, required 15 years of intensive negotiations, including extensive economic and legal analysis to conclude a set of systemic adaptations required of China so as to allow for its accession.

These systemic adaptations comprise obligations in the fields of: foreign exchange; state ownership and privatization; pricing policies; trading rights; subsidies; industrial policy; state-trading enterprises; investment; rule of law and transparency. These obligations were considered by the members of the WTO as indispensable for the establishment of a level playing field regarding trade with China and for the well-functioning of the WTO legal order.

After 10 years of China's accession, however, trade disputes and tensions between China and some of the most important members of the WTO, especially the US, have arisen over China's compliance with WTO obligations. In the wake of the worst financial crisis since the Great Depression, trade rows and resentment over China's trade and industrial policies have been present daily in international and local news. This study argues that much of the tension expressed by members of the WTO is due to the fact that the Multilateral Trading System is not apt to deal with NME features still present in China's economy.

The Multilateral Trading System, in its present state, does not offer the necessary mechanisms to allow a leveled playing field in trade between market and NMEs. A solution would be to negotiate new provisions to regulate specific features of China and other NMEs, if the transition of these countries towards a market oriented model remains incomplete.

The first action that should be taken is the creation of a Working Group under the WTO that would study the impacts caused by NME features to multilateral trade rules. The Working Group would be able to evaluate the specific elements of NMEs that may be considered incompatible with the Multilateral Trading System and which elements require an adaptation of the Multilateral Trading System in order to allow a better application of WTO rules.

It is also imperative to adapt the existing rules on trade defense: antidumping (especially the Ad Note to GATT Article VI, considered outdated), subsidies and safeguards. Special attention must be given to GATT Article XVII on SOEs. A deeper study in this Working Group could reveal more provisions that would need to be discussed.

It is essential to WTO members to deal with the concerns raised by NME's participation at the WTO. The rules of the Multilateral Trading System are no longer able to provide a

consistent trade regulation that assures the respect of the organization's core principles. The conflicts raised by the issue of NMEs between WTO members have the potential to undermine the Organization. Members must negotiate a solution urgently.

With the impasse of the Doha Round and no political will to unblock the System, either WTO members take the challenge in their hands and negotiate new rules to accommodate this challenge, or, once again, this explosive issue will go to the Dispute Settlement Body. The diplomatic-judicial "Tribunal" of the WTO will have the task to solve a dispute through rulings of the Appellate Body based on ambiguous old articles.

Once again, negotiations and diplomacy will be surpassed by judicial decisions, called upon to solve conflicts by adapting the existing rules to unforeseen situations.

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