Non-Market issues in WTO: With special reference to China

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ABSTRACT

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).

Keywords: Non-Market, Market, WTO, Trade

1. INTRODUCTION

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 – Comecon – 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 have 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 economy 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.

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 Accession [2]. 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”[3].

2. 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 an NME, but give no further clarifications.

China's Accession Working Party Report, when referring to Article 15 of the Chinese Accession Protocol, states that: 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 an NME or a “full market economy”. 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.
2.1 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 an NME. Apart from the United Nations Conference on Trade and Development (UNCTAD), a legally detailed description has still not been produced among influential 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: Uncutad 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” [4].

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):

2.2 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: (…) Through that indirect reference to the Ad Note, the Panel on the US – Antidumping and Countervailing Duties (WT/DS379), paragraph 14.119 declared that: 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: 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 Body (DSB), a definition of an 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 prices. [5]

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 State. This leads to the interpretation that, although the Ad Note provides a definition of an 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:

2.3 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 out 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 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 2.7 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 determining 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 an 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". All other agreements of the Uruguay Round are silent on the matter.

3. 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 labor between the Central Bank in charge of monetary policy and bank supervision on the one hand and the commercial banking sector on the other.

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 favored group of producers). There may also be a need for a positive program to encourage new entrants into particular activities. 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 a few activities, such as natural monopolies like water, electricity, and gas, and social services like health care, as in other market economies.

3.1 National definitions
Complementing the international provisions on market economy or NME, some countries have more specific legal definitions and procedures which often become a 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 an NME is under the Section 771(18) of the Tariff Act of 1930 and, as amended, under 19 USC § 1677(18):

**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:

**European Union:** The European Community had laid down several market economy features an 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 the size of China’s economy, the Council Regulation.

4. NMES AT THE MULTILATERAL TRADING SYSTEM

4.1 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 [6].

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.
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 appropriate [7].

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 [8]. 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 Agreement.

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 GATT made, therefore, only a 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 principles. [9]

**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 them. 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 economies.

### 4.2 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 adopting 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 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 transparency. [10]

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.

### 4.3 The accession of China to the WTO

The Chinese accession in 2001 and Vietnam’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 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 Accession 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. On the 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 the provisional character, similar to those used for NMEs during the GATT era.

5. CONCLUSION
There are several WTO provisions that are not adapted to NMEs. The 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.

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.

The definition of an 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 legislation 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.

6. REFERENCES