

Surpassing the EU-China Conundrum: From MES Denial towards FTA?

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Abstract: The economic relations between China and the European Union have developed at a very high pace in the past two decades. EU has become China's most important trade partner, and China represents EU's second largest trade partner. However, there have been some unresolved issues in the EU-China bilateral relations since the end of the Cold War. Although voices in the EU still object granting China the much-coveted Market Economy Status, signals indicate that parties are trying to reach a breakthrough and deepen economic ties. This paper focuses on the process through which the EU-China trade relations have gone and the possibility and probability of these relation to develop into a Free Trade Agreement.

Keywords: EU, China, MES, FTA

Introduction

China and the EU's economies are strongly entangled. The EU is China's main trading partner and China represents EU's second trade partner. After fifteen years since China joined the WTO in 2001 some provisions in China's Accession Protocol are expiring. Due to the expiry of Article 15 (a) (ii) from China's Accession Protocol to the WTO referring to China as a non-market economy in transition, and due to wariness of the EU members and especially some sectors of the EU economy with regard to China's possible dumping of goods in the EU market, conflicting positions have emerged both within the EU and in China on whether to grant China the Market Economy Status. The distinction between non-market economy and market economy was made by means of the introduction in 1995 of a paragraph into the addendum to article VI of GATT. This paragraph's importance lies in the determination of the 'normal value' of products given the fact that the domestic price of market economy states reflects the real costs of production and marketing, while in non-market economies the states can influence the domestic prices and therefore they cannot be used in anti-dumping investigations. As a consequence, the international law allows for the use of prices from a third market economy country (called analogue or surrogate) as the 'normal value' of a particular product.

Taking into account current tendencies, the present paper estimates that the EU will grant the MES to China in the near future. However, questions revolve around the conditions under which this status is granted to China, how the EU intends to continue protecting its common market from Chinese undervalued products, and whether the EU-China trade relations will eventually evolve into the disputed Free Trade Agreement.

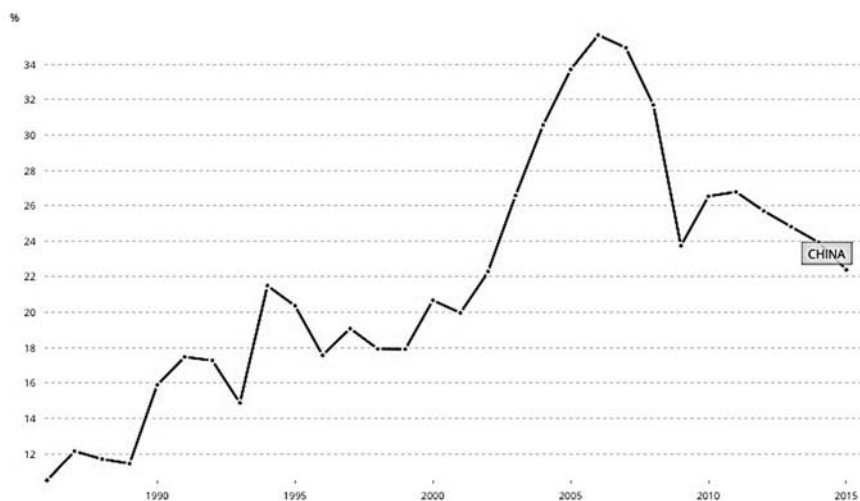
In the process, this paper also tries to answer questions related to the importance of the Market Economy Status for China, and why the EU would break away from its common stance with the United

States and grant China the MES.

Why does China covet the Market Economy Status?

When trying to answer the question of why China desires to be recognized the Market Economy Status more reasons become evident. First, the economic dimension seems to hold the first place in the discussion. Although the 2008 financial crisis had less impact on the Chinese economy than it had on the western economies, it still indicated that the Chinese economic growth model, based mainly on exports, was unsustainable. In 2007, Premier Wen Jiabao had warned about the Chinese economy being unstable, uncoordinated and unsustainable, also pointing at the reliance on exports as a driving force for economic growth (Xinhua news, 2007). Therefore, China has been taking steps towards boosting domestic consumption and reforming its economy so that it could lead to sustainable growth and less reliance on exports. However, even if its exports/GDP ratio decreased to 22.4% since the financial crisis from 35.6% in the pre-crisis period, exports still represent an important factor in China's growth, as indicated by Picture 1. In this context, the imposition of antidumping measures by the EU against Chinese exports would affect even further the slowdown in China's growth by affecting its exports. The WTO law does not offer clear criteria related to selecting the analogue country in antidumping disputes. So, the investigators can decide the basis for analogy, and sometimes the analogue country may be chosen among the developed countries where the production costs could be higher than those within China. In this situation the choice may be irrespective of the level of development, quality of products, and comparative advantages and disadvantages such as low labor costs or easy access to raw materials (Liu and Vandenbussche, 2002).

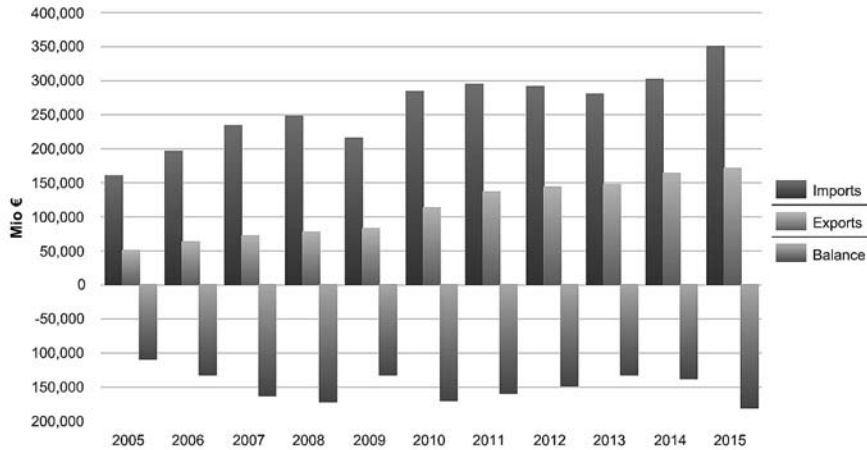
Picture 1 : Exports of goods and services (% of GDP)



(Source: data.worldbank.org)

Apart from relying heavily on exports, China gives much importance to its exports to the EU. As mentioned above, the EU is China's main trade partner, the total trade amounting to over EUR 520 billion in 2015, out of which over EUR 350 billion represent exports, and only EUR 170 billion represent imports from the EU (see Picture 2).

Picture 2 : EU trade with China



Total goods: EU Trade flows and balance								Source: Eurostat Comext - Statistical regime 4	
Period	Imports			Exports			Balance	Total trade	
	Value Mio €	% Growth*	% Extra-EU	Value Mio €	% Growth*	% Extra-EU			Value Mio €
2005	161,008		13.6	51,749		4.9	-109,259	212,757	
2006	195,816	21.6	14.3	63,696	23.1	5.5	-132,121	259,512	
2007	233,863	19.4	16.1	71,823	12.8	5.8	-162,040	305,686	
2008	249,102	6.5	15.7	78,301	9.0	6.0	-170,802	327,403	
2009	215,274	-13.6	17.4	82,421	5.3	7.5	-132,853	297,695	
2010	283,931	31.9	18.6	113,454	37.7	8.4	-170,477	397,385	
2011	295,055	3.9	17.1	136,415	20.2	8.8	-158,640	431,470	
2012	292,113	-1.0	16.2	144,205	5.7	8.6	-147,908	436,318	
2013	280,147	-4.1	16.6	148,153	2.7	8.5	-131,993	428,300	
2014	302,149	7.9	17.9	164,623	11.1	9.7	-137,526	466,772	
2015	350,436	16.0	20.3	170,376	3.5	9.5	-180,060	520,812	

(Source: European Commission -Directorate-General for Trade)

Second, China just like the other main actors in Asia is in search for legitimization as a global leader (Acharya 2011), and just like the other Asian major players China finds it difficult to emerge and be acquiesced as a regional leader. Starting with the 2008 financial crisis China has increased its participation in the global financial system. Adding to its increased participation in the UN, China has made efforts to open-up its economy (Huang and Zhou, 2014), and has greatly benefited from the current peaceful environment and the U.S.-established international governance (He et al., 2014). It has also made efforts to improve global governance through a more active participation in international financial institutions such as the IMF and the World Bank. It even made a step further and created the Asian Infrastructure Investment Bank (AIIB) that marks the moment when the United States lost the role of underwriter of the global economic system, but it also represents the moment China showed its willingness to fill the gap left by the important contributors to global development: the U.S., Europe and Japan (Sheng and Geng, 2015). Chen Fengying, from China Institute of Contemporary International Relations, considers that the

creation of the AIIB represents the moment when China turned from a participant within the global governance system to a contributor to this system (China Daily, 2016). Out of the \$ 100 billion authorized capital, China has initially contributed \$ 50 billion to the AIIB. But one should also take into account that China is committing more funds to global economic governance through its Silk Road Fund (\$ 40 billion), China Development Bank (\$ 32 billion), and the Export-Import Bank of China (\$ 30 billion). China does not only take the initiative in building more balanced global governance, but it is also a strong supporter of the existing institutions. Its growing importance has also been recognized by the international community. As an example, in 2011 the Deputy Governor of the People's Bank of China (the Chinese central bank) was appointed as the Deputy Managing Director at the IMF. As China's main participation in global governance is related to economic issues, being recognized as a market economy is the basic legitimization of its efforts in becoming a global leader.

Third, given EU's role on the world stage, it is believed that being granted the MES by the EU might create a spillover effect and it would put pressure on the other developed nations to grant China the MES. Rémond (2007) considers that because only a small amount of Chinese trade with the EU is affected by antidumping measures and because these measures did not hinder China from creating a large trade surplus (over 180 billion Euros in 2015), these antidumping measures, and consequently the MES dispute are more of a political nature than an economic one. To China, the recognition of its market economy would benefit it very little in point of economic gains. China sees the MES more as a recognition of its international status in the international community. Therefore for China it has more of a symbolic value. This recognition would also legitimize China's new strategy One Belt One Road initiative, and it would bring China closer to 'fulfilling its declared aim of making it an open platform which adheres to market rules and international norms' as desired by the European Commission in a recent communication on the new EU strategy on China (EU Commission, 2016). In the same communication the Commission considers that China registered a lack of progress in allowing the market play a more important role in the economy with regard to areas of deep interest for the EU.

The importance of EU recognizing China as a market economy could also be closely related to the concept of normative power. The EU has been perceived as a normative power and by enjoying this reputation has a stronger influence on the external world in shaping norms, either by means of contagion or transference (Manners, 2002). But in this particular case EU's identity as a normative power is a double-edged sword, and the EU might be caught in the dilemma of whether to grant the MES status to China because of this very identity. First, because the EU is a normative power and by granting China the MES it is expected that all the other powers see this move as a normal standard in international relations and they would find themselves under more pressure to grant China the MES themselves. Second, because of the very fact that the EU is a normative power it is expected to respect international agreements, in this particular case the WTO agreements, and grant China the Market Economy Status.

The European Union is readying itself to grant China the MES

As the expiry of the provisions in China's Protocol of Accession to the WTO is drawing near, discussions over the MES have intensified (Kratz, 2016). The stances from China and the EU differ on whether the European Union should grant China the MES.

The reputation of law-abiding behavior is valued by states and they tend to comply with international law desiring reciprocity from the other actors (Karns and Mingst, 2010). In recognition of this principle, Cecilia Malmstrom, the EU Trade Commissioner asserted that the EU will ‘respect its obligations under the WTO’ but will bring modifications to the dumping methodology in order to maintain the trade defense at the current level (Mucci, 2016). As a common opinion in the EU, China does not meet the requirements of a market economy. Members of all the political parties in the European Parliament acknowledge that China is not a market economy (Zalan, 2016) and it was reflected in the European Parliament’s vote on the non-legislative resolution related to not granting China the MES before it fulfills the five criteria of a marketing economy by 546 votes to 28, and 77 abstentions (European Parliament, 2016).

Some Chinese scholars (Huang and Zhou, 2014) also believe that although China has worked hard to fulfill its membership commitments, after its admission to the WTO, China’s efforts to open up in some areas stagnated. These areas include agricultural protectionism, restriction in the service industry, restrictions related to banking, securities, insurance, telecommunications, postal delivery, construction, and legal services.

The EU insists that the relation with China should be a win-win kind of co-operation, and it hopes that China will genuinely implement its slogan. At the same time the EU expects China ‘to assume responsibilities in line with the benefits it draws from the rules-based international order’ (EU Commission, 2016).

As a result of the complaints from the European Steel Association the EU imposed antidumping measures against some Chinese steel on August 4, 2016 (Nielsen, 2016). The steel issue was the main pain in the side of the trade relations between the EU and China in the past years and the members of this sector were the most vocal in denying China the Market Economy Status. These anti-dumping duties are going to be in place for five years and for the first time they are levied retroactively starting with December 2015. What this means is that the EU is moving closer to conferring the MES to China but before doing that it wants to make sure that some critical economic sectors are protected. According to Guarascio (2016), a draft document from the European Commission suggests that an increase in defense against unfair trade practices in the steel sector would be related to granting China the Market Economy Status.

Just like in the past, the US is critical of the possibility of granting China the Market Economy Status and calls the move a way of ‘unilaterally disarming’ itself (Euobserver, 2015). At the beginning of the century, the U.S. played an important role in the arms embargo issue between the EU and China at the beginning of this century. When the movement of lifting the embargo was gaining momentum in 2003–2004, the U.S. convinced the EU not to lift the arms embargo on China which led to more Chinese frustration towards the EU. As a result, China increased its focus on developing stronger bilateral relations with the EU member states in the detriment of relations with the European Commission.

The European Union wishes to develop deeper relations with China, and it is aware that not granting the MES to China might lead to continuous tensions in trade, and even retaliatory actions from China. At the same time, the EU cannot disregard the opinion of its most important trade partner and ally, the United States. However, the U.S. is caught up in presidential elections at this time, and prob-

ably the most controversial ones since the founding of the nation. Under these circumstances, all attention is focused on the internal debates and the EU granting China the Market Economy Status might go unnoticed, or at least there will be nobody to strongly voice concerns during the power transfer and in the first few months after the transfer of power taking place. This could represent a window of opportunity for the EU to circumvent the U.S. opposition and to deepen bilateral relations with China.

Despite all reasons against granting China the MES, it appears that the EU will finally grant China the much-coveted MES. Nevertheless, the EU is taking measures to ensure that the local industries are not hurt by this decision and jobs are saved. In its turn, China is making efforts to address EU's concerns and pledged to reduce steel overproduction in the coming years. Consequently, having protected the major industries that could be affected by China becoming a market economy, the EU is ready to bestow on China the much-desired MES.

Towards a EU-China Free Trade Agreement?

Free trade agreements are the new trend in global economic governance. However, the EU seems to head away from signing FTAs with its main partners, the U.S. and Canada. Recently, in spite of long negotiations between 2009 and 2014 and multiple efforts from both sides, the EU seems unable to conclude the Comprehensive Economic and Trade Agreement (CETA) with Canada because of the objection of Wallonia, the Belgian region. The Transatlantic Trade and Investment Partnership (TTIP) had the same fate as CETA because of strong opposition mainly from Germany and France. If these trade agreements have failed then BBC (2016) is right to 'call into question the EU's ability to forge other trade deals'. Moreover, both U.S. and Canada are allies and share common values with Europe, but it is still difficult to reach agreement on trade. On the other hand, Professor Michel Chossudovsky (2016a) considers that CETA is strongly connected to TTIP because of the interconnection of the Canadian and American economies under NAFTA. Therefore, each and both agreements would integrate EU and NAFTA in a larger Atlantic trading block. At the same time, and echoing the voices of the European people, Chossudovsky (2016a) cautions that these agreements are part of the corporate agenda and people might not agree to suffer from lowering EU's standards relative to food, health and safety. He also reminds that the protest movement views the U.S.-EU TTIP mechanism as one to enable Washington's appropriation of the EU's economic landscape (Chossudovsky, 2016b).

Under these circumstances, it is difficult to believe that an FTA between EU and China is possible as China is not an ally and it does not entirely share the values the EU is founded on. However, while the TTIP was not supported by France because of U.S. offering too little in exchange for the concessions made by Europe (Farrell, 2016), on the contrary, China might be willing to offer more concessions in order to seal a deal with the EU.

The EU, as well as China, would like to intensify and deepen their cooperation, especially their economic cooperation. The suggestion of an FTA between China and the EU was first made by President Xi Jinping in 2014. Since then, the European Union has been considering this possibility as well, but more cautiously. If the EU is willing to grant China the MES it is not because China has fulfilled the five criteria for becoming a market economy but mostly because the EU is willing to respect international agreements of which it is a signatory. Which means that when deciding whether to deepen the

economic relations with China to the level of an FTA, the EU will most certainly want to make sure the relation will be a win-win one and it will not reflect the present EU-China trade deficit. The arguments for developing an FTA are well discussed by CEPS (Center for European Policy Studies) and WTI (World Trade Institute) in their assessment of EU-China Free Trade Agreement which are: greater economic potential, comparative market access, not losing out on mega-regionals, the link between Chinese reforms and exposure to foreign competition, and strategic and geo-political advantages (CEPS and WTI, 2016).

The road towards a Free Trade Agreement between the EU and China will not be short and certainly not easy. As a first step, the EU and China agreed in 2012 at the EU-China Summit to launch negotiations for an investment agreement, and the first round took place in Beijing between January 21–23, 2014. This Comprehensive Agreement on Investment is perceived as a step in further opening the Chinese market to the European investors and to create a ‘simpler, secure and predictable legal framework to the investors in the long term’ (EU Commission, 2014). The CAI is also seen as a preliminary testing ground for a future FTA, and might even become a part of the FTA when it is agreed upon.

In the June 2016 joint communication the EU acknowledges the importance of the EU-China 2020 Strategic Agenda for Cooperation, but it also recognizes the need to formulate its own strategy for China, therefore it sets out the policy framework for engagement with China for the next five years. In this communication the EU also envisages an FTA with China if it liberalizes its economy and creates a level-playing field for business. The Commission not only does it aim at a deep and comprehensive FTA with China, but it also sets the standards in advance by referring to the benchmarks set by negotiations with United States, Canada and Japan (EU Commission, 2016). With these points in mind it is difficult to predict when the Chinese economy will be able to reach the benchmarks for the FTA negotiations with the EU, but given the present status when the CAI has not been completed yet, one may conclude that negotiations will not start in the foreseeable future. But because there is a will, and because the general global tendencies are tilting towards a global economic governance based on FTAs a EU-China FTA will be concluded in the future, everything depending on the speed at which China undergoes reform towards a market economy.

Conclusion

This paper has tried to look into the importance of the Market Economy Status for China and it identified various reasons why China covets so much the MET. These include economic gains resulting from different methods of calculating the price of the products exported, recognition as a major international player, and the spillover effect generated by EU’s granting the MES to China, given its identity of normative power. The EU granting the MES to China would be just the first step in deepening the relation between the two partners and setting the grounds for further agreements such as the EU-China Comprehensive Agreement on Investments and eventually a Free Trade Agreement. The present paper believes that the EU will grant the MES to China in the near future, based on the steps the EU has taken to protect its vulnerable sectors, and its responsibility to respect international laws.

A EU-China FTA is possible and desired but there are many aspects that need to be tackled before an agreement is reached. We can predict that in the near future a Comprehensive Agreement on Invest-

ments will be signed as negotiations have already started in 2014. However, depending on the results of the CAI further steps will be taken towards negotiations over an FTA. At this point the EU seems intransigent towards the benchmarks of trade agreements with any partner it is negotiating agreements with, even if they are allies and share common liberal values. This serves as an indication that China cannot expect less from negotiations with the EU on an FTA. Which means that real improvements need to take place in the Chinese economy and China should make efforts to create a level-playing field for business by opening sectors that are of interest to the EU investment.

The present research comes to the conclusion that if it is possible to predict that the EU will grant the Market Economy Status to China in the near future and that economic relations will deepen by signing a Comprehensive Agreement on Investment, it is difficult to predict when the negotiations for a EU-China FTA will start. However, the present research believes that as the trend in global governance tends to indicate and in corroboration with the desire on both sides, a EU-China FTA will become reality at some point in the future.

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