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The birth of a monstrosity: The EU's 'significant distortions' proposal

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On 3 October 2017 the Council and the European Parliament agreed on a compromise proposal which will shape the EU's new approach in anti-dumping cases against China, and possibly other countries, in the years to come. The proposal for assessing and addressing 'significant distortions' in the context of EU anti-dumping investigations is presently expected to enter into force on 1 January 2018.

When are significant distortions deemed to exist?

Significant distortions are defined as distortions which occur when reported prices or costs, including the costs of raw materials and energy, are not the result of free market forces because they are affected by government intervention. This may be the case where:

- The market in question is to a significant extent served by enterprises which operate under the ownership, control or policy supervision/guidance of the exporting country authorities;
- There is State presence in firms allowing the state to interfere with respect to prices or costs;
- Public policies or measures discriminate in favor of domestic suppliers or otherwise influence free market forces;
- Access to finance is granted by institutions implementing public policy objectives or otherwise not acting autonomously from the state;
- Bankruptcy, corporate or property laws are lacking, discriminatorily applied or inadequately enforced; and
- Wage costs are distorted.

The Commission is supposed to issue country or sector reports on distortions to alleviate the burden of proof on EU complaining industries.

How will the Commission deal with significant distortions?

If the Commission considers that significant distortions exist, it will construct the normal value on the basis of costs of production and sale reflecting undistorted prices or benchmarks. The sources that the Commission may use to arrive at such an 'undistorted' constructed normal value include:

- Costs of production and sale in an appropriate representative country at a similar level of economic development as the exporting country. Importantly, if there is more than one analogue country available, preference is to be given to countries with adequate level of social and

environmental protection; or
- Undistorted international prices, costs, or benchmarks; or
- Domestic (exporting country) costs, to the extent that they are positively established not to be distorted.

Why is the proposal problematic?

First of all, key concepts and details of the proposed approach are highly unclear and thus subject to discretionary application. Thus, for example, the new provisions conflate domestic sales prices and costs of production and the — non-exhaustive — criteria for assessing the existence of significant distortions lack a proper definition or threshold. To give but one example, 'public policies or measures influencing free market forces' exist in every country in the world and in the highly regulated EU member states probably more than anywhere else.

Moreover, while supposedly neutral, the proposal clearly targets China: The significant distortions criteria are basically repackaged MET criteria and reflect findings the EU made in CVD investigations against China. The context and timing of its adoption also evidence this. Recent press reports that the Commission has issued a 400+ pages' country report only for China and no other such reports are envisaged at least in the short to medium term offer further support.

Third, once country or sector reports are issued by DG Trade, subsequent findings of distortions by that same DG Trade will undoubtedly become a self-fulfilling prophecy.

Fourth, the reference to social and environmental standards (an idea of the European Parliament) in anti-dumping legislation sets a dangerous precedent, particularly if it is emulated by other user countries, many of which have tended to copy EU law and practice in the past.

On the basis of the above considerations and past EU analogue country practice it seems a foregone conclusion that high and inflated dumping margins will result from the proposed methodology.

Why will the approach likely be considered WTO-illegal?

The Commission and the Council have claimed the significant distortions proposal to be non-discriminatory, WTO-compliant and based on the rules of the Anti-Dumping Agreement. However, such claims do not hold up to scrutiny.

First, the rejection of exporting producers' prices or costs due to a finding of country-wide or sector-wide distortions seems inconsistent with the concept of 'dumping' which, as repeatedly noted by the WTO Appellate Body, concerns the pricing behaviour of individual exporters/foreign producers.

Second, Article 2.2 of the Anti-Dumping Agreement permits the construction of normal value in only three situations namely in case of (i) no domestic sales of the like product in the ordinary course of trade, (ii) insufficient (less than 5%) domestic sales of the like product, or (iii) when a particular market situation exists in the domestic market.

Third, the establishment of the cost of production is subject to the rules set out in Article 2.2.1.1 of the Anti-Dumping Agreement. The first sentence of Article 2.2.1.1 identifies the records of the investigated exporter or producer as the exclusive source for establishing the cost of production

unless the records are inconsistent with the exporting country's GAAP or do not reasonably reflect the costs associated with the production and sale of the product under consideration.

In fact, the Appellate Body in *EU – Biodiesel (Argentina)* already established that, even if an investigating authority considers that the actual and accurately recorded costs of an exporting producer are distorted or unreasonable, it cannot simply reject those costs by relying on the second condition in the first sentence of Article 2.2.1.1 of the Anti-Dumping Agreement.

Fourth, the envisaged recourse to undistorted international prices, costs or benchmarks and costs of production and sale in a representative third country will typically not result in a cost of production in the country of origin as required by Article 2.2 of the Anti-Dumping Agreement and interpreted by the Appellate Body in *EU – Biodiesel (Argentina)* as "*…the price paid or to be paid to produce something within the country of origin*."

Not surprisingly, at the time of writing the proposal has already met criticism from China, Russia, Kazakhstan, Egypt, Kuwait, Oman, Qatar, the UAE and Colombia. Thus, once the proposal is adopted and the methodology applied, it seems only a question of time before a WTO panel will rule that the methodology is WTO-illegal. This has led to some conspiracy theories in Brussels that the proposal was purposefully drafted so as not to withstand WTO scrutiny. If so, it has certainly taken a lot of time and effort to do so.

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