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2016 Market Economy Treatment for China?

An assessment from a EU perspective

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Introduction

“There’s no automaticity about the decision [to grant China market-economy treatment]. We need to make a formal decision and table a law.”

Source: Interview with Cecilia Malmström, Wall Street Journal 2014

This quote by the European Union’s (EU) trade commissioner, Cecilia Malmström in an interview with the Wall Street Journal in 2014 represents the current state of affairs regarding the upcoming query on whether to grant China market economy status (MES) in 2016. Art. 15 (d) of China’s accession protocol to the World Trade Organization (WTO) stipulates that the ongoing non-market economy status (NMES) is no longer applicable after 2016. This pressures the EU to draft a proper decision on whether 2016 will be the year in which it recognizes China’s economy as a market economy, making it significantly more difficult to initiate anti-dumping duties against Chinese imports.

This justifies the need to better understand the concept of MES and its influence on anti-dumping disputes between Europe and China. The WTO classifies dumping in Art. 2 of its anti-dumping agreement (ADA) and Art. VI of the General Agreement on Tariffs and Trade (GATT) 1994 as “[introducing a product] into the commerce of another country at less than its normal value”. By definition the ‘normal value’ refers to a “comparable price in the ordinary course of trade” between international traders which determine whether competition is fair. Thus, it ensures that products are not ‘dumped’ on another economy for less than the domestic price in its country of origin. In that regard, MES becomes an important tool because it determines the ‘ordinary cause of trade’. Accordingly, a comparison between different markets can only be fair, if they operate under similar conditions: that of a market economy.

China is not recognized as such by the EU so the GATT grants the right to determine the normal value of a product by “using the methodology [a country] finds most appropriate” (Second Ad note to Art. VI: 1 GATT 1994). This means that countries which do not recognize China’s MES are employing the ‘analogue country method’ to calculate the normal value of Chinese products. This conveys that the domestic price of another country which is recognized as a market economy serves as a surrogate to Chinese domestic prices. Even though the GATT/WTO agreement does not specifically contain any reference or provision on MES as such, it is still the most important denominator for China which decides

anti-dumping disputes because “the classification is a rational mechanism in Anti-Dumping Law” (Tietje and Nowrot 2011: 3).

This mechanism is intrinsic to the WTO system because the EU and other nations want to reassure themselves against unfair pricing. It is a loophole that grants trade remedies while simultaneously adhering to the binding commitment of lower tariffs that are negotiated in the WTO. The EU wants to protect its producers from unfair competition through anti-dumping duties. Generally speaking, anti-dumping favors producers and harms consumers but it is believed that the protection of the established industry is more beneficial than lower prices for consumers. This notion is outdated because anti-dumping is no longer an adequate tool to protect the European industries from Chinese competition. “EU producers [are located] in one or a few member states while there are consumers in every member state” which makes anti-dumping prone to the influence of business lobbies (Baldwin and Wyplosz 2009: 459). Moreover, severe state subsidies by the Chinese government might prove to be a bigger distortion to trade than price differences (Yu 2013). In light of these arguments, non-recognition of MES and the analogue country methodology disproportionately favor European markets and makes it easier for the EU to utilize the WTO anti-dumping mechanism against Chinese imports (Remond 2007; Kerr and Fei 2007; Shambaugh et. al. 2008).

Thus, MES defines how the EU trades with China today and remains a source of major disagreement. Yet, cooperation between the two has intensified over the last decade with the recent establishment of the EU-China comprehensive strategic partnership in 2014 and the ongoing negotiations towards a joint international investment treaty, China’s market economy status remains a source of major disagreement. In 2013, the EU ranked China as its number one trade partner with a trade volume of roughly € 428 bn (European Commission 2014c). Despite the ongoing Eurozone crisis since 2008, trade has been growing steadily from 2009 to 2013 with a 6.8% average growth between the EU and the People’s Republic of China (PRC) (European Commission 2014c). Yet, western states have not been willing to grant China the privileges of market economy status (MES) since it entered the WTO in 2001.

This gives reason to examine whether the EU is capable and willing to grant China MES by 2016 and whether it would be beneficial for EU stakeholders to do so. Therefore, the

goal of this dissertation is to assess whether the EU is capable, within its decision-making processes, and willing, among its different stakeholders, to grant MES to China by 2016.

Economically, the EU has employed a total of 52 anti-dumping duties against Chinese products but they affected “less than 2% of total imports from China” (European Commission 2014d). This amounts to roughly € 8,5 mn, which were lost in 2014 as a direct cause of anti-dumping measures by the EU on Chinese imports. Hence, even if European producers fear unfair competition as a result of international price discrimination, the economic net benefit of anti-dumping initiatives is controversial.

Politically, Chinese scholars attach more meaning to the recognition of China’s MES than a mere economic term as it plays an important role in their foreign and trade policy as well as the identity of the Chinese economy. There have been arguably two events which inherently define the history of contemporary Chinese economic development. Firstly, Deng Xiaoping succeeded in initiating groundbreaking economic reforms in 1978 and, secondly, China was able to join the WTO in 2001 (Pan 2015). Throughout the whole negotiation process there have been many different obstacles and disagreements but one of the most crucial remains the identity of the Chinese economy. While China insisted on its concept of a social market economy, western countries remained concerned about central planning and were unwilling to grant China the official status of a market economy when it entered the WTO in 2001. This could change in 2016 as the Chinese economy would be recognized with the same label as its major trading partners. Moreover, having MES is important for the PRC because not only Chinese producers that face direct anti-dumping duties, but also related industries suffer the biggest financial losses that are considered unfair and discriminatory. Products might not even have been dumped in the first place but the surrogate country methodology permits anti-dumping duties nonetheless (Rao 2013).

In legal circles, scholars took Art. 15 (d) as a guarantee, that MES treatment would automatically evolve by 2016 (Andersen 2009; Cornelis 2007). Yet, more recently, this notion was challenged by different politicians and scholars. For example, newly appointed Commissioner for Trade, Cecilia Malmström, or legal scholar Bernard O’Conner. Still, popular consensus among lawyers exists. Art. 15 of China’s Accession Protocol to the WTO implies the right to use the surrogate country method to determine the normal value of Chinese prices by members of the WTO. It is no longer operable as soon as China or one of its

economic sectors is established to be functioning under market economy conditions, usually by being recognized as such by states. The question posed by lawyers is whether “15 years after the date of accession” MES for China is guaranteed (WTO 2001).

Furthermore, the unique character and features of EU-decision making includes important aspects of member states interests and external influences that can have a potential impact on the negotiations. Depending on different interest stakeholders and decision-making procedures in the EU, anti-dumping remedies can be utilized for different reasons depending on what interests are at stake. For these reasons, this dissertation tries to answer the following research question:

Why should the EU, within its unique decision-making framework, seriously consider granting ‘market-economy status’ to China by 2016 as partially suggested in Art. 15 of the Chinese accession protocol to the WTO?

Granting MES to the PRC is not only a symbolic label but a decisive factor in international trade and politics. It has various economic, political and legal layers which have to be incorporated in the unique structures of EU decision-making. Previous studies contributed insightful and different arguments through economic analysis, legal debate or in the context of international relations (Kerr and Fei 2007; Qingjiang 2012). However, these studies fail to adequately connect their findings as they all influence the EU’s decision-making process. Further, new global challenges that came about in the EU with the ongoing Eurozone debt crisis as well as recent economic and socioeconomic development in China itself have been widely disregarded by European scholars. Politically, granting MES can help to stabilize the EU-China strategic partnership while it can yield trade benefits and better trade protection given the changing economic environment of the Chinese economy where anti-dumping is no longer an adequate tool to tackle subsidies and state aid. Further, it is legally possible to make that decision even if the Commission emphasizes technical conditions for a market economy because these are not legally binding. At the same time, the protectionist national interests of member states as well as individual business lobbyists prefer not to grant China MES by 2016.

For this reason, this dissertation employs the framework of European economic diplomacy, developed by Stephen Woolcock because it ensures that China’s MES is considered from several different vantage points and it provides the necessary scrutiny to

include the EU decision-making processes. The practical problem is the recognition of the PRC's market economy status by the EU in light of the recent changes in the political environment that came about during the Eurozone crisis and Art. 15 of China's accession protocol. The complex relationship between the EU's recognition of China's MES is difficult to sketch within the limits of one paradigm in international relations because the literature stays within its own realm and fails to connect the different its findings with the unique EU decision-making structures. This does not imply that theoretical advances are not important but that the imminent evaluation of China's MES by 2016 necessitates the urge to translate different interests through the decision-making processes. Therefore, Stephen Woolcock's framework of economic diplomacy presents a unique opportunity. It aims to "explain the processes by which the EU seeks to decide on a common position and how it goes about representing this common position in international negotiations" (Woolcock 2012: 3).

This dissertation aspires to be problem-driven and pragmatic. Ideally, a pragmatist methodology is based on a mix of qualitative and quantitative methods that promote pluralism. Philosophically, a pragmatist methodology "accepts [...] that there are singular and multiple realities that are open to empirical enquiry and orients itself towards solving practical problems in the 'real world'" (Feilzer 2014: 8). The aim of this methodology is not to provide evidence for a certain theory or paradigm but to solve real problems in politics. Given the limited scope of this dissertation, employing mixed methods is impossible. This is another reason why the framework of Stephen Woolcock is used. Given its inclusiveness; it guarantees that different arguments are not left out.

The structure of the dissertation is split into three chapters. The first chapter provides a brief historical overview of contemporary EU-China relations and what the arguments by either party for and against market economy status have been. It continues to show how recent developments have changed the environment of EU-China relations to be more economically driven than concerned over normative differences. The second chapter identifies what economic diplomacy is and how the framework, as developed by Stephen Woolcock, can be applied and tested in the case of the EU granting MES to China by 2016. The third chapter applies the theoretical framework to the case in order to determine the different variables that are most likely to influence EU decision-making in the upcoming year when considering the MES of China.

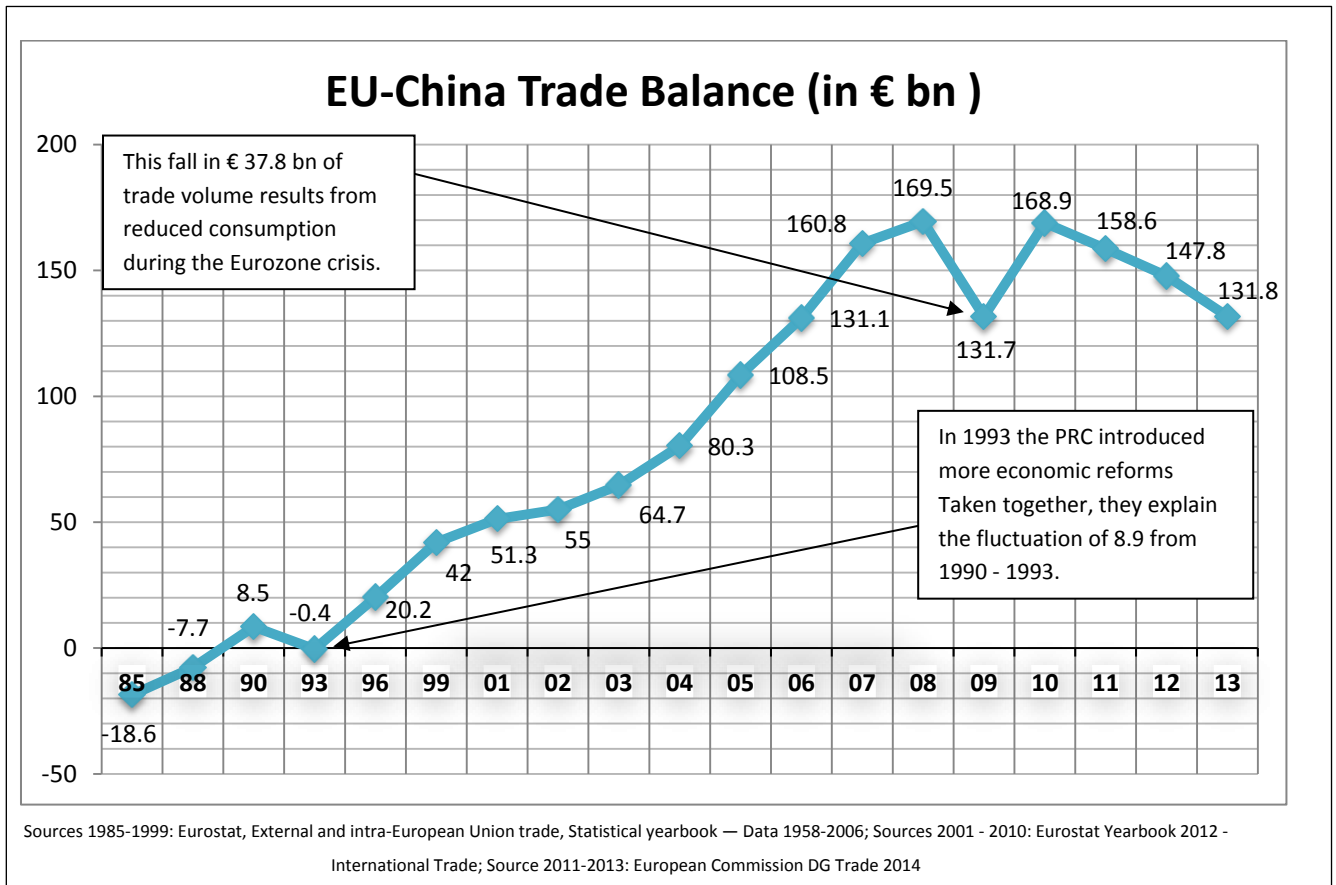
In this study there are several sources of uncertainty. Regarding the material used, the sources present a mixture of primary and secondary sources, specifically official WTO and EU documents. As for primary Chinese sources, publicly available English translations of the original texts is used.

Chapter 1: Overview of EU-China relations

Strategic Partners?

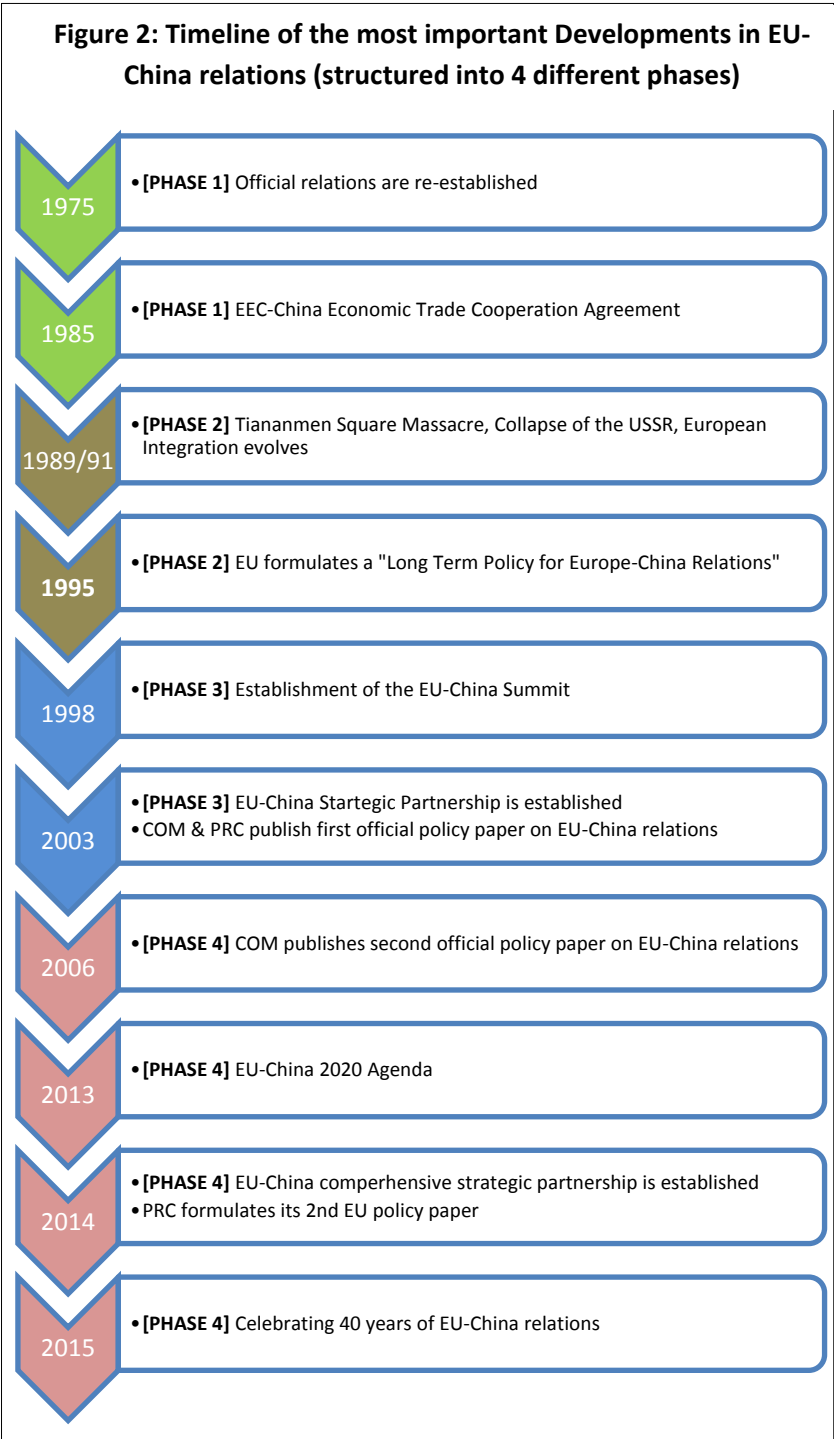
This section provides a short overview of how the relations between the EU and China developed and where they stand at the moment. Trade has always been one of the main drivers behind EU-China relations. Figure one shows that trade volume between the EU and China rose even before its admission to the WTO, amounting to € 51.3 bn in 2001.

Figure 1: Trade Balance of the EU with China from 1985 to 2013 (excluding Hong Kong)



The trade balance shows that from 1985 until the outbreak of the Eurozone crisis in 2008/2009 the trade deficit of the EU with China has been growing almost continuously. During the late 1980s and early 1990s trade was seen as a positive initiator that reinforced deeper relations because China needed foreign investments in order to succeed in its economic reform while European economies benefitted from China's cheap labor and production costs. As the trade deficit grew, this sentiment began to fade and EU exports were unable to catch up with Chinese imports (European Commission 1995).

On the backdrop of this uneven trade relationship, the history of EU-China relations are structured into three different time periods by Kong Qingjiang. Firstly, the period from 1975 to 1989 was still characterized by the bipolar structures of the Cold War. Official relations were re-established in 1975 and a decade later the 1985 *EC-China Economic and Trade Cooperation Agreement* reinforced commercial exchanges. The 1985 agreement still forms the official legal basis of the EU’s China policy to date (Qingjiang 2012; Yahuda in Shambaugh et. al. 2011: 22-29).



Secondly, during the period from 1989 to 1995 the steady increase in trade between the European Community and the PRC was disrupted by the 1989 Tiananmen Square Massacre which led to economic sanctions imposed by the European Community. All official relations were put on halt, including the infamous trade embargo on arms sales (European Council 1989). Nonetheless, except for the arms embargo almost all relations were restored by 1991 as the PRC was eager to join the GATT after the collapse of the Soviet Union in 1990 (Zhao 2004: 66-84). Additionally, the GATT transformed into the WTO by 1995 and the PRC ideally wanted to become a full member before the end of the Uruguay Round (Lardy 2002: 63-65; Gill and Murphy 2008).

According to Quingjiang, the third period from 1995 onwards is characterized by a common EU policy approach that was initiated with the first official long term policy paper *A long term Policy for Europe China Relations* in 1995. An update of the policy was adopted in 2003 with the Commission's Policy Paper: *A maturing partnership – shared interests and challenges in EU-China relations*. Both entities saw benefits in deepened economic and political cooperation and transformed from a mere 'relationship' towards a more sophisticated 'strategic partnership' (Casarini 2006). This partnership was characterized by rhetorical and political commitments from both entities. On the one hand, the EU's aim was to help China advance into a more democratic and pluralist society through increased non-commercial projects and exchanges. On the other hand, one of China's original reasons to cooperate with the EU after the end of the Cold War was aimed at counterbalancing US hegemony (Breslin 2012).

Although, Quingjiang did not elaborate further on the short history of EU-China re-engagement, other scholars differentiated the period after 2003 (Shambaugh 2010; Garlick 2013; Fallon 2012). Accordingly, Jeremy Garlick argues that "a marriage of convenience produced a 'honeymoon period' of optimism on both sides of the diplomatic table [after 2003]" (Garlick 2013: 54). The political rhetoric was positive as China had joined the WTO in 2001 and further opening and liberalization of the market was anticipated to give Europe the possibility to decrease their trade deficit. Yet, various post-2003 trade disputes revealed that the hollow rhetoric in the form of non-binding policy papers held no real incentive for substantial cooperation from both sides.

Firstly, contrary to widely held expectations, economic reforms began to slow down after the PRC had entered the WTO. It took 15 years to negotiate China's entry to the organization and it was pictured as a final goal and not the starting point of more liberalization, whether economic or political (Breslin 2013).

Secondly, Chinese policies made it almost impossible for European businesses to access the Chinese market, specifically financial services and telecommunications (European Commission 2006a: 7; 2006b: 9). Chinese economic policy was designed in such a way that it benefitted from international trade through the promotion of exports while simultaneously protecting the domestic industry from the negative effects of globalization. China attracted foreign investments and sold the locally produced products abroad while imports from the rest of the world faced protective tariffs and other non-tariff barriers. These protective measures ensured that state-regulated sectors stayed within regulatory reach of the government and protected infant industries (Breslin 2013: 83-106; Lardy 2002: 4-9; Zweig and Zhimin 2007: 95-150).

Therefore, the fourth phase in EU-China relations starts after the 2003 proclamation of their strategic partnership. The EU realized it will remain unable to access the domestic Chinese market and the trade deficit will not slow down. The result was a more mercantilist EU trade policy and the 2006 policy paper of the Commission *EU-China: closer partners, growing responsibilities*. It is the last genuine update by the EU on its China policy as all post-2006 publications have mere reporting functions (Smith and Xie 2010: 439; Sajdak 2013: 12-13). In 2006 the Commission felt the need to protect the domestic market from Chinese competition and the ever increasing trade deficit by installing specific trade remedies against Chinese competition. These include an increased use of the WTO dispute settlement mechanism but also a dialogue on intellectual property rights and climate change (European Commission 2006b: 13).

The Status Quo on China's Market Economy Status

The purpose of this chapter has thus far been to outline the development of the EU-China relationship in order to understand their position and interdependence with one another. This development also leads to a better understanding of the current status quo on the MES by the EU and China's critical response to it.

European Interests

European interests on granting China market economy status have been in constant change. As early as 1998, Europe already recognized China as a transitional economy and it changed legislation in order for individual producers to apply for market economy treatment specifically (Andersen 2009; Hoogmartens 2004). However in 2012, the Commission amended their anti-dumping regulation to include longer waiting periods and limit the number of producers that can actually apply. This renders it almost impossible for Chinese producers to successfully claim individual MES treatment as of 2012 (HFW 2013). As for country-wide recognition of MES, the EU levied five technical conditions in 2004 which are meant to judge any countries economy on their market-economy potential (European Commission 2004; European Commission 2008).

1. A low degree of government influence over the allocation of resources and decisions of enterprises, whether directly or indirectly.
2. An absence of state-induced distortions in the operation of enterprises linked to privatization and the use of non-market trading or compensation system
3. The existence and implementation of a transparent and non-discriminatory company law which ensures adequate corporate.
4. The existence and implementation of a coherent, effective and transparent set of laws which ensure the respect of property rights and the operation of a functioning bankruptcy regime.
5. The existence of a genuine financial sector which operates independently from the state and which in law and practice is subject to sufficient guarantee provisions and adequate supervision.

Through these formal criteria EU politicians emphasize that granting MES is a purely technical matter which can be reached by sole economic means. In a renewed report of 2012, the EU continues to insist that China only fulfills the second of these conditions (European Commission 2012).

Yet, scholars argue that there is more to it than a mere formality (Remond 2007; Quingjiang 2012). As outlined above, the EU still struggles to gain market access in China and it has been argued that negotiators are looking for “concessions beyond pure economics” (Remond 2007). Thus, “the Commission itself insinuates that the MES question is a technical

one but could be solved more quickly if “a ‘favorable general climate’ was created” (Remond 2007: 354).

Chinese Criticism

Chinese arguments for market economy status evolve around its general stance that WTO anti-dumping rules are discriminatory against developing/transitional economies and that it deserves to be on equal terms with other western economies in the international trade regime. Specifically the non-market economy treatment is viewed as hindering “the healthy development of the Chinese economy and [a violation] of the non-discrimination principle in the WTO” (Pan 2015: 742). However, it should be noted that the original difference between a market economy and a non-market economy derives from the Cold War period because it was a political differentiation to distinguish soviet from western regimes rather than a sole economic term. Thus, it is worthwhile to question whether discrimination via WTO anti-dumping measures due to China’s NME status is uniquely levied against China as such or is an intrinsic product of the GATT/WTO system (Yu 2013: 82). Nonetheless, China is facing an ever increasing number of anti-dumping duties. By 2010 the EU had implemented more than 50 anti-dumping and anti-subsidy measures against Chinese producers, causing substantial criticism of the EU (WTO) (European Commission 2011). This is usually organized in three broad arguments.

Firstly, China is the biggest target of EU anti-dumping procedures. Although, it was stated above that overall trade is only affected by roughly 2%, the biggest impact of anti-dumping investigations and duties hits producers in China. Further, EU procedures are automatic, quick and prone to outside influences, specifically by European business lobbies. The EU anti-dumping regulation stipulates in article 5 (4) that “no investigation shall be initiated when Community producers expressly supporting the complaint account for less than 25 % of total production of the like product” (Art. 5(4) European Council 2009). This gives EU competitors an unfair advantage because Chinese prices are naturally cheaper and more competitive. Moreover, the entire definition of ‘market’ is contested in different policy areas because different levels of scrutiny what contains a market can be applied (Baldwin and Wyplosz 2009: 426-446). For example, a car producer can claim anti-dumping in the entire European car market or, alternatively, in a very small and specific market niche such as caravans or motorcycles, where it might own 25% of the market share more easily. Still, the

analogue country methodology gives the EU the right to choose any surrogate prices in the first place. When Europe is choosing the price upon which it values Chinese products, it is not an accurate reflection of the actual economic realities in China and violates the principle of fair trade (Quingjiang 2012; Andersen 2009).

Secondly, China sees anti-dumping procedures as retaliation for its international competitiveness and trade surplus. China's comparative advantage as a developing/transitional economy is cheap labor. Thus, while the EU has the aim to protect itself from an increasing trade surplus, it is ignoring the actual root of that problem: a shift in the international division of production. Together with globalization, production is outsourced to countries with cheap labor costs. Yet, imposing anti-dumping duties on Chinese products but not on intra-industry products is criticized as inherently unfair. In other words, China is the workshop of the world and then punished for it with anti-dumping duties (Yu 2013: 13).

Thirdly, the double standard of the EU when granting MES creates unrest among Chinese politicians and scholars. The EU insists that granting MES is a technical matter when it issued a five-step framework with which market economies can be identified. Yet, the fact that MES was granted to arguably less developed market economies such as Russia or Ukraine and the lack of clear guidance from EU institutions have led to the widespread belief that granting MES is inherently politically motivated (Remond 2007; Pan 2015).

New challenges after a 40 year long relationship

What Europe was left with after 2006 was a protectionist trade policy against Chinese imports with the backing of WTO rules that resulted in the status quo described above. However after 40 years of re-establishing relations, the political environment of the EU-China partnership has changed dramatically as of 2015. Generally, the EU's external policy is defined by a commitment to Human Rights, the rule of law and good governance/democracy in its external norms promotion via Art. 21 TEU. Moreover, cooperation and a strong international system with multilateral institutions should promote these norms as an alternative to military power. This is commonly labeled 'normative power' as the EU utilizes its ideational impact to create a collective identity among states (Manners 2002, p. 238). Despite a very critical debate on normative power among scholars, the EU

itself aims to be one¹. Therefore, the recent Eurozone crisis and the inability to solve it, tests the EU-China relationship on the EU's willingness to stick to their idea of a normative power.

The PRC is EU's largest trade partner and has an interest in solving the Eurozone crisis. Chinese exports to the EU fell dramatically between 2008 and 2010, a devaluation of € 37.8 bn within one year (figure 1). In this new environment there are at least two important developments that changed the dynamic of the EU-China relationship

Firstly, the proclamation of the 'EU-China 2020 Strategic Agenda for Cooperation' (EU-China 2020), announced during the 16th annual EU-China summit in 2013, and the 2014 upgrade from a 'strategic partnership' to a 'comprehensive strategic partnership' indicate renewed efforts of advancing the EU-China relations (European Commission 2014e). EU-China 2020 is the first long term policy strategy of the strategic partnership as it has thus far changed annually with every EU-China summit. It combines the targets of the Europe 2020 Agenda and the 12th Chinese Five Year Plan (figure 3).

Figure 3: The combined targets of Europe 2020 and the 12th Five Year Plan

Key Targets of Europe 2020	Key Targets of the 12th Five Year Plan
<ol style="list-style-type: none"> 1. Raise employment from 69% to 75% amongst 20-64 year old citizens 2. Invest 3% of GDP in Research and Development 3. Reduce greenhouse gas emissions by 20%, increase renewable energy consumption by 20% and achieve 20% energy efficiency 4. Reduce share of early school leavers from 15% to 10% 5. Reduce European citizens living below national poverty line by 20% 	<p><u>Economic Targets:</u></p> <ol style="list-style-type: none"> 1. Annual GDP growth of 7% 2. Increase urbanization from 47.5% to 51.5 % 3. Increase GDP contribution of the service sector by 4% 4. Invest 2.2% of GDP in Research and Development 5. Annual Inflation of maximum 4% <p><u>Non-Economic Targets:</u></p> <ol style="list-style-type: none"> 1 11.4% usage of non-fossil fuel 2 Reduce energy use per unit of GDP by 16% 3 Reduce greenhouse gas emissions per unit of GDP by 17% 4 Reforestation of 21.66% 5 Reduce Carbon dioxide and sulfur dioxide pollution by 8% each
<p>Sources: <i>Europe 2020 – A strategy for smart, sustainable and inclusive growth</i> <i>National People's Congress (2011)</i></p>	

¹ Interview with José Manuel Barroso by John Peterson, EU-Consent Constructing Europe Network, 17.07.2007. Accessed in June 2015, <http://www.eu-consent.net/library/BARROSO-transcript.pdf>

A short comparison highlights a focus on economics, investments and the environment but avoids normative controversies such as good governance, Human Rights, or other values. This is in line with another observation made by David Scott on the 2014 Chinese policy paper about cooperation with the EU. He concludes that “China-EU relations may [...] be developing in greater pragmatically-driven economic, financial, and environmental directions” while “China would also seem to be showing a greater confidence and assertiveness in dealing with European criticisms of Chinese politics” (Scott 2014: 7). Thus, norms promotion is getting less and less attractive for the EU as a strategy in external relations vis-à-vis China and a common economic rationale is endorsed instead. Moreover, scholars of the EU-China strategic partnership have been calling for more economic pragmatism and less normative rhetoric in the EU-China partnership all along (Men 2014; Geeraerts in Christiansen et.al 2013).

The second development is the ongoing negotiation for an EU-China investment agreement since 2013. It is the first time the EU is trying to come up with a common external investment policy which would substitute all 26 bilateral agreements of member states. The main provisions evolve around investment protection on the one hand, and market access to investment on the other. For the EU, increased Chinese investment could help in aiding crisis struck economies while China would have greater access to the European market. Likewise, the EU wants China to reform its state-controlled investment administration regime which requires all foreign investments in China to be approved by the government (European Commission 2014a; Xiaotong 2015). However, according to the European Council on Foreign Relations think tank, negotiations did not have a smooth start because of the 2013 solar panel anti-dumping case disrupted the negotiations and officials avoided meetings until the 2013 EU-China summit (ECFR 2013).

In conclusion, EU-China relations were left with a protectionist trade policy after 2006. But, new efforts to increase cooperation between the EU and China have emerged with EU-China 2020 and negotiations for an investment treaty. However, anti-dumping can still disrupt the delicate relationship as the solar panels case indicates. Therefore, the 2016 Chinese market economy status is a game changer in contemporary EU-China relations and it has to be put in context of EU decision-making to understand the different processes behind it.

Chapter 2: A Theoretical Framework for Analysis

Reviewing EU-China relations has shown that the current status quo on MES is unfit with regard to the new challenges that face the relationship. Therefore, this chapter outlines the theoretical framework with which the 2016 choice on China's MES is analyzed.

Defining Economic Diplomacy in EU External Action

With the increasing interdependence between states as an effect of globalization, scholars have re-discovered the concept of economic diplomacy. In other words, how economic considerations play a role in diplomacy and foreign policy making. This is not new to the study of international relations. Maaïke Okano-Heijmans, a researcher at the Dutch Clingendael Institute, pointed out that "diplomacy was about war and trade issues and the history of consular relations" referring to Thucydides accounts of the Peloponnesian war 431 BC (Okano-Heijmans 2011: 16). Traditionally, the state plays a vital role in defining what diplomacy is. Henry Kissinger points out that the 1648 Treaty of Westphalia marked the establishment of sovereign nation-states that are primarily concerned with their own survival and diplomacy is merely one of its tools to conduct its foreign relations (Kissinger 1994). Within a fast landscape of different paradigms in international relations, economic diplomacy remains a contested concept and no universally applicable definition exists.

Still, a popular definition is given by Kishan Rana, who connects the response of developing countries to globalization with how effectively they pursue their economic interests in bilateral and multilateral forums. Accordingly, Rana defines economic diplomacy as "the process through which countries tackle the outside world, to maximize their national gain in all the fields of activity, including trade, investment and other forms of economically beneficial exchanges, where they enjoy comparative advantage; it has bilateral, regional and multilateral dimensions, each of which is important" (Rana 2007: 1).

Applying Rana's definition to the EU means its external behavior has to be understood as a pursuit of national interests and power through economic tools. However, the EU cannot be characterized as a traditional sovereign state neither an international organization but a "provider of collective goods which the Union's member states cannot deliver on their own" (Peterson and Shackelton 2012: 2). The EU is a 'suis generis' actor on the international stage that has uniquely developed on its own terms by creating economic interdependence between its members. It has its own legal character in international trade

negotiations in the WTO and it conducts its own external trade policy with third countries on behalf of the member states.

Still, specific EU decisions and policies depend first and foremost on how much state competences have been conferred from the member states to the EU institutions. For example, the power to conduct external trade policy lies with the EU institutions as part of the common commercial policy (Art.207 TFEU) but matters concerning the common agricultural policy remain partly within the hands of individual members. This is a problem in international trade negotiations, for example during the Doha Round. The overproduction and dumping of agricultural products by EU farmers damages developing economies. Hence, its reform was a major concern. However, EU representatives were unable to make a clear statement on how to reform their agricultural policies because legislative powers remain partly within the member states. Figure four illustrates EU competences and the blurry lines between EU institutions and member states sovereignty.

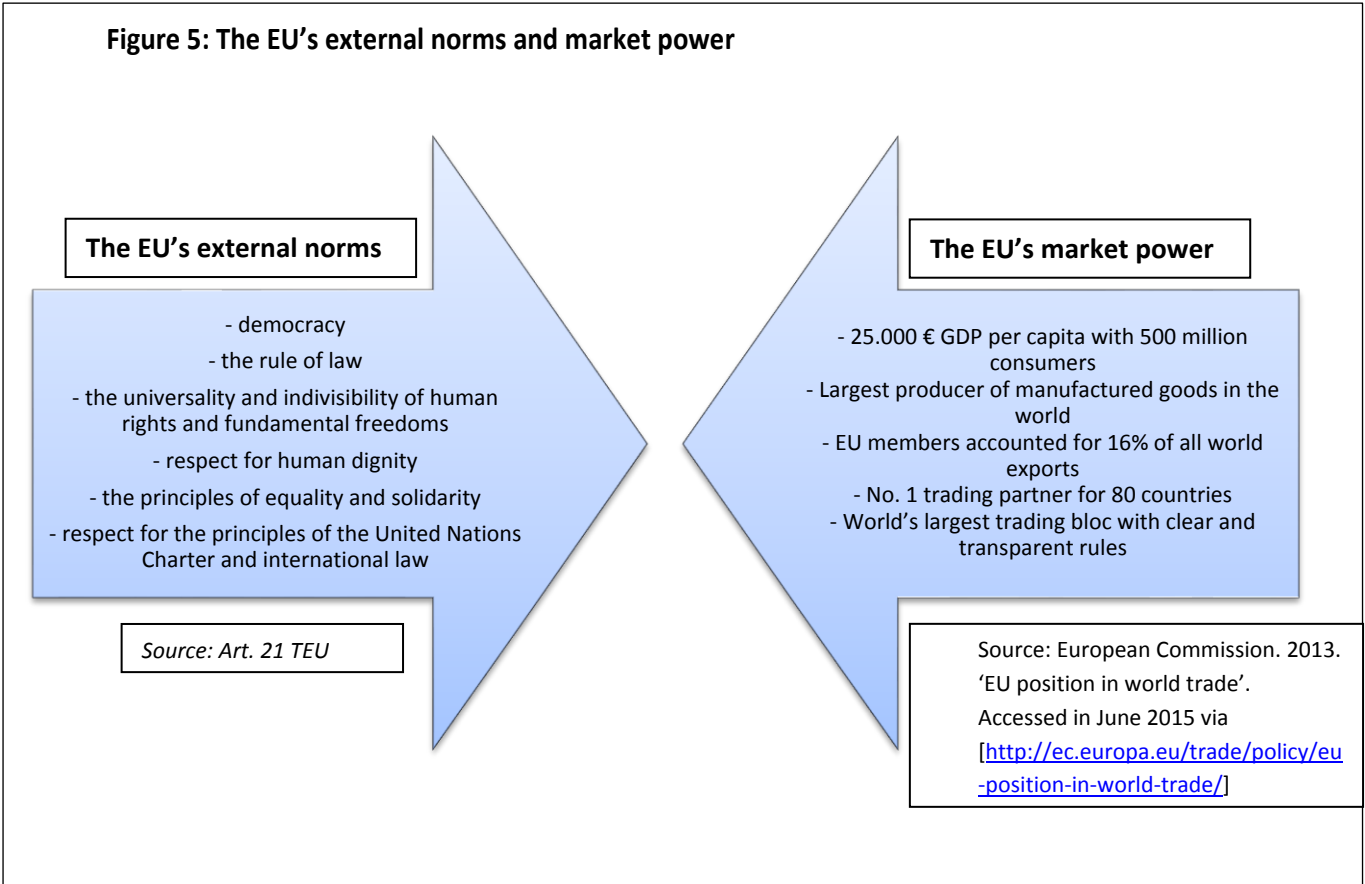
Figure 4: Overview of EU Competences according to Art. 2-6 Treaty on European Union (TEU)

<p style="text-align: center;">Exclusive Competences (The EU institutions hold the power to legislate)</p>	<p style="text-align: center;">Shared Competences (The EU institutions share the power to legislate with the member states)</p>
<p>Examples:</p> <ul style="list-style-type: none"> - Customs Union - Monetary Policy (for eurozone members) - Common Commercial Policy - Common Fisheries Policy 	<p>Examples:</p> <ul style="list-style-type: none"> - Internal Market - Energy and Environmental policy - Common Agricultural Policy - Transport Policy - Consumer Protectio

In summary, the unique character of EU external action is defined by a mixture of exclusive competences, where the Commission has the right to legislate, and powers partly remaining within the member states in shared competences. Within exclusive competences EU member states are guaranteed to ‘speak with one voice’ and have aligned interests but within shared competences, individual national interests of member states can differ and cause different policy responses. This means that it is difficult to apply Rana’s definition of economic diplomacy to the EU’s behavior because the national interests of its members are

only guaranteed to be coordinated within the realm of exclusive competences (Peterson and Shackelton 2012: 288 - 300).

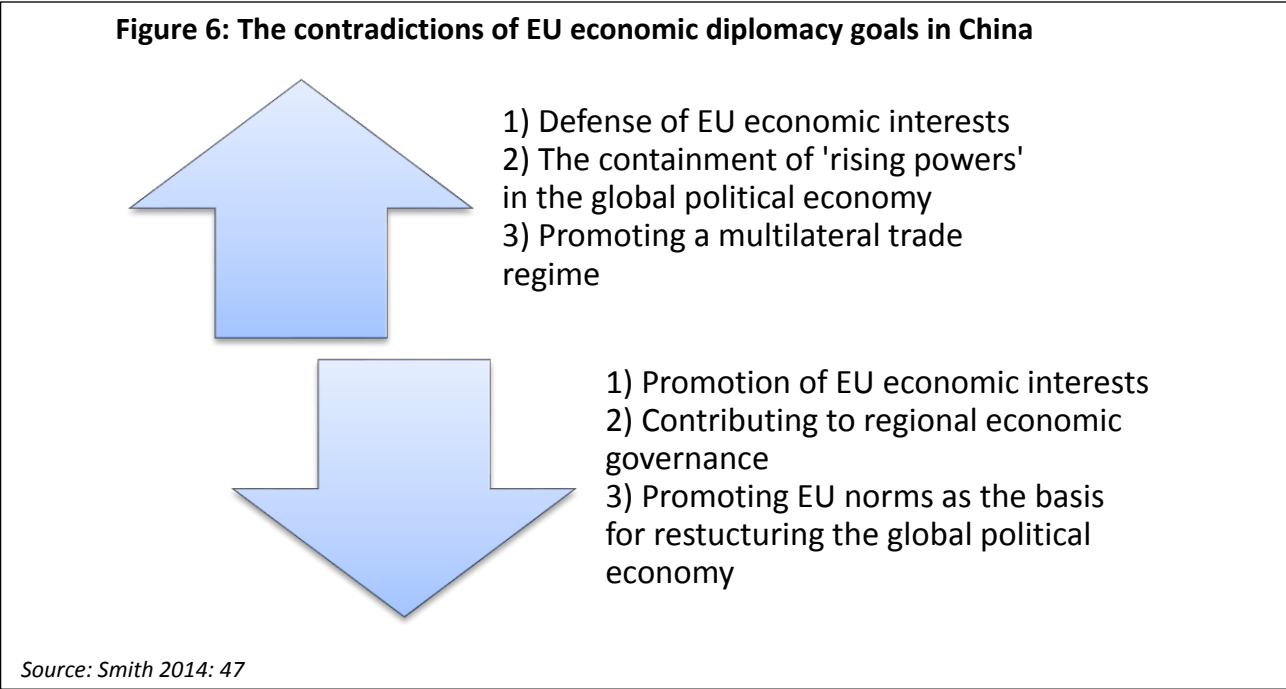
Contributions by Sophie Meunier or Chad Damro take this unique character of the EU into account when applying economic diplomacy. Their conclusion is that the EU is a ‘conflicted trade power’ (Meunier and Nicolaidis 2006; Damro 2012). Given that the EU as a whole does not poses adequate military power, EU external action is based on a balance between market power and normative concerns, displayed in figure five.



A back-and-forth between norms promotion through trade negotiations and economic benefits results from the EU’s structure and competences. Ideally, market power is constrained by the EU’s external norms that are promoted through specific trade conditions and bargains. These stem from the EU’s commitment to an external commercial policy (Art. 207 Treaty on the Functioning of the European Union (TFEU)). Moreover, internal economic integration provides the necessary power alternative to traditional hard power. Instead of military threats, the EU has the potential to exert economic influence by using access to its markets as a powerful bargaining position in international trade negotiations (Smith 2014: 37). Additionally, the European single market has exceeded that of the United

States, giving it greater influence in international trade negotiations altogether (Meunier and Nicolaidis 2006).

However, efficiently translating trade power into political influence is very case-dependent and often ineffective. Different interests among member states, business interests or a conflict between the EU’s own guiding principles can fuel disagreement (Smith 2014). Taking China as an example, EU economic diplomacy has been characterized as ‘multiple and often in conflict’ by trying to promote contradicting policy goals simultaneously. An example thereof is illustrated in figure six, visualizing contradicting policy goals the EU had vis-à-vis China.



Next to Meunier’s ‘conflicted trade power’ there are more straightforward theoretical accounts of the EU’s role in the world by other scholars, describing it as either ‘liberal’ through the display of its ‘normative power’ (Manners 2002 and 2007) or ‘realist’ when negotiating trade deals (Zimmermann 2007). On the one hand, it is “the ability to define what passes for ‘normal’ in world politics” which gives the EU the means to conduct external policies by defining international standards (Manners 2002: 236). Manners draws this conclusion after conducting a case study analysis on the role EU norms played in the abolishment of the death penalty throughout its extended neighborhood. On the other hand, Zimmermann came to a different conclusion by looking at the negotiations between the EU and China on the latter’s accession process to the WTO. He suggests that geostrategic and

mercantilist interests played a significant role for the EU in protecting its economy instead of norms promotion.

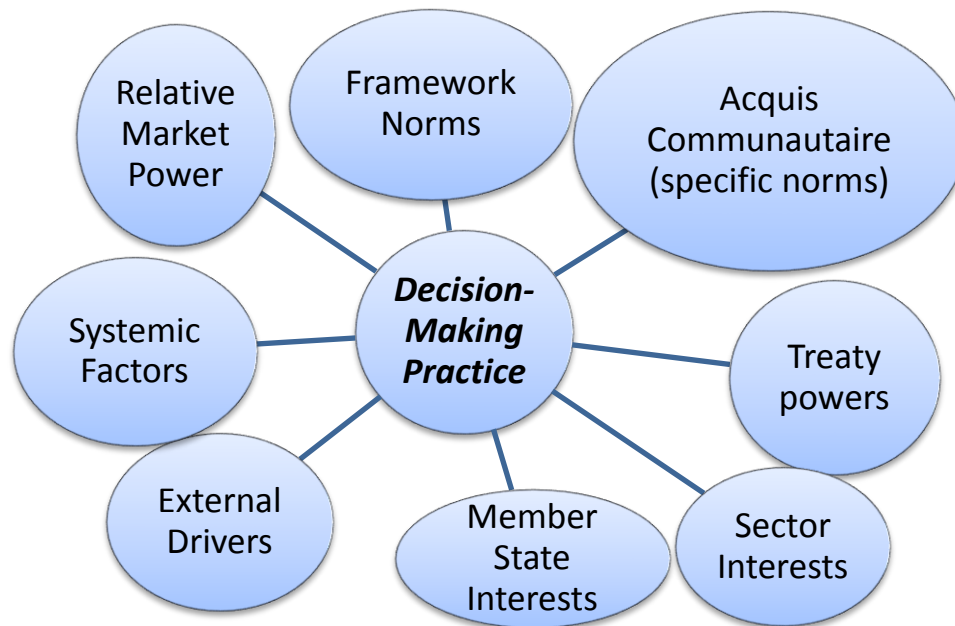
What is important to realize is that neither observation, whether the EU is a 'normative power', a 'realist power', or a 'conflicted trade power' excludes the other. All of these theoretical advances represent selected case studies that have a contingent character. They are unique and convincing within in their own context but cannot be applied universally to all of EU external action because different policy areas have their own mix of competences and interested stakeholders that influence decision-making.

In summary, the nature of the EU is at the same time its biggest dilemma in external relations and economic diplomacy: a mixture of different interests, competences and powers result in incoherent and conflicting decisions. Therefore, in order to critically analyze the 2016 market economy status of China, a framework for analysis which is tailored to the unique features and dynamics of the EU decision-making is necessary.

European External Economic Diplomacy vis-á-vis China: a framework for analyzing the EU's choices on granting MES to China

A framework for analysis of economic diplomacy, which incorporates the abovementioned unique features of the EU's external action, was developed by Stephen Woolcock in his publication *European Union Economic Diplomacy* (Woolcock 2011; 2012). Accordingly, actions by diplomats, who consider economic or commercial action as an enforcement of foreign policy, are distinguished from the actual negotiation on core economic issues between the EU and third parties. Economic diplomacy is defined as "how the EU decides on a common position and how it goes about presenting that common position in international trade negotiations" (Woolcock 2012: 9-12). This common position is influenced by eight independent variables which can determine the decision of the EU in international economic negotiations (Figure 7).

Figure 7: Factors Shaping the Role of the EU in Economic Diplomacy according to Stephen Woolcock (Woolcock 2012: 18)



- 1) **Relative Market Power:**
The relative market size of the EU can be translated into relative market power if the EU is able and willing to offer access to its market as a bargain in international economic negotiations.
- 2) **Systemic Factors:**
Broad international pressure on the EU to act (i.e.: through the international trade regime)
- 3) **External Drivers:**
Specific demands on the EU to negotiate (i.e.: individual countries or ongoing negotiations such as the G20 summit).
- 4) **Member States Interests:**
The interests of different member states on specific policy areas vary according to how much decision-making power they have and according to their different national economic interests given different economic sectors and preferences.
- 5) **Sector interests:**
The costs and benefits between different economic sectors and their policy preferences (i.e.: tradeoff between keeping the agricultural sector protected while opening up the manufacturing sector).

6) Framework Norms:

The more the member states agree to common norms, the more normative power the EU can have. In this context, framework norms ‘determine the underlying approach to market regulation’. In other words, the EU agrees that free markets operate within a framework of rules which should reinforce common policy objectives such as the environment or fair competition.

7) Acquis Communautaire (specific norms):

Standards codified in EU legislation that make up a detail of the *acquis communautaire* (the accumulated embodiment of all EU legislation).

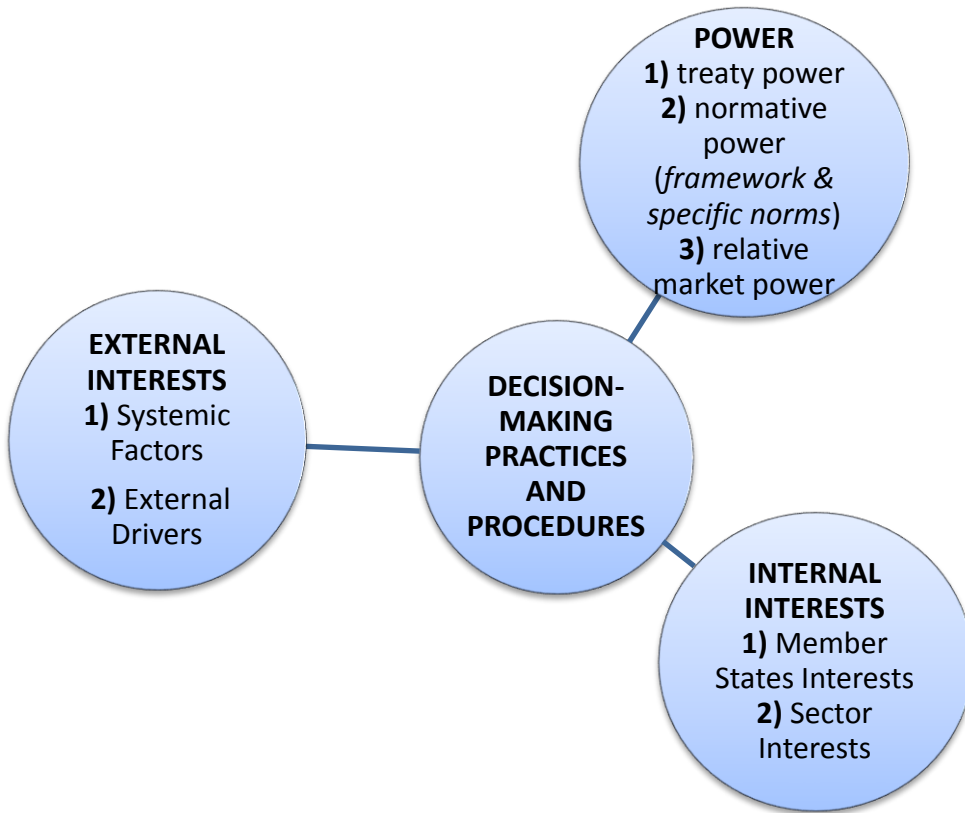
8) Treaty Powers/formal competences:

It is much easier for the EU to adopt a common position effectively if there are common procedures in place which are determined by the actual competences to legislate as they are conferred to EU institutions by the member states governments in the treaties.

All of these eight variables have an impact on the actual negotiation while decision-making in the EU follows specified patterns which are laid out in the European treaties. Each policy area has to determine its own unique decision-making procedure as competences differ accordingly. Moreover, apart from the formally visible practices, many stakeholders influence EU decision-making through active lobbying. Therefore, “the challenge of EU diplomacy is to find an agreed position among various ministries, branches of government and other sector interests and stakeholders *and* still be able to negotiate at an international level” (Woolcock 2012: 15).

In order to organize the variables neatly and not go beyond the scope and word limit of this dissertation, all eight independent variables of Woolcock’s framework have been summarized into three variables: power, external interests and internal interests (figure 8). Each represents one of the sub-chapters in the analysis and ultimately includes Woolcock’s entire framework. The author of this dissertation does not claim any originality as it is a mere re-organization which guides the readers through the analysis.

Figure 8: [Re-defined] Factors Shaping the Role of the EU in Economic Diplomacy



Chapter 3: Analysis

In order to answer the research question the following chapter analyzes the eight variables that have been introduced with the framework for analysis of EU external economic diplomacy by Stephen Woolcock. Three subcategories present the structure of the subchapters: power, internal interests and external interests (figure 8). The variables are employed to the EU-China relationship and the decision-making processes that are initiated when the EU is tabling a law, as proclaimed by Cecilia Malmström.

Power

Treaty power/formal competence

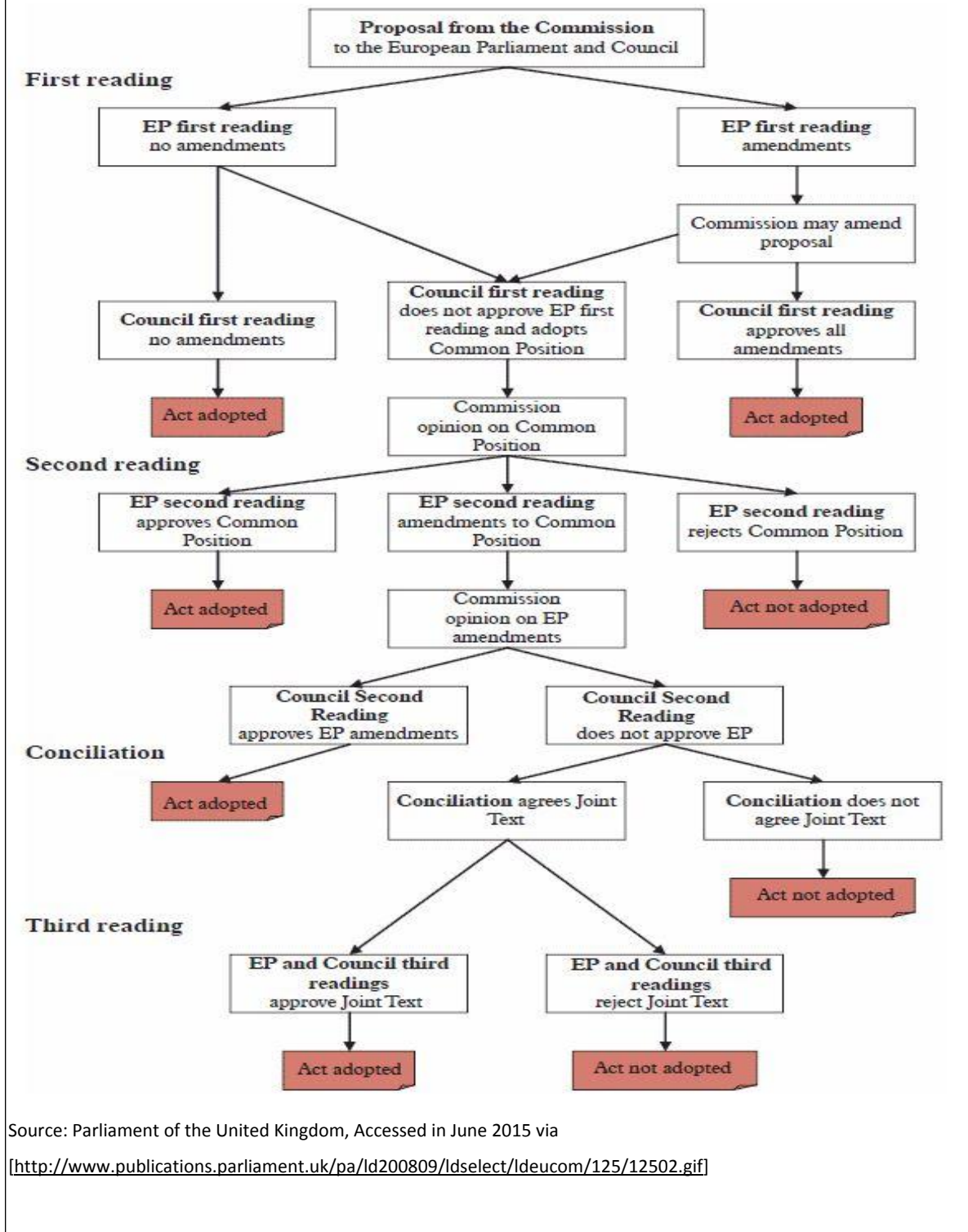
According to Woolcock, treaty power refers to a smooth process through established formal decision-making patterns and competences for EU institutions. Formal competence to conduct the EU's common commercial policy is enshrined in Art. 3 of the TEU, as well as Art 207 TFEU and has been an essential policy throughout the process of European integration. Moreover, it provides a legal basis to use the anti-dumping mechanism.

Art 207 (1) TFEU: The common commercial policy shall be based on uniform principles, particularly with regard to [...] export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies.

Since the 50 years of its establishment, EU institutions have constantly improved the efficiency and policy-making procedures while being contested by member states individual policies. For example, the Common Foreign and Security Policy loses its potential impact because member states still have their own national foreign policies in place. This makes the common commercial policies one of the most successful cornerstones of EU policy-making because it is executed exclusively without member state interference. This is not surprising given that a common trade policy is a necessary complement a functioning customs union.

Still, the matter of the upcoming decision on China's MES is trickier because common procedures by which the Commission initiates anti-dumping remedies do not apply when the EU faces the decision whether to grant China MES or not. For a 'lawful decision' the Commission has to draft a proposal to change current legislation through the ordinary legislative procedure (OLP) (Art. 207 (2) TFEU) (Woolcock 2012: 62; Buonanno and Nugent 2013: 257).

Figure 9: The Ordinary Legislative Procedure of the EU



Source: Parliament of the United Kingdom, Accessed in June 2015 via <http://www.publications.parliament.uk/pa/ld200809/ldselect/ldecom/125/12502.gif>

As of 2009, the Lisbon reform introduced changes to the EU legislative procedures that have a big impact on how the decision to grant MES will be reached. It introduced a more democratic procedure of decision-making by involving the European Parliament (Parliament) which had previously been a mere advisor. Illustrated in figure 9, three institutions are

involved in the decision-making process: The Commission, the Parliament and the European Council (Council). Every decision-making process can consist of a maximum of three readings in which legislation is amended by the Council and the Parliament while the initial proposal is introduced by the Commission.

The debate on country-wide MES for China usually focusses on the 2004 conditions which were introduced by the European Commission to analyse the preliminary state of market economies and have also been applied in 2012 to evaluate the market economy of China. Based on these conditions, European politicians usually argue that MES is a purely technical matter. However, legal scholars have debunked the fact that MES is purely dependent on their fulfillment. According to Anderson “the [2004 conditions set up by the Commission to judge MES] have been made after the accession of China [to the WTO], and they are thus non-binding to Art. 15(d) of the Protocol, which states that criteria must be incorporated in national law on the date of the accession.” (Andersen 2009: 296). Moreover, the document containing the EU’s MES criteria is a mere working document and not a legally binding form of legislation, a so called soft law document. Accordingly, the 2004 conditions are used by the Commission to evaluate whether to initiate a policy proposal in the first place but they cannot form a legal basis that prevents a legislative process. Although controversial in EU law, it is not per se illegal to violate soft law rules (Chalmers 2010).

In summary, the right to initiate legislation lies with the Commission and it is on them to initiate a proposal to change EU legislation however they find most appropriate. Whether that includes the 2004 criteria or not is up to the politicians in the Commission. Still, the Council and the European Parliament have a say in the decision-making process only after a proposal by the Commission.

Normative power

There is no clear consensus on whether the EU is overall an effective normative power as elaborated in chapter two. But, Woolcock did not try to validate Ian Manner’s normative power approach in the first place. In this context, normative power consists of ‘specific norms’ and ‘framework norms’. The first is seen as a specified normative standard within EU legislation (the *aquis communautaire*) and the latter represents the underlying norms and standards it pursues in its external trade policy with regard to market regulation.

Firstly, broad foreign policy norms of article 21 TEU are binding policy guidelines but controversial in EU-China relations. As was demonstrated in figure 10, this can be controversial. Secondly, framework norms are not specifically documented but common practice. According to Neil Nugent, the EU's trade policy is built upon three distinct framework norms. Primarily, international trade is built upon liberal foundations, specifically the reduction of trade and tariff barriers. At the same time, the EU wants to be able to protect its own producers from the disadvantages that an open trading system brings about. For example, the common agricultural policy that is heavily protected by subsidies and price support schemes given the conviction that severe food shortages as those experienced during World War II should never occur again. Lastly, preferential access to specific trading partners should be granted if deemed appropriate. These norms are inherently in conflict with each other and have been criticized on multiple occasions, especially from developing countries, as a double standard (Buonanno and Nugent 2013: 261-265).

EU norms are general and not specifically tailored to China. Given that the EU wants other nations to adjust their norms systems to their own through normative power, this is unsurprising. Accordingly, Woolcock suggests that "the EU's framework norm takes the form of the broad consensus that liberal markets should function within a regulatory framework of agreed rules covering essential social or environmental objectives"(Woolcock 2012: 71). Thus, it can be assumed that the EU aims to impose a regulatory framework which is favorable to their economic position in the world but might contrast that envisioned by China.

The PRC is commonly portrayed as a counterpart or "threat" to the European norms. Yet, is China actively trying to overthrow the current regime in the international political economy? An analysis by David Shambaugh, renders China a "moderate revisionist [...] that seeks to selectively alter rules, actors and the 'balance of influence' largely from within existing institutions - while simultaneously trying to establish alternative institutions and norms of global governance [...]" (Shambaugh 2013: 125). Hence, the government in Beijing is not seeking to completely replace international norms in the global political economy but to gradually reform the system from within and adapt to it at its own pace. Chinese foreign policy norms reflect this urge for international reform by advocating equality in international

relations and the empowerment of developing countries (Song in Christiansen et. al. 2013: 472 – 475).

Thus, the challenges that arose with globalization, different historical and societal structures put China and the EU in completely opposite positions into two diverging normative systems. Yet, it is important not to attach too much influence to these normative conflicts. Although the EU proclaims itself to be a normative power, recent analyses suggest that, the impact of normative power in EU decision-making has become less and less important vis-à-vis China. Scholars of EU-China relations have recently been calling for a re-orientation of the EU's overall China policy, away from norms promotion towards more constructive economic synergies (Men 2014: 16; Geeraerts in Christiansen et.al 2013: 502-503; Wood 2014: 253). The strategic partnership itself became more pragmatic. For example, disputes over values on Human Rights and democracy receive little attention and are sidelined in the EU-China 2020 agenda while economic, financial and environmental issues are emphasized (Scott 2014: 7).

Market power

It has been generally accepted among scholars that the EU possess a vast amount of relative market power as it is among the biggest trade blocs worldwide. The relative size and level of integration among the 28 EU economies is important but what translates it into political influence is “the ability and willingness to use it in negotiations” (Woolcock 2012: 19). It has been argued before, that the external power in the EU's market size can be used to ‘externalize’ its internal policy goals and regulatory standards by “affecting material incentives and others’ perceptions over possible outcomes” (Damro 2012: 687). For example, the EU would allow more market-access to Chinese producers by granting MES while simultaneously bargaining for some form of concessions from Chinese negotiators in return.

This variable is concerned about the economic effects of granting China MES, which generally result in more competition for European producers but cheaper prices for European consumers. Quantitative research by Francisco Urdinez and Gilmar Masiero at the University of Sao Paolo, showed on the examples of Latin American countries that accepting market economy treatment for China results in less anti-dumping procedures in 14 out of 16 countries with the expected number of anti-dumping investigations initiated per year to drop by over 50% (Urdinez and Gilmar 2015: 169-170). With such expectations, a popular

concern within EU economies is that they will be overpowered by a massive inflow of cheap Chinese goods in light of the immense trade surplus. For example, EUProSun, a consortium of 20 solar companies in the EU, claims that “China is flooding the European Union with cheap solar products” (The China Times 2012).

However, these claims should be viewed with suspicion, as the European Commission itself has admitted that merely 2% of all EU-China trade is affected by anti-dumping procedures (European Commission 2014d). Additionally, assuming that China’s economic structures are constant disregards recent developments towards more high-end manufacturing goods and vast technological development. David Shambaugh and others have argued before that China utilized a comparative advantage in cheap labor to become the world biggest exporter of ‘low-end’ manufactured goods. At the same time, “this product mix and reputation is changing, as China seeks to move up the value chain [...]” (Shambaugh 2013: 161). Specifically, this includes a focus on the development of the service sector and the production of more technology-intensive goods. If China is ‘moving up the value-chain’ it begs the question whether it will remain economically desirable to initiate as many anti-dumping procedures as the EU does nowadays.

Firstly, current practices in Argentina and Brazil show that MES can be granted while simultaneously taking unilateral measures to protect the domestic economy from Chinese competition (Urdinez and Gilmar 2015). Secondly, countervailing duties against disproportionately illegal state subsidies might become a new and more demanding challenge for EU trade policy officers rather than mere anti-dumping concerns. According to Yu, “countervailing duties are generally not able to be applied to NME countries, and this is the domestic practice undertaken by most member states during the past decades” (Yu 2013: 108)². In a 2014 report by the European Parliament on EU relations with China, unfair government subsidies, lack of access to government procurement and intellectual property rights construct common irritants in EU-China bilateral relations (European Parliament 2014).

Therefore, acknowledging MES can contribute to utilizing internationally accepted trade remedies against unfair subsidies rather than waiting for 25% of the European industries to feel outcompeted by a more technologically advanced product to initiate anti-

² It has been common practice that countervailing duties are not applied to NME countries, such as China, because government payments in a non-market economy are not characterized as subsidies (Yu 2013).

dumping procedures. In other words, precisely because market power is so important for the EU, granting China MES proves economically more beneficial against the popular belief that the European market will be flooded by cheap Chinese goods.

External Interests

Systemic factors

'Broad international pressure on the EU to act' stems from the 2016 deadline in Art. 15 (d) of China's WTO accession protocol. It is part of the WTO trade regime which binds its member states through international agreement and agreed standards. Arguably, the GATT/WTO establishes international norms that govern international trade between states. This translates into international pressure upon the EU to act. Yet, there is no consensus on the automaticity by which MES is assumed to be granted to China. Up until a few years ago, legal scholars rarely questioned the natural shift from non-market economy status (NMES) to MES by 2016 (Anderesen 2009; Cornelis 2007). As 2016 drew closer, others disclosed a more critical analysis and invalidated the automaticity by which previous scholars have thus far assumed MES will arise (Tietje and Nowrot 2011). Conner remarks that "[Article 15] addresses techniques in the comparison of costs and prices in antidumping procedures. There is nothing providing that market-economy status can be automatic." (O'Conner 2011). Others, such as the Brussels-based trade lawyer Folker Graafsma, who defends Chinese producers in anti-dumping cases in front of EU courts, argued that China would immediately and successfully sue the EU in the WTO for not adhering to their rules if MES is not granted in 2016 (Wall Street Journal 2014).

Clearly, a political rationale behind these arguments cannot be denied but the continued use of the analogue country is the core of the debate. It allows the use of a surrogate prices to determine the normal value of Chinese products in anti-dumping investigations. Under current rules in the EU anti-dumping regulation and the WTO, it is the Chinese producer who has to prove to the importing country that it is working under market economy conditions because Art. 15 of the accession protocol is invoked. However, it expires by December 2016 and "WTO members have to invoke other provisions that have been embedded in the existing WTO agreements" (Yu 2013: 93). Most likely, this will be paragraph 1:2, Article V. Annex I of the GATT 1947, from which Art. 15 of the Chinese accession protocol originated. Accordingly, the burden to find proof of dumping would be

with the importing country and no longer with the producer which means that EU authorities “would have to prove that the current Chinese market is still in a ‘monopoly position’” (Yu 2013: 94) (para. 1:2, Article V. Annex I of the GATT 1947). Thus, even if the EU does not grant MES to China, it will become much more difficult for them to use the analogue country methodology which is the main tool to initiate anti-dumping investigations in the first place because they can no longer rely upon Art. 15 of the accession protocol but have to utilize the complicated provisions in the initial GATT agreement.

In summary, there are several legal possibilities within the boundaries of WTO law for the EU to technically grant China MES or not. What is certain is that a necessary interpretation by the EU is imminent because it has the potential to influence how decision-making proceeds. This is underlined by the fact that Cecilia Malmström employed a group of legal experts, not economists, to analyze the market economy status of China this year (Wall Street Journal 2014). More importantly, it gives the systemic factors of the WTO regime an immense influence in EU economic diplomacy in this case.

External drivers

There are at least two important external drivers “in the form of initiatives by other countries or ongoing negotiations” that impact the 2016 MES status of China (Woolcock 2012: 24). Firstly, the transatlantic alliance between the US and the EU is reviving in a current momentum through negotiations on the controversial Transatlantic Trade and Investment Partnership (TTIP). It is a proposed free trade agreement that influences where China will stand geopolitically as it has the potential to strengthen the alliance between western countries. For example, Peter van Ham at the Dutch Clingendael Institute argues that TTIP could “re-balance the ‘pacific pivot’ and keep Europe on the US strategic radar” (Van Ham 2014: 5-6). Further, TTIP could also reinforce the power of western states of setting standards in international trade that “are the best way of beating China (as well as Russia and other Gulf states) at their own economic game” (van Ham 2014: 5). Finally, TTIP could be a reinforcement of global hegemony of western based capitalism based on the principles of democracy and a free market that underpin a worldwide economic liberalization process. Van Ham’s arguments are criticized as Eurocentric and over exaggerated because TTIP is first and foremost a free trade agreement, nothing more. Further, the US is also a member of the WTO and faces the same MES decision in 2016. Thus,

for the EU it is important how the US will decide because it can be a powerful bargain position vis-à-vis the US and China alike.

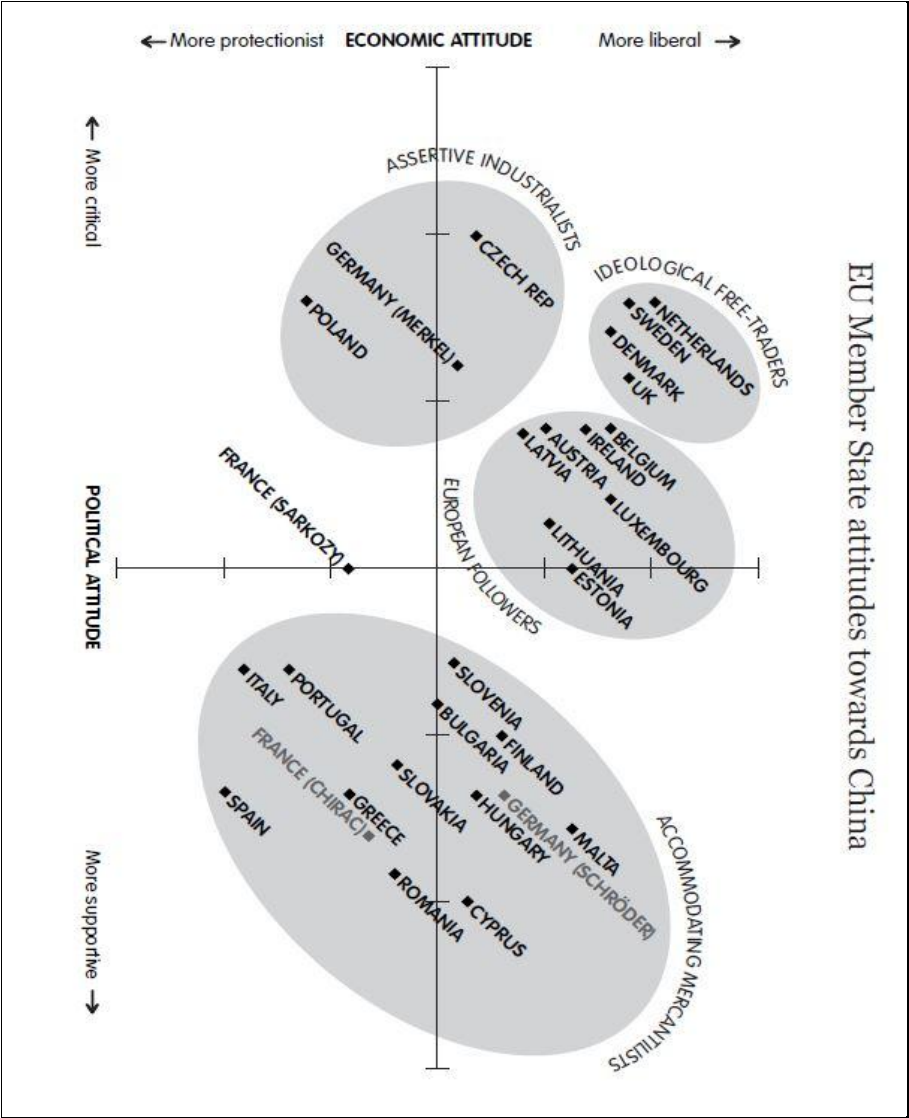
The second external driver comes from China itself. Apart from having a general interest in being granted MES and lobbying for that in EU institutions, the EU and China are currently negotiating an investment treaty. China has quickly developed into one of the leading investors in Europe because “all the foreign currency reserves China has accumulated over the years need to find an outlet” (Meunier (et.al.) 2014: 111). This negotiation was declared one of the main goals in the EU-China 2020 agenda and it has the potential to have a big impact on the EU-China strategic partnership overall if considered within the decision-making process (Godement 2015). Further, it provides an important bargain tool.

Internal Interests

Member states interests

The European Commission has the competences to execute the common commercial policy but fragmentation among member states and the inability to ‘speak with one voice’ is a common setback in European policy-making, especially vis-à-vis China. A 2009 survey among high-ranking EU officials by Françoise Godement mapped the different attitudes of member states towards China, which usually results in the inability to coordinate common policies altogether (figure 10). Accordingly, southern EU members are prone to favor a protectionist trade policy because they see Chinese competition as a threat to their own economies while northern member states are generally more liberal-minded.

Figure 10: Attitudes of EU member states towards the PRC



Source: Fox and Godement (2009): 23.

One of the most popular examples that demonstrates the division among different member states is the vote on the abolishment of the arms embargo. After the EC originally responded to the Tiananmen Square massacre by imposing economic sanctions on arms sales to China in 1989, a vote to end the sanctions was due in 2004. In the run up to the vote, Chinese lobbyists worked hard to convince European states of lifting the embargo. Yet, the US also engaged in lobbying activities and convinced the UK and Sweden to demand additional benefits and to withdraw their vote. “After months of embarrassing confusion and argument, the EU postponed the decision entirely, damaging its credibility [...]”(Fox and Godement 2009: 29). Some might argue that the arms embargo issue has a different rationale overall and it does not qualify to judge member states interests on MES. However,

the controversial anti-dumping case on solar panels of 2013 reveals that anti-dumping can cause division among member states interests just as much. According to one analysis, “Germany spearhead[ed] the effort to defeat the sanctions, and France [served] as the leading proponent of the Commission proposal [to impose sanctions]” (Freudelsperger 2014: 13).

Therefore, it is hard for member states to come together if they are willing to block decisions because of individual national interests. Moreover, assuming EU member states are able to find a compromise on the decision of granting MES to China and find a common ground which appeals to all 28, this position is always “the lowest denominator, which makes it even harder to negotiate with international partners” (Maihold 2010: 150). In other words, the EU position is be a compromise in itself which leaves little to no room for bargaining with China.

Sector Interests

An updated 2015 SWOT analysis by BusinessEurope, the biggest lobby group for small-, medium- and big enterprises in Europe, summarizes the ongoing skepticism of European businesses in having less trade defense mechanisms at hand when facing Chinese competition (figure 11). Generally,

Figure 11: ‘Threats to European Businesses in China

- Technology transfer from Europe to China
- Strong state influence in China
- Discriminatory treatment for EU businesses
- Weak IPR enforcement / counterfeiting
- Exclusive State Subsidies

Source: BusinessEurope 2015

the organization wants “to highlight that the decision on MES should be technical, and not politically motivated” (BusinessEurope 2015). That statement most likely refers to the 2004 publication by the Commission which established technical criteria to judge MES.

Still, China has arguably made legitimate progress in its economic liberalization reforms. The economic policy under Xi Jinping enforced more liberalization in November 2013 during the Third Plenum of the Chinese Communist Party. It states that the PRC aims to “[...] promote market-oriented reform in width and in depth, greatly reducing the government's role in the direct allocation of resources, and promote resources allocation according to market rules, market prices and market competition [...]” (Central Committee of the Chinese Communist Party 2013). Thus, economic policy is modeled less interventionist and more regulatory. For example, inside the newly established Shanghai Free Trade Zone,

foreign firms and investors are no longer obliged to invest in pre-identified industries or to establish joint ventures.

Regardless of whether European producers fear of Chinese progress in economic liberalization is legitimate, in the run-up to the 2016 MES decision in EU institutions it is important to realize who would benefit the most from keeping anti-dumping law as it is. A common argument in trade defense literature maintains that domestic producers are more likely to mobilize political pressure to introduce trade defense measures (Freudelsperger 2014). Accordingly, “import-competing firms face direct welfare losses every time when their domestic market share decreases due to rising or strong import-competition” (Eckhardt 2011: 969). Moreover, the structure of anti-dumping and trade defense measures in the EU invites the industry to organize itself and guide trade defense policy with lax definitions of markets and the 25% rule. Recent anti-dumping cases have shown that raw materials, chemicals, renewable technologies, textiles and machinery are sectors which have been able to upload their interests onto the European agenda by initiating anti-dumping proceedings. Believing analysts in Brussels, “the powerful European metals lobby and other sectors such as chemicals continue to support the idea the China should not be recognized as a market economy. These sectors have won over some key MEPs in the EU parliament” (Borderlex 2015). Although, the decision to grant MES is not a specific anti-dumping duty but a change of existing legislation, business interests have the potential to play a big role if they believe the costs of effective and continued lobbying are worth it.

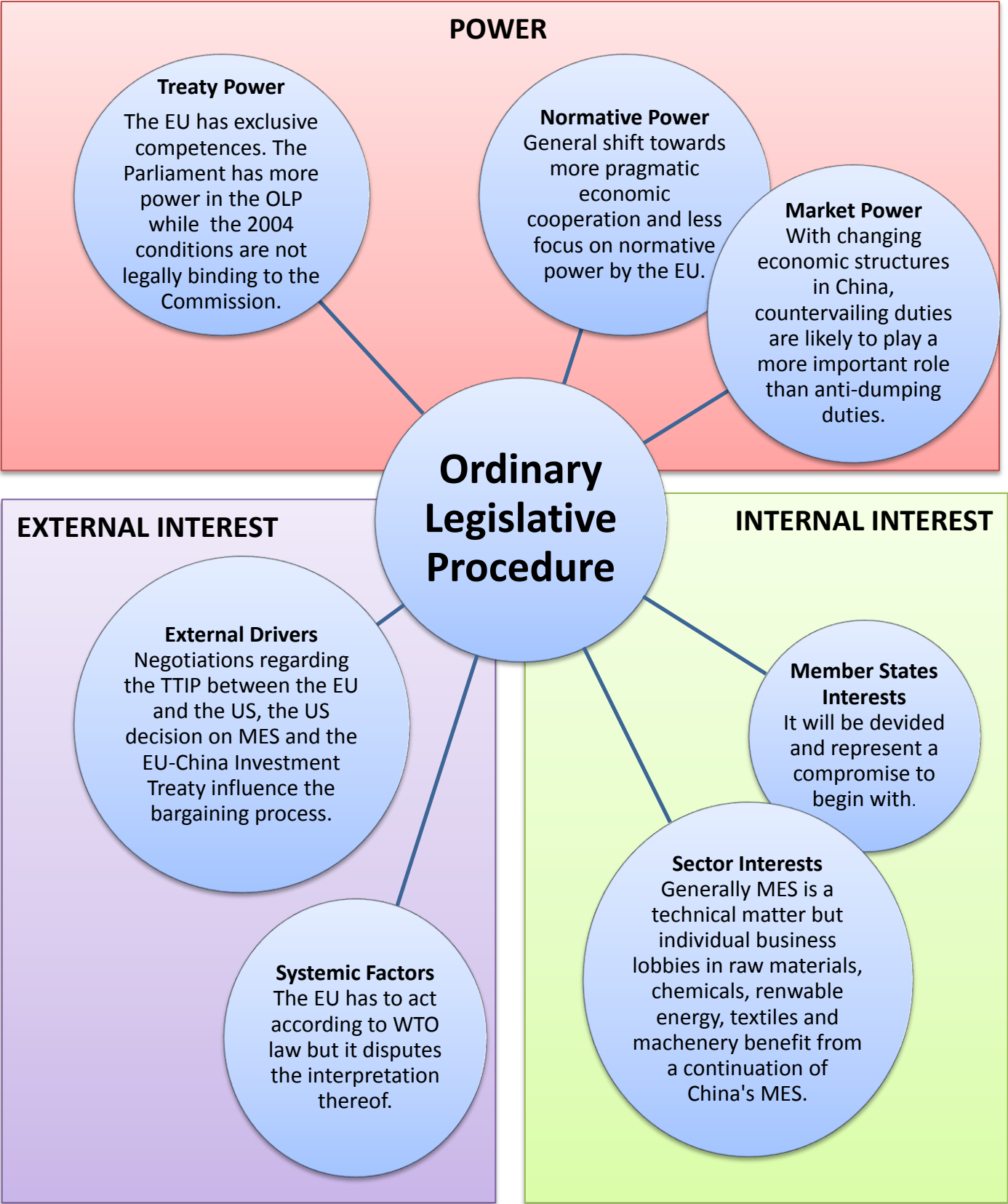
How different independent variables access and influence the decision-making in the EU regarding China's MES in 2016

Thus far the dissertation has identified the variables of economic diplomacy as suggested by the framework of Stephen Woolcock, in the context of the 2016 decision on MES for China. The previous analysis was structured into the three following parts:

- 1) Power (Treaty Power, Normative Power, Market Power)
- 2) External Interests (External Drivers and Systemic Factors)
- 3) Internal Interests (Sector Interests and Member States Interests)

The issues that were described give rise to a series of different dilemmas in the EU's economic diplomacy vis-à-vis China as they are confronted with various conflicts of interests. Figure 12 summarizes the findings to demonstrate how the different variables influence the decision-making processes of the OLP.

Figure 12: Economic Diplomacy Framework applied to the EU decision-making processes regarding the MES of China in 2016



It is impossible to say what variable will be most decisive as it is mostly a mix thereof which contributes to the decision-making process. However, given that the OLP must be used if the EU changes its anti-dumping regulation, there are a certain number of deductions that can be made.

Firstly, the OLP can be quite complex and hard to grasp (figure 9). Yet, there are three institutions which each have an individual impact on the process: the Commission, the Parliament and the Council. The Commission drafts the proposal to start the legislative procedure as part of its right of initiative. Next, the Council and the Parliament serve as an alternative to a bi-cameral system in normal states and negotiate the adoption of the legislative proposal. It was established that the conditions upon which the Commission judges MES are not legally binding to the EU or the WTO as it is a soft-law instrument. Therefore, it is for the Commission to decide whether it disregards established rules and practices to initiate the proposal of the OLP. As the Commission already established that the PRC only fulfills one of the five conditions in 2012, it will be difficult to initiate legislation if it sticks to the 2004 conditions.

Although, the Commission rarely disregards its soft-law, the EU is also bound by WTO law as a form of international norm, represented by the variable of systemic factors. Moreover, the Commission's legal advisors have pointed out that "it would be unwise not to grant market-economy treatment to China" (Wall Street Journal 2014). Therefore, there is a conflict between 'treaty power' in the form of the 2004 (non-binding) conditions and 'systemic factors' in the form of external pressure to act from the WTO regime.

Secondly, member states interests, however divergent, are most influential within the Council. It is composed of national ministers that are directly representing the governments of EU member states. Therefore, member states interests are directly represented and can differ according to their economic policy attitudes.

Thirdly, external factors do play a role but being too concerned with them will result in speculation. It is no doubt that the same decision the EU is facing, also has to be taken in the US. Moreover, the TTIP negotiations and the EU-China investment treaty negotiations are powerful bargain tools. However, clearly showing to what extent they had an influence is only possible in retrospect.

Finally, it was shown in chapter two that the EU's role in the international political economy and its external action in general is conflicted. Terms such as normative power, realist power or conflicted trade power have been authentically applied to the EU's external action in different cases. Based on these reviews the Commission has to decide what aim it wants to pursue in its economic diplomacy in this case. The choice lies between the variables of normative power, market power and sector interests. Powerful European businesses want to protect their market shares. The founding principles of the EU explicitly state that external action should be designed on the basis of its intrinsic and normative values. And, given new economic realities of the EU-China trade relationship, countervailing duties instead of anti-dumping might be a more appropriate tool in EU trade policy in the future. As not all variables can be satisfied together, there exists a trade off the EU has to take.

In conclusion, the answer to the research question evolves around the variables of market power, treaty power and systemic factors. Firstly, the EU has to act given the systemic factors in the form of pressure from the WTO. Secondly, considering the macroeconomic position of the EU, it is more beneficial to switch from using anti-dumping duties to countervailing measures in the future. For individual businesses, it remains beneficial if the European market remains protected which results in the lobbying efforts in some EU industries. However, given that the EU will utilize the OLP to change legislation, lobbying will be very costly. Thirdly, the argument that the 2004 conditions of MES prevent the Commission from granting that right to China does not hold as it is mere soft law document and not legally binding. Further, it is not applicable to the legality of WTO law. Fourthly, norms and normative power have been in decline vis-à-vis China. This trend has continued thus far due to the changed environment in EU-China relations after the Eurozone crisis. Further, is it worthwhile to consider whether China really is a threat to European values and standards. Opposition is voiced by member states who favor a strong protectionist trade policy in the Council and by individual business lobbyists while external factors present powerful bargaining tools.

Conclusion

Art. 15 (d) of China's WTO accession protocol stipulates that 15 years after the PRC's accession to the organization the use of the surrogate country methodology in anti-dumping legislation, the decisive factor that differentiates a market economy from a non-market economy in the WTO, shall expire. This pressures the EU and other WTO members to table a decision by 2016 concerning the MES of China. Therefore, the goal of this dissertation has been to evaluate different interests and influences inside and outside of the EU that affect the EU's decision-making processes in economic diplomacy. Accordingly, the question posed at the beginning of this dissertation was:

Why should the EU, within its unique decision-making framework, seriously consider granting 'market-economy status' to China by 2016 as partially suggested in Art. 15 of the Chinese accession protocol to the WTO?

In order to give an adequate answer, the dissertation was structured into three chapters. The first outlined the history of EU-China relations. They are characterized by four different time periods after both re-established diplomatic contact in 1975. Firstly, the trade agreement of 1985 still forms the official legal basis of EU-China relations. Secondly, relations stagnated for a short time period in 1989 with the Tiananmen Square massacre but soon regained its former strength as China was pressured by the implosion of the Soviet Union and its eagerness to join the GATT. Thirdly, together with increasing trade, the official EU-China strategic partnership was established by the Commission in 2003. However, a fourth period was distinguished after the so-called 'honeymoon period' of 2003. By 2006 EU-China trade had the biggest trade deficit in EU history. Within three years the deficit rose from € 64.7bn in 2003 to € 131.1 bn in 2006. As a result, various disputes regarding anti-dumping, the arms embargo, intellectual property and the difficulty for EU companies to gain market access in China came to the forefront. To address these, the Commission equipped its trade policy with remedies to protect the European market.

Within this context, the EU was reluctant to grant China MES in 2004 and issued five technical conditions to judge whether a country has a market economy. However, China continues to criticize EU regulations as unfair, having a double standard by retaliating against its international competitiveness. Therefore, the status quo on the MES issue should be reconsidered given developments after 2006. The recent Eurozone crisis led to the establishment of the EU-China 2020 agenda and the start of negotiations for a common

investment treaty in 2013, confirming the trend of avoiding normative controversial issues and focus on economic cooperation instead.

The second chapter outlined the theoretical framework of economic diplomacy. Scholars have linked economic diplomacy with developing countries efforts to yield the benefits from their comparative advantage through international trade. Although not a developing country, the EU tries to exert political influence through trade. Being a 'sui generis' entity within an international system of sovereign states, EU external action remains diverse and hard to characterize in one universal approach. Further, the fact that the EU does not always have the competences conferred to it by the member states to conduct certain policies, limits its negotiation power. Hence, scholars deduced different theoretical concepts, such as 'conflicted trade power' or 'normative power', with which EU external behavior can be characterized in certain cases.

In order to assess incorporate the unique features EU decision-making and the EU-China relationship, the framework of analysis on European external economic diplomacy by Stephen Woolcock was used. This framework provides the necessary freedom to include all stakeholders in the EU decision-making process. The fact that it analyzes "how the EU decides on a common position in international trade negotiations" (Woolcock 2012: 9) and an inclusion of the difficult EU decision-making process grants a pragmatic analysis that can be used to advice policy-makers. The eight variables are summarized into three broad categories for better oversight: power; interests; and; systemic factors and external drivers.

In chapter three the variables of economic diplomacy that have been outlined in chapter one were applied to the decision-making processes of granting China MES. The results are summarized accordingly:

1) Power

Treaty Power/Formal Competence: EU institutions have the formal power to conduct a common trade policy and to negotiate on behalf of the EU member states in international trade negotiations (Art. 207 TFEU). However, the issue of China's MES necessitates a change to existing EU legislation in the form of the basic anti-dumping regulation through the OLP. It empowers the European Parliament to more influence in the decision-making process together with the Council, which consists of the ministers of the member states. However, the initial proposal to change

legislation comes from the European Commission in the first place. They have previously used the five technical conditions to judge MES but it was shown that these conditions are actually not legally binding and theoretically they do not have to be used. Further, the 2004 MES conditions of the Commission were made after China had already entered the WTO in 2001 and are therefore not applicable to the validity of Art. 15 of China's accession protocol which stipulates that MES has to be granted to China by 2016.

Normative Power: Besides the EU's general guiding principles in external action (Art. 21 TEU), specific norms on external trade remain contradicting. As Neil Nugent suggests, being an advocate of liberal trade and a reduction of tariff barriers but simultaneously rigorously protecting European producers and granting market access as a form of preferential treatment is the inherent double standard the EU is criticized for. Although controversial, the EU is promoting liberal international trade within a common regulatory framework. Assuming that China is a 'threat' to these common regulations is only one side of the story as China is commonly described by sinologists as a 'moderate revisionist power' in the international political economy. Therefore, Beijing politicians do not aim to overthrow the established regime per se but to reform it in order to make it a more level playing field for developing countries. In light of the Eurozone crisis, the relationship between the EU and China became more pragmatic and economically oriented which gives reason to argue that normative power differences might not be among the most important variables that influence decision-making.

Market Power: The variable of market power measures the extent to which the EU is willing and capable of using its relative market power as a trade bloc to achieve its own policy interests. Generally, European producers are concerned over Chinese products outcompeting them on their own markets. However, besides the fact that only 2% of EU-China trade is affected by anti-dumping measures, the changing Chinese economy is transforming from a comparative advantage in cheap labor to more high-end manufacturing. This makes anti-dumping even more ineffective as the EU is faced with state-subsidies, where countervailing duties are most appropriate. Countervailing duties cannot be invoked against a non-market

economy and plus it will not become completely impossible to use anti-dumping against a market economy. Therefore, this variable benefits from granting China MES.

2) Systemic Factors and External Drivers

Systemic Factors: Being a member of the WTO and deeply committed to the established system of global governance in the international political economy puts pressure upon the EU to react to the 2016 deadline in Art. 15 of China's Accession Protocol. Despite a vivid legal debate on the automaticity of Art. 15 what is most important is the fact that the EU has to invoke a clause in the old GATT 1947 agreement if it wants to continue to utilize the analogue country methodology post-2016. This is highly contested and the easiest way to please WTO pressure is to grant MES to China rather than finding a legal loophole.

External Drivers: At least two important and ongoing negotiations have been identified that are influenced by the MES decision on China and vice versa. Firstly, the ongoing negotiations between the US and the EU on TTIP, including the US's own stance on China's MES. Secondly, the ongoing negotiations on the EU-China investment agreement, being also one of the main goals in EU-China 2020. These external influences are important bargaining tools and the potential to heavily influence decision-making. However, this dissertation cannot provide an adequate answer to the extent, to which external drivers will be influential.

3) Interests

Member States Interests: A fragmentation between EU policies and different member states interests is a common problem in EU external action. Although, given that the EU has exclusive competences in trade, member states interests remain vital in the decision-making process as they are directly represented in the Council, which decides in the OLP. Some member states favor a more mercantilist trade policy vis-à-vis China while other aspire to be more liberal, which influences the decision-making directly.

Sector Interests: The biggest representation of European businesses has urged the technical nature of the 2004 criteria by the European Commission. Yet, keeping anti-dumping law as it is and not recognizing MES is most beneficial to specific

sectors and firms in the metals and chemicals industry. Their lobbying efforts can have a potentially negative impact as they influence decision-making.

Combining these variables has led to four conclusive statements that illustrate diverging interests which policy-makers will face throughout the decision-making process. Firstly, the Commission, the Parliament and the Council have a distinct role in the OLP which is equally important but it all depends on the Commission to initiate the proposal. At the same time, the systemic factors variable in the form of pressure to implement the WTO regime will also pressure the Commission to reach a conclusion. This results in a conflict between the variable of treaty power and systemic factors. Secondly, when the OLP is started, member states interests will be most impactful in the Council. Thirdly, estimating the effects of external factors is difficult but the influence of the ongoing TTIP negotiations, the MES decision in the US and the EU-China investment treaty have the potential to be powerful bargaining tools. Finally, the Commission has to solve a conflict of interest regarding the direction it wants its economic diplomacy to take. Normative power, market power and sector interests are in conflict with each other and not all of these variables can be satisfied.

In conclusion, the status quo on MES which is based on the 2004 Commission document as well as the EU's 2006 policy paper on China do not adequately reflect the new realities of the EU-China relationship. Further, recent trends in EU-China relations sideline normative differences and developments in the Chinese economy suggest that anti-dumping remedies, next to being discriminatory by using the analogue country methodology, will most likely become an un-useful tool in tackling increasingly important trade conflicts in intellectual property rights and illegal state subsidies. However, there are a lot of obstacles within the decision-making process in the form of individual member states as well as business lobby interests that have the potential to steer EU decision-making into their favor.

This research extends our knowledge of the dynamics that are at place in EU decision-making processes and it provides an overview which conflicts of interests have to be resolved by the EU when considering the MES of China in 2016. Further, the aim was to pinpoint what influences will play a role in the decision-making process. Therefore, it is not possible to generalize the findings on to similar cases such as in the US or specific European

countries. At the same time, the variables presented do not limit themselves as being the only and most important factors, rather than being the most visible. It would have been beyond the scope of this dissertation to verify each variable with quantitative data, which should be the focus of future research. In addition, the variables of member states interests and sector interests are hard to summarize in in as it is there are several different individual members and business players.

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