

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## Multilateral Trade Negotiations

### GROUP 3(b) SUBSIDIES AND COUNTERVAILING DUTIES (TASKS 9 AND 10)

#### Background Note by the Secretariat

1. At its meeting of March 1974, Group 3(b) agreed to take up tasks 9 and 10 of the Programme of Work at a meeting to be held on 29-31 May (MTN/3B/7, paragraph 23).
2. The mandate of the Group with regard to these tasks, as set out in MTN/2, is as follows:

Task 9. Continuation of the work already begun on export subsidies in respect of products other than primary commodities (Chapters 25-99).

Task 10. Continuation of the study of a possible code regarding countervailing duties (General Aspects).

When the Programme of Work was adopted the representative of Canada said that his Government "attached great importance to continuation of the work on internal aids which distorted trade as had been specified in the terms of reference of Working Group 1 of the Committee on Trade in Industrial Products. It was with this understanding that Canada accepted the Chairman's proposal". (MTN/P/2, paragraph 3)

3. Both tasks 9 and 10 call on the Group to continue work started in the Committee on Trade in Industrial Products. This note provides a short guide to the relevant work done in that forum.
4. The secretariat prepared two background notes for Working Group 1, one on export subsidies (COM.IND/W/73 of 28 April 1972) and the other on countervailing duties and domestic subsidies that stimulate exports (COM.IND/W/98 of 14 March 1973). Both notes set out the relevant GATT provisions, refer to the problems contained in the Inventory of Non-Tariff Measures<sup>1</sup> and indicate the solutions which had been proposed up to the time of drafting. The background note by the secretariat on

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<sup>1</sup>The Inventory has since been revised. Relevant notifications are contained in part one of the Inventory, MTN/3B/1.

non-tariff measures affecting the trade of developing countries (COM.TD/W/182) deals with export subsidies and countervailing duties in paragraphs 19 to 23. An earlier note by the secretariat on incentives for industrial exports from developing countries was circulated as COM.TD/72.

5. Working Group 1 held five meetings directed to the establishment of possible ad referendum solutions to problems created by subsidies and/or countervailing duties - in May 1972 (for a note on the meeting see Spec(72)33), June 1972 (Spec(72)61), October 1972 (Spec(72)129), April 1973 (Spec(73)18) and June 1973 (Spec(73)44).

6. The following paragraphs summarize the main points raised at these meetings. For more details reference should be made to the documents cited.

A. Export subsidies

7. Working Group 1 agreed to adopt as a working technique an approach that would involve the general principle that countries should not institute or maintain export subsidy measures that distort trade and the drawing up of a list of practices that would be prohibited. The general view was that the list should not be exhaustive, as it could not be expected to cover every possible type of export subsidy (Spec(73)18, paragraph 2).

8. The following is the list of prohibited practices as examined by Working Group 1 at its last meeting (Spec(73)44, paragraph 6), it being understood that this list did not commit any delegation and that the 1960 list of prohibited practices remained as it stood:

- (a) The provision by governments of direct subsidies to exporters.
- (b) Internal transport and freight subsidies on export shipments on terms more favourable than for domestic shipments.
- (c) The government bearing directly or indirectly all or part of the transport or freight charges incurred on export shipments beyond national frontiers.
- (d) The government bearing all or part of the costs incurred by exporters in obtaining transport and freight insurance cover.
- (e) The government bearing all or part of the costs incurred by exporters in obtaining credit for financing export shipments.
- (f) Government loans to exporters on concessional terms for working capital purposes, where such loans enable the exporter to offer concessional sales terms, including financing.
- (g) The grant by governments (or special institutions controlled by governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed.

(h) The provision by governments (or special institutions controlled by governments) of export credit insurance and guarantees, or insurance against increases in the costs of products at premium rates which are manifestly inadequate to cover the long-term operating costs and losses of the insurance institutions.

(i) The accordance by governments of preferred treatment to certain exporters based on their export performance, such as the extension of time for the re-payment of loans, easier access to credit, or more favourable terms in export insurance programmes.

(j) Loans that minimize the risk involved in developing new markets abroad, (i.e. the obligation to repay the loan is forgiven if the firm is not successful in developing a substantial market abroad).

(k) Currency retention schemes or any similar practices which involve a bonus on exports or re-exports.

(l) Special government measures to offset, in whole or in part, the price disadvantages on exports that result from its own or other countries' exchange rate adjustments.

(m) The remission (including credit allowances) or deferral of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises when the criterion for remission or deferral is related to the export performance.

(n) The exemption, in respect of exported goods, of charges or taxes, other than charges in connexion with importation or indirect taxes levied at one or several stages on the same goods if sold for internal consumption.

(o) The allowance of special deductions related to exports, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged (e.g. accelerated depreciation allowances on capital goods used in the production of exports; deduction of special reserves set aside to cover risks connected with export sales).

(p) Tax rebate allowed beyond that of actual costs incurred, in calculating income payable for expenses incurred in developing markets abroad.

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<sup>1</sup>It was understood, as suggested by the representative of the IMF, that the "special government measures" were measures other than through the exchange rate system, since the latter could give rise to multiple currency practices, which fell under the competence of the Fund.

(q) Rebate of indirect taxes or charges on exports or components thereof, in excess of accrued indirect taxes or charges on the exported products.

(r) Remission calculated in relation to exports of taxes not borne by the products (taxes occultes).<sup>1</sup>

(s) The reduction of the direct tax burden on producers and exporters or a product accompanied by an increase in the indirect taxes borne by the same product.

(t) In respect of deliveries by governments or governmental agencies of imported raw materials for export business on different terms than for domestic business, the charging of prices below world prices; and for such deliveries of raw materials of domestic origin, the charging of prices for such materials destined for processing for export sales, below those charged for materials destined for processing for domestic sales.

(u) Government payments to producers or exporters that vary with the value of domestic materials used in the manufacture of goods for export.

9. The following comments were made by various delegations on certain points in the above list:

- (i) On point (c), it was noted that "transport on freight charges" were not to be understood to include ship-building subsidies.
- (ii) On point (j), some delegations pointed out that a situation as described in this paragraph could not lead to trade damage in the sense of Article XVI:2.
- (iii) On point (l), some delegations were of the view that this point should not be included in a list of prohibited practices because "special government subsidies" were either outright subsidies and were therefore covered under other points, or they were measures

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<sup>1</sup>The following examples were given of taxes not borne by like products:

- (i) Customs duties on plant and equipment (as opposed to customs duties on raw materials consumed in the manufacturing process)
- (ii) Stamp taxes for shipping and other documents
- (iii) Registration taxes on deeds and documents
- (iv) Mortgage taxes
- (v) Taxes on insurance
- (vi) Advertising and publicity taxes
- (vii) Taxes on government licences and permits
- (viii) Registration and other motor vehicles taxes.

taken for domestic reasons and as such did not constitute subsidies. A number of delegations thought that the measures in question should be considered in the light of their implications, and that the matter needed further reflection. One delegation specified that the provision should not include any temporary measures taken by government in view of compensating exporters for losses incurred as the result of changes in the exchange rate (e.g. when an export contract is closed at one rate of exchange, but payment is later effected at a different rate).

- (iv) On point (r), some delegations recalled the findings of the Working Party on Border Tax Adjustments with regard to "taxes occultes". (BISD, 16th Supplement, page 101, paragraph 15)
- (v) On point (s), some delegations were of the view that this practice did not constitute an export subsidy. They recalled the extensive work undertaken on the subject in the Working Party on Border Tax Adjustments, and the view held by most members of that Working Party that the present rules served the purposes of trade neutrality of tax adjustment appropriately and that no motive could be found to change them. (L/3454, paragraph 9)
- (vi) With regard to point (t), one delegation drew attention to the fact that, whereas the 1960 list contained two criteria on this point, namely that of price differential for raw materials between export business and domestic business, and that of prices below world prices, in the present formulation of the second alternative only the former criterion had been retained.

10. Other possible elements of a solution to problems created by export subsidies, which were not discussed in detail, were (Spec(73)18, paragraph 7 and Spec(72)129, paragraph 11):

- (a) the extension of the prohibition to cover all industrial products,
- (b) a separate solution for concessional export financing,
- (c) wider acceptance of the obligations,
- (d) revival of the standstill provisions of Article XVI:4,
- (e) improved notification procedure, and
- (f) possible action that might be taken in case of an infraction of the prohibition.

11. Representatives of developing countries stated that it was their understanding that the solutions to export subsidies were being developed in the context of an elaboration and refinement of the provisions of Article XVI:4. They explained that, as Article XVI:4 was not in effect for their governments, they had refrained from participating in the development of solutions which would not be applicable to them. (Spec(73)18, paragraph 8)

B. Domestic subsidies that stimulate exports

12. In the view of a large number of delegations possible elements of a solution to the problem of domestic subsidies that stimulate exports would consist of improving the procedures laid down in Article XVI:1 (Spec(73)12, paragraph 9).

13. One delegation said that its aim was more ambitious and put forward the following list of prohibited practices in the field of domestic subsidies that stimulate exports, for consideration by the Group (Spec(73)13, paragraph 10 and Spec(73)44, paragraph 9):

"The following government aids constitute an export subsidy whenever, with respect to a production activity receiving such aids, the aids involved are greater than a de minimus amount and the percentage of the output exported is significant:

(a) Aids to plant modernization under which a firm is granted a special tax depreciation allowance on production equipment in addition to the regular depreciation allowance.

(b) Research and development activities in advanced technologies, underwritten by the national government, where the technologies developed are turned over to the private sector for commercial exploitation.

(c) Sale of electric power by a government-owned utility to certain industries (aluminium, ferro-alloy producers) at rates below those charged by other comparable industrial users.

(d) Agreements entered into between a national government and a domestic firm where the latter undertakes a large development project (aircraft, computers) based on a guarantee the government provides to make up the difference between actual sales (domestic and foreign) and the firm's break-even point.

(e) Grants, loans on concessionary terms and reduced taxes."

Many delegations expressed reservations on this proposal (Spec(73)44, paragraph 8).

C. Domestic subsidies with import substitution effects

14. This subject was not discussed in detail by the Group.

D. Countervailing duties

15. Some delegations considered that the acceptance of the injury criterion by all contracting parties should be the fundamental element of any solution. These delegations supported a suggestion that a Code be established on countervailing duties similar to the Anti-Dumping Code and constituting a further interpretation of Article VI. (COM.IND/W/93, Annex III and Spec(73)18, paragraph 14)

16. Other delegations pointed out that, unlike anti-dumping duties, countervailing duties were a response to deliberate government measures. In their view the basic problem for which solutions should first be sought was that of export subsidies. If an adequate solution could be found to export subsidization, countervailing duties would cease to be a problem. In cases where a contracting party subsidized its exports in breach of its GATT obligations, it did not seem reasonable to require the affected country to prove that material injury was caused or threatened to its domestic industry. (Spec(73)18, paragraph 15)

17. Representatives of developing countries pointed out that in their view countervailing duties should not be applied to their exports. Developing countries were not bound by the prohibition on export subsidies and in fact they felt it was recognized in Part IV of the General Agreement that certain export incentives were a legitimate method for developing countries to increase their exports. Since exports under these incentive schemes from developing countries were not in breach of GATT rules, and as the growth of exports from developing countries was recognized as an objective of the GATT, counter measures should not be taken against these exports (Spec(73)18, paragraph 17)

18. In the view of one delegation, the GATT rules on countervailing duties were not adequate to protect exporting industries from injury caused by competition from subsidized exports in third country markets (Spec(73)18, paragraph 13).