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GENERAL AGREEMENT ON TARIFFS AND TRADE

Multilateral Trade Negotiations

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Group "Non-Tariff Measures"
Sub-Group on Subsidies and Countervailing Duties

SUBSIDIES AND COUNTERVAILING DUTIES

1. At its meeting in June 1975, the Sub-Group "Subsidies and Countervailing Duties" agreed "that participants should submit in writing by a target date of 15 October 1975 to the secretariat, for distribution to members of the Sub-Group, their comments on problems encountered in the areas of subsidies and countervailing duties as well as any specific proposal for appropriate solutions to these problems including, where feasible, draft texts or suggestions" (MTN/NTM/5, paragraph 4, and GATT/AIR/1184).

2. The following communications have been received from Austria, Brazil and the United States.

3. Further communications will be reproduced in addenda to this document.

4. Delegations who have not yet submitted their comments or proposals are invited to do so without delay.

AUSTRIA

In the view of my authorities the negotiations on countervailing duties should aim at the elaboration of an appropriate instrument, e.g. a code or an interpretative note. The main purpose of such an instrument should be to ensure that all contracting parties are bound to the same obligations in their respective system of levying countervailing duties and that such a levying could only be taken into consideration if injury or threats of injury to domestic industries has in fact been established. Such an instrument could take the form of a Code as well as of interpretative notes to Article VI of the General Agreement.

BRAZIL

I. Problems encountered in the areas of subsidies and countervailing duties

1. In September 1974, the Government of the United States of America imposed countervailing duties on Brazilian exports of non-rubber footwear, following allegations by the domestic footwear industry that these exports were subsidized by the Brazilian Government. The countervailing duties in question were broken down into two duty rates: the first one at the level of 4.8 per cent and the second, of 12.3 per cent. The first rate applied to products exported by firms whose export receipts corresponded to 40 per cent or more of their total sales, the products of all other firms being subject to the higher rate.

2. This measure, which is still in force, has affected 176 firms, whose exports to the United States market in 1974 totalled around US$87 million.

3. Besides this measure, the United States Government, moved exclusively by its domestic Trade Act, are presently conducting two additional investigations on alleged subsidizations by the Brazilian Government of Brazilian exports to the United States market of other products, namely, leather handbags and castor oil products.

4. Following the imposition of countervailing duties on imports of non-rubber footwear from Brazil, the Brazilian Government launched a protest to the United States Government against this measure, which was unilaterally adopted on the sole basis of the United States domestic law and at variance with the GATT provisions on the matter. Brazil declared then that this measure had no juridical, economic or political justification.

5. As to the juridical aspects of the question, Brazil underlined that, in spite of GATT providing for a set of rules on subsidies and countervailing duties, the United States, in the cases of leather handbags and castor oil products, had recourse exclusively to domestic legal requirements, now incorporated into the Trade Act, which are not compatible with the pertinent GATT rules. This is brought out mainly by the fact that the United States domestic law determines that countervailing duties should be imposed without a test of substantial injury, or at least the threat thereof, to the importing country's industry, which is the fundamental prerequisite for the imposition of compensatory measures according to Article VI of the General Agreement.

II. The Brazilian position

6. Brazil reaffirms its position that, as far as developing countries are concerned, juridical situation under GATT is unequivocal. As it is known, the developing countries have not adhered to the 1960 Declaration giving effect to the

provisions of GATT Article XVI:4, which deals with subsidies on industrial exports. Therefore, developing countries are not bound to subsidize their exports. If it is permitted that developing countries apply subsidies to their exports it follows as a corollary that it is not permitted that developed countries cancel out the effects of such subsidies through the levying of countervailing duties. Even if it were agreed that exceptions should exist to this rule the actual application of compensatory measures should be preceded by a thorough demonstration, on the basis of objective criteria, that the subsidized exports from the developing country in question was indeed disrupting the market for the product and causing serious injury to the domestic industry in the importing country. It should be added that GATT Article VI, relating to the imposition of anti-dumping and countervailing duties, does not lay down objective criteria for the determination of material injury, which must be the underlying cause for the imposition of such duties.

7. Part IV of GATT refers, inter alia, to the need for "a rapid and sustained expansion of the export earnings of the less-developed contracting parties", and for "positive efforts designed to ensure that less-developed contracting parties secure a share in the growth in international trade commensurate with the needs of their economic development" (Article XXXVI:2 and 3). Aside from this, Article XXXVII:3(c) affirms that developed contracting parties shall "have special regard to the trade interests of less-developed contracting parties when considering the application of other measures permitted under this Agreement to meet particular problems and explore all possibilities of constructive remedies before applying such measures where they would affect essential interests of the contracting parties".

8. As regards this paragraph of Article XXXVII, GATT documentation indicates that it is clear, from the drafting history of Part IV, that countervailing duties are among the measures permitted by GATT in relation to which developed countries should dispense special attention to the trade interests of developing countries before the application of such measures (documents L/2114, Section III(E), and MTN/3B/21, Section C(ii)).

9. In the light of what is stated above, it is the understanding of the Brazilian Government that the set of GATT rules on this question, albeit imperfect, together with the fact that developing countries did not subscribe to the 1960 Declaration on the implementation of Article XVI:4, ensures these countries a differentiated and more favourable treatment both in relation to the application of incentives to their exports and to the criteria that should be observed when developed countries impose countervailing duties to imports from them.

III. Brazilian proposals on the multilateral treatment of the question of subsidies and countervailing duties

10. The lack of specificity of present GATT rules on this matter, which tends to annul the differentiated treatment which can be inferred from them, has led the Brazilian Government to propose, in a constructive spirit, within the framework of

the MTN, a revision of these rules, so as to be explicit, in a form which would meet the interests of both developed and developing countries, rules and special procedures which would confer a differentiated and more favourable treatment to developing countries both in relation to the application of incentives to their exports and to the imposition of countervailing duties, by developed countries, to imports from them. This attitude is based on the Tokyo Declaration, which in its paragraph 5 explicitly recognizes "the importance of the application of differential measures to developing countries in ways which will provide special and more favourable treatment for them in areas of the negotiations where this is feasible and appropriate".

11. In Group 3(B) of the Trade Negotiations Committee, presently replaced by the Sub-Group on Subsidies and Countervailing Duties of the Group on Non-Tariff Measures, Brazil has defended the need to revise the present rules of GATT, and declared itself prepared to negotiate on the following basis: (a) to seek a more explicit definition of rules on export incentives which, within the framework of differentiated treatment, would be explicitly allowed to developing countries; (b) to accept the possibility of countervailing action against exports from developing countries which benefit from incentives, providing that such action is taken in exceptional circumstances and in accordance with objective criteria.

12. Accordingly, Brazil submitted to participants in the negotiations the suggestion of elaborating a "positive list" of export subsidies which, within the framework of differentiated and more favourable treatment to developing countries, would be expressly authorized for these countries. Measures included in the positive list could not, therefore, lead to the imposition of countervailing duties by developed countries.

13. Brazil proposed, furthermore, that the positive list be sufficiently flexible to take into account the trade needs of developing countries. Brazil indicated, in defending a flexible positive list, that a vast range of export incentives is already applied by developing countries within the framework of their national development plans, and that it would therefore not be reasonable to expect such countries to accept an extremely rigid and limited list.

14. In relation to other incentive measures not included in the positive list, Brazil maintained that the imposition of countervailing duties, as a last resort, and in accordance with Article VI and its basic criterion of serious injury, should respect the following special procedures:

> (a) Prior consultations between the developed importing country and the developing exporter country, at the request of the former. Procedures for such consultations should be the same as those normally adopted under Article XXII of the General Agreement;

(b) the establishment of objective criteria to determine if the support measure caused real injury to the market of the importing country (not merely to an industry, but to an industrial sector as a whole). In other words, there should be irrefutable evidence that the injury results from a substantial increase of imports of subsidized products, and that such products are offered at prices which are substantially inferior to those which would exist if there were no support measures. Account should be taken, in such procedures, of the trade and development needs of the developing country involved, as provided for in paragraph 3(c) of Article XXXVII, especially in relation to such elements as the stage of development of the country, the strategic importance of the subsidized exports to its economy and the need to increase its export revenue;

(c) consideration of the prejudicial effects which the imposition of countervailing duties might have on the market and the economy of the developing exporting country; in other words, it is also necessary to take into account market disruption in the exporting country, in conformity with the concept already adopted in Annex A, paragraph III, of the Arrangement Regarding International Trade in Textiles;

(d) should there fail to be an agreement in the consultations mentioned in (a) above, the developing country would be free to take the question to the CONTRACTING PARTIES or to any other body to be created to administer a Code or an Agreement in this area. The multilateral examination of the question should obey the criteria indicated in items (b) and (c) above. If the CONTRACTING PARTIES find that the developed importing country is effectively suffering serious injury, they may recommend to the developing exporting country to limit the specific support measure accorded to the products in question. However, the developing country should be allowed the necessary period of time to conform to such a decision and to make the necessary internal adjustments. If the developing country, at the conclusion of the alloted time period, does not conform to the decision of the CONTRACTING PARTIES, the developed importer country would have the right to impose countervailing duties, which should not exceed the amount necessary to offset the subsidy totally or partially.

15. Once the above procedures are negotiated for consolidating differentiated and more favourable treatment to developing countries, it would be necessary to discuss how to insert these procedures in the framework of the General Agreement. Brazil proposes that such procedures be given reality through interpretative notes and/or supplementary provisions to Articles VI and XVI, or through the negotiation in the Multilateral Trade Negotiations of a binding code of conduct on the subject, or, finally, through any procedure or agreement aimed at conforming the present GATT rules to the special trade and development needs of developing countries.

16. As it was already pointed out by the Brazilian delegation in paragraph 12 of document MTN/W/5, the negotiating exercise on the questions of subsidies and countervailing duties, in order to consolidate differentiated and more favourable treatment to developing countries, presupposes a further essential element, namely, a "standstill" agreement or understanding, so as to prevent indiscriminate recourse to countervailing action against developing countries pending the final agreement on special procedures on the matter. As a result of this standstill agreement, and until new rules or interpretative notes to the present GATT rules are worked out, the developed countries should refrain from compensatory measures against exports from developing countries and should commit themselves to adopting them only after having exhausted all possibilities of agreement in previous consultations, in the course of which:

(i) the developed importing country would have to offer irrefutable evidence of the existence of material injury to a productive sector, accruing from subsidized exports from developing countries; and,

(ii) the various aspects of the question and the eventual prejudices for the exporting developing country resulting from the envisaged countervailing measures would be duly weighted.

UNITED STATES

The United States believes that an appropriate solution for the problems that countries encounter in the areas of subsidies and countervailing duties is an international code that clearly delineates rules and limitations on the use of subsidies and sets out the rights and obligations of countries in the use of offsetting measures in response to failures to abide by those rules and limitations.

For discussion the United States is outlining its ideas on the broad framework of a code of rules governing subsidy practices and responses to them. It welcomes the ideas of other delegations and looks forward to the negotiation of an improved set of rules in this area.

Agreement on an international code that lays down an improved set of rules governing subsidy practices and responses to them would strengthen the world trading system. It would do so by reducing conflict in the interpretation of what the rights and obligations of countries are in these areas. It would do so by clarifying nations' responsibilities in the use of such measures. As a result, all countries that adhered to the code would benefit from it.

Such a code should deal with three basic problems. First, subsidization can lead to increased exports by one country artificially distorting normal market forces. Second, a country may experience loss of sales in third-country markets

if another country's subsidies result in increased exports to those markets. The United States considers this situation to be a problem of increasing frequency and importance affecting the exports of both developed and developing countries. Finally, a country may experience loss of sales in a subsidizing country's market when the subsidy results in import replacement in that market. Moreover, subsidies that result in import replacement in one country may deflect other countries' exports previously entering that country to third-country markets, often to the detriment of producers in those third countries.

New international rules on subsidies and offsetting measures should deal with all three of these problems. The objective of these rules would be to categorize all types of subsidy practices and set forth the conditions by which offsetting measures could be taken against such practices. In particular, rules are needed to:

(1) Effectively delineate that category of subsidies that should be prohibited;

(2) Place limits and constraints on the use of domestic subsidies that benefit exports to the detriment of other nations;

(3) Delineate which subsidy measures should be permitted;

(4) Regulate the imposition of countervailing duties by agreement on the conditions and procedures under which such duties may be imposed;

(5) Establish effective and fair countermeasures against foreign subsidization that results in displacement of sales in third-country markets; and

(6) Establish improved notification and consultation procedures on subsidy practices, including those resulting in import-replacement.

Subsidies and offsetting measures, including countervailing duties, are inextricably related issues, requiring co-ordinated solutions. A framework for discussion of these problems could consist of defining three categories of subsidies - prohibited practices, practices that are subject to offsetting measures only when certain conditions are met, and practices expressly permitted - and defining the conditions and procedures under which offsetting measures may be taken. In addition, it can be expected that controversial or complex subsidy practices, particularly those that are in widespread use or that are closely linked to national socio-economic goals, will require special rules.

Agreement on an approach such as this will provide a common basis for discussion and negotiation. Past efforts in GATT to develop a specific definition of a subsidy have been unsuccessful. The advantage of the three-category approach

is that it provides a pragmatic framework for discussing the treatment of the entire range of subsidy measures. The focus then, is not whether a particular practice is or should be within the purview of international rules on subsidies, but rather whether the category of the practice is prohibited, conditional, or permitted.

Possible framework for a solution

The Code should consist of three categories of subsidy practices - prohibited, conditional, and permitted. The potential use of offsetting measures would, in turn, be determined by the nature and, as appropriate, the effect of the subsidy. Their actual use would be subject to agreed conditions and procedures.

Prohibited. Benefits directly or indirectly conferred upon exports that are not equally conferred upon goods produced domestically and destined for the domestic market, and benefits conditioned on export performance, would be prohibited. Countries would be permitted to take offsetting measures against prohibited practices without any conditions, except as may be otherwise provided in supplementary protocols.

Conditional. Benefits whose application and use equally affect all production, whether destined for the domestic market or for export, would be conditional and would be subject to offsetting measures only under certain conditions, such as an injury test.

Permitted. The permitted category would consist of practices that are considered to have minimal impact on international trade. Permitted practices would be limited to those specifically agreed as falling within that category. Such practices and any practices judged to result in a de minimus subsidy, would not be subject to offsetting measures.

Supplementary protocols. The framework outlined above would establish the general rules governing subsidies and offsetting measures. In certain cases, special rules might be more desirable for particular subsidy practices. Such special rules could be incorporated in the code by supplementary protocol. For example, an agreement on export financing or regional aid might regulate the use of such practices.

Subsidized competition to third-country markets. The categorization of subsidies as prohibited, conditional, and permitted would also apply to subsidies that result in exports to third-country markets that displace exports by other suppliers. Since countervailing is not appropriate in this case, other countermeasures would be available under the rules for supplying countries whose sales have been displaced in third-country markets by subsidized exports of other suppliers.

Countermeasures. Rules and procedures would be provided for the application of countermeasures where permitted by the rules on subsidies. Such rules could provide for injury determinations where appropriate in cases involving countervailing duties or other countermeasures in response to subsidization in third markets.

Subsidies resulting in import replacement. Subsidies that result in import replacement would require a different approach. Such subsidies can have a significant adverse effect on the trade of suppliers to the market in question and on suppliers in third countries into which exports previously entering the subsidizing country are deflected. Such subsidy rules should provide for obligatory consultations regarding complaints on domestic subsidy practices that could result in import replacement. In addition, signatories to the code should have a reasonable expectation that new or increased subsidies will not result in the nullification or impairment of benefits under trade agreements.

Developing countries. The United States believes it will prove feasible and appropriate to negotiate provisions for differential treatment under prescribed conditions for developing countries in certain areas of subsidies and countervailing duty rules. Such treatment should be geared to the particular situations of developing countries and to periods linked to achieving particular development objectives.

Non-market economy countries. The nature of non-market economies makes it difficult to determine whether a subsidy exists and in what amount. Subsidies by non-market economy countries will require different rules, perhaps in the context of safeguard provisions.

Notification procedures. The code should provide for effective notification procedures, whereby the subsidy practices of countries can be brought to the attention of the adherents of the code by a number of ways, including notifications by countries other than the one granting the subsidy.

Administrative provisions. Provision should be made for effective administration of the code. Until there is general agreement on the more important substantive issues, the United States believes that consideration of these questions should be deferred.