

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

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The following communication has been submitted by the delegation of the European Community for circulation to the Negotiating Group on Textiles and Clothing.

ELEMENTS OF THE NEGOTIATING FRAMEWORK

INTRODUCTION

The well-known problems which have arisen in connection with the functioning of the Subsidies Code are due to ambiguities and lack of precision, in the Code, on a number of crucial points. These have been the source of serious conflicts, to the detriment of the credibility of the Code itself and, more generally, of the multilateral trading system.

These ambiguities were left over after the Tokyo Round negotiations because of persisting differences between signatories of the Code on the exact scope of the discipline set forth in the Code itself: that is, on the definition of a subsidy as opposed to other forms of government intervention, and on the definition of an actionable subsidy.

The European Community is committed to the objective of the Uruguay Round negotiations, as established in the Punta Del Este declaration, that is, to improve GATT disciplines relating to all subsidies and countervailing measures that affect international trade, and believes that the logical first step towards any meaningful discipline is a common understanding, between participants, of the object of these improved disciplines.

The Community considers, therefore, that it is one of the fundamental tasks of the Negotiating Group to identify and define the various subsidy practices in a politically balanced and technically workable manner, in order to subject them to appropriate discipline according to their impact on international trade.

For the above reasons, this contribution by the European Community concentrates on the issues of identification and definition of subsidies, along the lines of the Negotiating Framework endorsed by the TNC, as well as on the issue of notification and surveillance, which is also essential for the practical functioning of any disciplines which may be agreed upon.

This does not mean that the European Community considers the other issues identified in the Negotiating Framework (or, for that matter, any other relevant issue) as being of lesser importance, and the Community reserves the right to intervene with further contributions, if and when appropriate, in the light of the development of discussions in the Negotiating Group.

As far as agricultural, forestry and fishery products are concerned, they pose special problems which can only be solved in the wider context of agricultural and other relevant negotiations. However, the results of these negotiations will have to be taken into account in this Negotiating Group.

1. PROHIBITED SUBSIDIES

1a. Identification

So far this category of subsidies has included, according to Article XVI:4 of GATT and Article 9 of the Subsidies Code, export subsidies on products other than certain primary products. This prohibition should be maintained, and be made more effective according to its rationale: that is, that these subsidies have a direct impact on international trade, and therefore their use should be prohibited per se.

Thus:

- (a) The prohibition of export subsidies in Article 9 of the Subsidies Code should be reformulated in order to define clearly its scope.

This prohibition must apply to all export subsidies, that is, all government interventions which confer, through a charge on the public account (in the form of either direct financial outlays or revenue foregone, such as tax relief and debt forgiveness), a benefit on a firm or an industry contingent upon export performance.

- (b) In addition, since experience has shown that government practices may be easily manipulated or modified in order to avoid this prohibition, it is apparent that a prohibition only of those subsidies which are de jure (that is, expressly) made contingent upon export performance is open to circumvention.

The prohibition, in the present discipline also applies to subsidies de facto contingent upon export. This, however, makes it necessary to provide for clearer guidance in identifying de facto export subsidies, in order to avoid undue extensions of the category of export subsidies. De facto export subsidies are those where facts

which were known - or should clearly have been known - to the government when granting the subsidy demonstrate that the subsidy, without having been made expressly contingent upon export performance, was indeed intended to increase exports.

This element of finality flows logically from the rationale for prohibiting export subsidies, that is, that these subsidies aim at distorting trade by favouring exports. A mere reference to the effect if a subsidy on exports, as observed ex post facto, would be inconsistent with this rationale. If it cannot be shown that, on the basis of facts which the government know - or should clearly have known - when granting the subsidy, the intention of the government was in fact to favour exports, and therefore it cannot be said that the subsidy aims, de jure or de facto, at distorting trade, this subsidy should not be prohibited; it should rather be subject to remedial action if and when it produces demonstrable negative effects on trade.

As evidence of de facto export subsidies, one might consider, for instance, cases where export performance is only one of the eligibility criteria for receiving a subsidy, but where the granting authority has wide administrative discretion and in fact exercises it so as to favour exporting firms or industries;

- (c) At the same time, the Illustrative List of Export Subsidies should be clarified and improved. However, the non-exhaustive nature of the List should be preserved, given the risk of circumvention of an exhaustive list, no matter how comprehensive. To this end, and given the technical complexity of the issues involved, the Negotiating Group may envisage the establishment of a technical group to develop common ideas, to be examined later by the Group itself.

1b. Remedies

According to currently applicable multilateral rules, the consequence of the prohibition of a subsidy is of course the obligation not to grant such a subsidy and, in case of violation, the obligation to remove the measure. If the subsidizing country refuses to remove the measure, it may offer compensation, or be subject to retaliatory action authorized by the GATT. In this context, a country affected by the use of prohibited subsidies in another country only has to show the export-oriented nature of the subsidy, and the negative trade impact would be presumed, as long as it is not rebutted by the other party.

This discipline should continue to apply to the category of prohibited subsidies as identified in this contribution. It could however be improved to ensure equitable solutions for both parties to a dispute. This problem should be examined in the light of the results of discussions in the Negotiating Group on Dispute Settlement.

As far as countervailing duties are concerned, although they are authorized by GATT and the Code (provided that their application meets the substantive and procedural conditions laid down in the GATT and the Code), their nature is and must remain inherently remedial. The consequence of this is that an "injury test" must remain necessary to justify the application of countervailing duties even when they are imposed to offset the effects of a prohibited subsidy.

2. NON-PROHIBITED BUT COUNTERVAILABLE OR OTHERWISE ACTIONABLE SUBSIDIES

Current rules (Articles 8.1 and 11 of the Subsidies Code) establish the principle that domestic subsidies are per se legitimate instruments of social and economic policy. They also recognize that the use of these subsidies may cause adverse effects on international trade, and in particular on the interests of other countries; therefore, these subsidies can be actionable, once their negative effect on trade interests of other countries has been demonstrated. Indeed, since domestic subsidies do not aim at affecting trade interests of other countries, and for this reason do not necessarily affect, in practice, such interests, it seems obvious that the only reason which justifies an interference in a country's sovereign use of an instrument of domestic economic policy, and is at the same time practically workable, is the existence of an identifiable and demonstrable negative effect of the subsidy on other countries' trade interests.

The Community believes that this principle should be maintained. At the same time, much clearer guidance is needed as to when domestic subsidies have a negative trade impact on the interests of other countries and on means to remedy such impact.

This involves clarifying:

- (a) the definition of an actionable subsidy;
- (b) the method for the calculation of its amount; and
- (c) the conditions under which the subsidy has a negative trade impact.

2a. Definition of an actionable subsidy

Whereas it might be difficult to envisage an exhaustive definition of an actionable subsidy, there exist some basic criteria which should be followed in making such a determination.

- (i) Obviously, a subsidy must confer a quantifiable benefit to the recipient, since the reason for action against a subsidy is the artificial competitive advantage it is supposed to confer on the beneficiary.
- (ii) However, this element cannot be taken in isolation. Action by public authorities cannot and should not be considered as a subsidy only because all or part of the citizenry (including enterprises) benefit

from that action, because it is indeed a function of governments to undertake actions which are of benefit to the citizens. The idea that any such action constitutes a subsidy would bring within this concept almost every conceivable action by public authorities. Therefore, it appears necessary that the concept of subsidy be limited to actions which imply expenditure of public funds, or otherwise a cost for the government.

A corollary question is how to assess the cost for the subsidizing government of providing a given subsidy. It would seem appropriate that this assessment take into account not only any direct expenditure (in the form of either financial outlay or revenue foregone), but also the risk incurred by the government in providing the subsidy to a firm or industry (for instance, through a loan or a loan guarantee). When the risk assumed by the government is remunerated, however, this risk does not constitute an element of subsidization because, when a government assumes the risk of a commercial operation (in the sense that it assumes both the possibility of a loss and that of a gain) and this assumption of risk is based on sound economic considerations, the government intervention does not constitute a subsidy at all. All these assessments should be made against the background of non-intervention and according to usual government practices in a market economy.

- (iii) The two criteria above relate to the question of the existence of a subsidy. A third criterion seems also to be necessary for a subsidy to be actionable, that is, that the subsidy be specific to a firm or an industry. In other words, a distinction should be drawn between general measures designed to stimulate economic activity as a whole and specific measures with identifiable beneficiaries whose competitive position is improved by the intervention, and only the latter should be actionable.

The concept of specificity as a criterion for countervailability of domestic subsidies is widely known in the countervailing duty laws of various signatories of the Subsidies Code, and its application has proved both feasible and appropriate. The Community believes, however, that the concept should be clearly spelt out in the Subsidies/CVD Code: it should be defined precisely, and it should be one of the essential conditions for actionability of a subsidy, not only in the context of CVD procedures, but throughout the Subsidies Code wherever a different discipline is not provided.

The main problem raised by the application of the concept of specificity is that subsidies which are de jure generally available may be, in fact, granted in a selective manner. Therefore, the concept should also cover de facto specificity.

¹It is understood that expenditure of public funds which is the remuneration for goods or services received by the government or other public authority is not a "cost" for the purpose of determining whether or not a subsidy exists.

In this respect, the degree of administrative discretion enjoyed by the granting authority and the presence (or, conversely, the absence) of objective criteria for exercising this discretion are certainly relevant. Nevertheless, these and/or any other criteria to determine whether a de jure generally available subsidy is de facto specific must be sufficiently precise to avoid rendering the specificity criterion meaningless.

The Community also believes that consideration should be given anew to the situation of those countries where, due to a particular constitutional structure, subsidies may be granted not only by the central authorities of that country, but also by its subdivisions. In these cases, where macro-economic variables such as exchange rates do not play a corrective rôle of the effects of subsidies, the result may be that a country can escape its obligations under the Code, and thus create an imbalance in respect of countries with a different constitutional structure. The concepts about regional specificity which have been set forth sometimes in the past, and in particular the idea that "general availability" relates to the jurisdiction of the granting authority, rather than to the subsidizing country, lack economic rationale. Indeed, there is no difference, as to their economic effect, between a subsidy granted by a regional or local government to all firms in that region on one hand, and the same subsidy granted to the same firms in the same region but by the central government on the other hand. Both cases are liable to have the same economic effect, and they should both be subject to international discipline but only insofar as this effect is not limited to trade and competition within the subsidizing country, but extends to international trade.

Finally, certain government actions which are not prima facie related to trade may nevertheless have an effect on trade, and should be included in the scope of the negotiations: for instance, the civil "spill-over" effects of military expenditure leading to commercially exploitable products, and public contracts awarded at prices well above market prices. Even in cases where these activities as such would not be, in principle, covered by GATT disciplines, they should not be used to disguise unfair competitive advantages to firms engaged in international trade, and should be actionable according to subsidies disciplines.

2b. Negative trade effect

Once it has been established that a given practice constitutes a subsidy, and that this subsidy is specific, it is necessary to lay down criteria for determining whether the subsidy has a negative trade effect, and is therefore in fact actionable.

The definition of these criteria may vary according to the type and nature of the remedial action, but the principle should underlie all such actions, whether they are in accordance with unilateral or multilateral procedures.

As far as unilateral remedies (countervailing duty procedures) are concerned, the present concepts of material injury to the domestic producers of the like product and of a causal link between subsidized imports and injury have proved to be fair and effective. More precise criteria for the practical application of these concepts have been developed by the investigating authorities of signatories of the Code: these criteria should be consolidated into existing discipline, as appropriate. In addition:

- (i) the injury test should be applied erga omnes by all signatories, since it is an essential logical element for justifying application of countervailing duties, which are remedial in nature and not punitive;
- (ii) determinations of injury should not be limited to the existence of injury, but should ensure that countervailing measures do not go beyond what is necessary for the elimination of the injury.
- (iii) strict criteria should be maintained and applied for identifying the injured domestic industry;
- (iv) even in the presence of material injury, domestic legislation should enable the imposition of duties, but should not make it mandatory.

As far as multilateral remedies are concerned, there remains the question of determining the negative trade effect in the context of multilateral remedies. The Community believes that the concept of "material injury" to an industry of the complaining signatory may be transposed from the countervailing duty area to other procedures. In addition, there is nothing to prevent development of the concept of "serious prejudice" in a similar manner, and it is submitted that the lack of such a development under current rules has been perhaps due more to the lack of effectiveness of current dispute settlement procedures, than to a flaw of the concept itself.

Another important issue is the need to tackle the problems of import substitution and of displacement of exports on third country markets. In this respect, it might be worth exploring whether to provide precise guidelines as to the remedial measures which the Subsidies Committee may recommend if an offending subsidy is not eliminated by the country giving it, upon a showing that a subsidy has a negative trade effect. This would ensure, together with an improved dispute settlement mechanism, that appropriate remedies to those situations are available to aggrieved parties.

3. NON-COUNTERVAILABLE, NON-ACTIONABLE GOVERNMENT INTERVENTIONS

The existence of this category is closely linked to the rationale for discipline of subsidies, that is, a negative effect on international trade and competition due to an artificial alteration of the competitive position of enterprises engaged in international trade.

Therefore, this category should include those practices which do not affect international trade, or whose effect is less than significant or not identifiable. Some of these practices can hardly be considered as subsidies: nevertheless they are mentioned to point out that they do not meet the conditions for actionability. Others do fulfil some of the criteria for the existence of a subsidy and for specificity, but have no significant negative trade effects, and thus should not be actionable. This is true, however, subject to strict conditions, and whenever these conditions are not met the subsidy may cause negative trade effects (with actual action being subject, of course, to determining whether the subsidy does in fact cause negative trade effects).

3a. Government interventions at no charge on the public account

Actions by public authorities which do not imply expenditure of public funds or anyway a charge on the public account are not subsidies, and thus a fortiori cannot be actionable or be otherwise subject to subsidies discipline.

3b. Non-trade related government actions

These may include measures, normally of a general nature, which are not trade-related. They concern, for instance, education, culture, health, social welfare and general infrastructure. Action in these fields may have an effect on the economy of a country, and thus on the international economy, but they are not normally subsidies, because they merely contribute to setting the terms and conditions of a country's economic and business environment. therefore they do not alter the competitive position of firms.

3c. Generally available public support measures

The distinction between generally available subsidies and other general measures designed to stimulate economic activity is often a fine one, and is difficult to draw. In any event, the lack of specificity of these measures is sufficient to exclude their actionability.

In this context, it should be confirmed that export credit practices which are in conformity with international agreements on official export credit not only do not constitute prohibited export subsidies but are not subject to subsidies discipline at all under the Code.

The same applies to trade promotion assistance, which does not confer specific advantages to firms and is therefore a generally available measure.

3d. Measures with de minimis trade effects

It would seem that the trade-distorting effects of remedial actions might be in some cases, more serious than the effect of a subsidy itself. The problem in this case is that of setting an appropriate de minimis threshold. The Community proposes that when a subsidy does not exceed X per cent ad valorem (provided it cannot be cumulated with other subsidies) the subsidies should be presumed to have a de minimis trade effect.

3e. Subsidies with little or no effect on international trade and/or competition

(i) Regional aids ("aides à finalité régionale")¹, which merely compensate a firm for the greater disadvantage of being located in a less favoured region of a signatory, may affect trade and competition within the subsidizing signatory, but not the external trade of that signatory. This presumption of non-actionability based on absence of effects on international trade could be reversed if it can be shown that there has been overcompensation of those greater disadvantages: to this extent, at least a portion of the aid would be considered as an actionable subsidy.

(ii) Aid for research and development, the results of which are either published and may be utilized without restriction, or are prior to the industrial or commercial exploitation of a product;

environmental aid (such as compensation of higher cost of developing and/or adopting "clean" technologies, or inducement to consumers/users to prefer environment-friendly, albeit more expensive, products);

aid for energy-savings (such as compensation of higher costs of developing and/or adopting technologies which induce consumers and users to make a more rational use of energy);

under these conditions these types of aid do not confer a competitive advantage on the recipient, and therefore should not be actionable.

(iii) Aid for structural adjustment, far from altering conditions of normal competition, aims at restoring them in situations where the entire trade in a given sector has been disrupted by structural imbalances on an international basis. To be considered as true structural adjustment aid, however, these aids should meet strict conditions, among which should be, in particular, the existence of an overall sectorial crisis characterized by overcapacity and long or medium-term imbalance between demand and offer, and at least a direct link between the aid and effective reductions in capacity. Such aids should also be of a temporary nature.

(iv) Aid aimed at improving security and diversification of energy supply, provided that:

- the aid is limited to the greater costs of producing or securing and storing energy or energy products; this presumption of non-actionability could be reversed if it can be shown that there has been overcompensation of those greater costs; and

¹"Regional aids" ("aides à finalité régionale") are subsidies given to firms by any central or local public body or agency, solely on the basis of the location of a firm in a given region and with a purpose linked to the particular characteristics of that region and/or to regional disparities within the subsidizing country.

- the aid is not passed through to users of energy in such a way as to confer a specific competitive advantage upon some of them or on producers of commercial by-products of the production processes involved.

4. NOTIFICATIONS AND SURVEILLANCE

An effective and workable notification mechanism is an essential pre-requisite for any meaningful discipline on subsidies. Transparency is instrumental to multilateral surveillance, and this is the basis for mutual trust among signatories about respect of mutually agreed disciplines.

It must be recognized that the existing mechanism has not fulfilled this rôle. This has happened largely because of the lack of a commonly agreed definition of subsidies, and the resulting excessive latitude for signatories in determining the extent of their notifications, as well as the lack of clarity about the consequences of notifications.

An agreement on identification and definition of subsidies will partly solve this problem, by putting notifications on a more certain and objective basis. This, however, does not in any way reduce the need for transparency and multilateral surveillance; indeed, they become even more important, given the increased discipline envisaged for certain subsidies, and the need to ensure that conditions for actionability of other categories of subsidies are met.

For these reasons, all subsidies, including those granted by States or by any regional or local authority, and not included in the category described in section 3 of this contribution, should be notified.

In general, the "self-incrimination" effect of notifications should be overcome, by recognizing that notification of a measure does not prejudge either its legitimacy under the General Agreement, the effects under the Code, or the nature of the measure itself.

The content of notifications should be sufficiently precise to allow assessment of the trade effect of any measure, as well as to allow an understanding of the working of the notified subsidy regime. The questionnaire concerning subsidies should be revised with the aim of simplifying notifications.

Finally, current provisions for counter-notifications should also be improved, and consideration should be given to enhancing their corrective rôle for cases of lack of (or insufficient) notifications. Countries concerned by counter-notifications should be ready to explain their practices.

5. SPECIAL AND DIFFERENTIAL TREATMENT FOR DEVELOPING COUNTRIES

The issue of special and differential treatment of developing countries is an important one, and deserves further attention. With regard to the participation of developing countries in the improved disciplines on subsidies and countervailing measures which will result from these negotiations, the European Community believes that:

- on the one hand, due account must be taken of development needs of least developed countries;
- on the other hand, however, care must be taken to ensure that all participants in those disciplines assume the ensuing obligations to the fullest possible extent, according to their ability to compete in international markets.

For this purpose, consideration shall be given to amending Article 14 of the current Subsidies/CVD Code, with a view to making its provisions consistent with the above-mentioned principles.