

GENERAL AGREEMENT ON TARIFFS AND TRADE

Multilateral Trade Negotiations

Original: English

Group "Non-Tariff Measures"

Sub-Group "Subsidies and Countervailing Duties"

SUBSIDIES AND COUNTERVAILING DUTIES

Addendum

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 communication has been received from India.
3. Delegations which have not yet submitted their comments or proposals are invited to do so without delay.

INDIA

1. The Tokyo Declaration (paragraph 5) explicitly recognized "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 negotiations where this is feasible and appropriate". Later, in adopting its programme of work on 2 February 1974, (MTN/2), the Trade Negotiations Committee determined that each of its groups "shall in the course of its work be guided by the Ministerial Declaration as it relates to developing countries".
2. Articles VI and XVI of the GATT deal with Countervailing Duties and Subsidies respectively. Section A of Article XVI makes it obligatory for all contracting parties to notify all subsidies which directly or indirectly increases exports while Section B of Article XVI recognizes the harmful effects of subsidies and, therefore, stipulates that contracting parties should avoid using subsidies on the export of primary products.

3. Article VI:6 of the GATT which deals with countervailing duties envisages that before action for countervailing duties is initiated by any importing country for the "alleged subsidization", the importing country which intends taking countervailing measures must prove that such subsidization by the exporting country causes or threatens material injury to established domestic industry or is such as to retard materially the establishment of a domestic industry. Some countries while acceding to Part II of GATT, protected the earlier national legislation on the subject which does not require material injury to be established at all.

4. The General Agreement was negotiated in the post war era when the problems of the developing countries had not received the attention of the international community. The basic elements of the GATT are based on the principles of equality, reciprocity and mutuality of benefit. Some recognition to the problems of developing countries was given when Part IV of GATT was negotiated in the early sixties, though this did not take into account all the problem areas in relation to GATT and did not go far enough. One such area which needs to be given urgent attention is that of promotional measures which the developing countries have to take to expand their exports including incentive and subsidies which they have to grant to selected sectors. The following are some of the considerations which justify the grant of incentives and subsidies by the developing countries.

- (i) The growth of industries in the developed countries took place in the world economy under circumstances very different from the present one, when many of them had unrestricted access to raw materials and markets for their products and they were relatively in not very different stages of development. These countries have now advanced very far ahead of the developing countries. The latter countries now wanting to enter the world of manufactures have to face competition from products well established in the market, often branded products marketed by multinational corporations. They lack wide technological base and versatility available to the industries of developed countries to match the quality range and variety of products. They often lack infrastructure. Many such products require organization of sales and service facilities in the respective markets which they are unable to organize. Thus, in order to enter markets where powerful industrial countries are entrenched, with the handicap of lack of technology, skill, industrial infrastructure, the developing countries need to grant incentives and subsidies to their products.
- (ii) The newly established industries in developing countries often are high-cost industries because economies of scale and the advantage of generally industrialized environments are missing. This hurdle in the ascent stage of industrial development requires export subsidies to be granted.

- (iii) In the context of the situation prevailing in developing countries, exchange rate adjustment is not always an appropriate solution for promoting exports. The grant of subsidies for exports is, on the contrary, more suited to the needs of the situation in such cases. The concept of a unitary and stable exchange rate is proving to be increasingly inadequate to respond to the new situation which developing countries are confronted with in their efforts to industrialize themselves. Where either the foreign demand for a country's exports or their domestic supply or both are not sufficiently elastic, devaluation will fail to produce the desired result. If, however, there are a few exports, which are subject to high elasticity of both demand and supply and would, therefore, respond to a foreign price reduction, export subsidies, and not devaluation, would serve the purpose fully. Since devaluation is a general policy instrument unlike subsidies which are selected, a given rate of devaluation would tend to confer excessive benefits on some exports and not quite enough on others. In the latter case, there would be no increase in exports at all. While, in theory, therefore, there would have to be many rates of export subsidies, in practice, for the sake of administrative simplicity, one will have to settle for a limited number of rates of export subsidies. Experience shows that this can be easily done by grouping together products with roughly equal cost disadvantages.

Therefore for developing countries, a tariff-cum-subsidy system is preferable to an adjustment in the exchange rate to achieve equilibrium in the balance of payments.

- (iv) Partly because in developing economies the production base is small, which makes it necessary to curb domestic consumption through taxes in order to generate an exportable surplus and partly because of the inevitable reliance on indirect taxes as the principal source of tax revenue, the incidence of such taxes on all production tends to be on the high side. A very important cost raising factor is the heavy reliance placed on excise duties on intermediates which cannot be refunded wholly at the export stage. In addition to excise duties, the indirect incidence of import duties on the inputs of the export products also makes subsidies necessary, especially when the precise calculation of such incidence is difficult or impossible. Finally, subsidies are also necessary to offset the import duties levied by importing developed countries which cannot be justified in terms of economic logic as well as to offset the subsidies given by developed countries for their exports to third markets where they compete with the exports from developing countries.

- (v) The International Community has accepted the principle of discriminatory treatment in favour of the developing countries through the acceptance and implementation of the GSP. The granting of export subsidies on manufactured items by the developing countries is merely the other side of the coin and could be construed as supplementing the efforts under GSP. Similarly, the grant of subsidies for commodities is not altogether prohibited. The principle needs to be extended to manufactures of developing countries also.
 - (vi) The traditional objection of laissez-faire economists to export subsidies is that they tend to introduce distortions in a country's trade and production structure. On the contrary, the trade and production structures of most developing countries are already distorted because of policies pursued for compelling socio-economic reasons. For example, their cost structure often tends to be vitiated by such policies as the promotion of the small-scale sector, where production can be at less than the optimum scale, geographic decentralization which tends to raise the cost of production by locating industries in areas where the cost of transport gets added to that of the product, the desire to protect and increase employment, the provision of minimum wages which are higher than the marginal product of labour etc., the development of backward areas which lack an adequate infrastructure etc. Obviously, these handicaps are of a temporary character and are bound to disappear as development proceeds. By offsetting these distortions which are inherent in the peculiar situation of a developing country, export subsidies simply serve to correct them. Since ex hypothesi these distortions are expected to disappear over a period of time, so would the export subsidies designed to correct them.
5. In view of the above, the right of the developing countries to grant subsidies taking into account the interests of other exporting developing countries should be recognized and built into the provisions of GATT.
- 6.(a) Subject to what has been stated in the foregoing paragraphs, the developed countries should contemplate countervailing action ONLY if there is material injury, directly as a result of subsidy.
- (b) The injury should be to the industry as a whole and not to certain units and the fact of injury having been caused should be subject to multilateral surveillance.
 - (c) In taking action it should be examined if the advantage lies in favour of a developing country (labour intensiveness local raw materials low technologies). Such areas should be vacated by developed countries and adjustment assistance granted to their industry instead of taking protective measures.

- (d) The impact of measures taken on the economy of the developing exporting country should also be considered.
- (e) It should be examined whether subsidies have any element of discrimination.