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Negotiating Group on Subsidies
and Countervailing Measures

COMMUNICATION FROM SWITZERLAND

The following communication has been received from Switzerland with the request that it be circulated to members of the Group.

The Declaration of Punta del Este and the Negotiating Plan commit the present Negotiating Group to review articles VI and XVI of the Gatt and the MTN Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade with a view to improve GATT disciplines relating to all subsidies and countervailing measures that affect international trade. Within this task, and working towards a common negotiating basis, the Swiss delegation submits the following proposals on the classification of subsidies in a future framework.

In a nutshell, the proposal suggests to redefine existing categories and to introduce three different classes of subsidies: prohibited subsidies, actionable subsidies and non-actionable subsidies. Unlike today, distinctions are drawn on the basis of different legal effects attached to each class:

- o The use of prohibited subsidies allows, subject to procedural safeguards, for unilateral countermeasures without the legal requirement of material injury, or threat thereof.
- o Actionable subsidies are lawful, but subject, as today, to countermeasures to the extent they cause material injury.
- o Finally, non-actionable subsidies have to be tolerated, even if they cause negative effects to trading partners.

The approach allows for new combinations: subsidies related to a particular sector of the economy no longer need to be treated all alike. The allocation of different types of national subsidies to the three classes or baskets will be a matter of subsequent negotiations based on the legal framework further developed in this communication.

1. Introduction

Attempts to achieve greater discipline in the use of subsidies has led to the development and introduction of different categories of subsidies in GATT. While article VI of GATT basically relies upon a uniform concept of subsidies, article XVI, as amended, introduced the distinction between subsidies on primary products and subsidies on non-primary products [Sec. B(3) and (4)]. The MTN Code on Subsidies and Countervailing Duties finally added yet another group. The agreement relies upon a classification of three well-known categories:

- c Export subsidies on products other than certain primary products (art. 9)
- o Export subsidies on certain primary products (art. 10)
- o Subsidies other than export subsidies (art. 11)

Existing distinctions thus primarily rely upon the basis of the purpose (motivation) and the objective of a subsidy and upon the economic sector it relates to. Export subsidies on non-primary products start from the premise of a prohibition (though under GATT merely binding upon 17 contracting parties and actually a total of 23 parties under the Code). Export subsidies on primary products are recommended to be avoided but not illegal up to the blurred line when they start affecting existing allocations of so called equitable shares of world exports. Finally, subsidies other than export subsidies start from the premise of lawfulness both in GATT and the Code.

Distinctions made among the three groups based on purpose, objective and lawfulness, however, are not strongly reflected in legal effects attached to them. It imports to emphasize that serious prejudice, or material injury, or threat thereof, is compulsory for all of them under art. VI GATT which, ever since,

established such requirement for all countervailing duties alike whether or not the subsidy is legal at the outset. Under the Subsidies Code, other forms of nullification and impairment besides serious injury are possible as well [cf. art. 8(3)(b)]. But all these forms equally require proof of harmful effects in order to justify appropriate countermeasures under art. 18(9) of the Code. Distinctions drawn between the prohibition of a subsidy and correction of adverse affects to international trade merely work out in procedural terms. It is understood that a prohibited subsidy of a developed country per se establishes a presumption of injury, thus shifting the burden of proof from the importing to the exporting signatory [cf. Code art 8(4) note 26]. Beyond that, the fundamental distinction between prohibited and lawful subsidies remains without any major impact.

2. New Classifications Based on Legal Effects Attached to Subsidies

The present distinctions should be reviewed in accordance with the Declaration of Punta del Este and the Negotiating Plan. The Swiss delegation suggests the following classifications with a view to simplify a presently unduly complex system which is difficult to manage and without much practical effect. It hopes to strengthen disciplines and takes up, in this paragraph, ideas proposed by other contracting parties, in particular the notion and distinction of actionable and non-actionable subsidies. In addition, the category of prohibited subsidies is sought to be redefined.

Instead of classifying subsidies both according to purpose (motivation) and objectives, **basic distinctions in GATT law should rely on different legal effects (substantive and procedural) attached to different classifications.** This approach does not exclude partly identical effects (e.g. with regard to notification and consultation). But it essentially starts from the idea, that different categories only should and need to be created to the extent different legal effects are attached to them. Three different classes are proposed:

2.1. Prohibited Subsidies

Subsidies defined under this heading are per se prohibited. Violations of such prohibitions therefore constitute a violation of international law which allows a contracting party affected by such violations to retaliate in accordance with the principles of international law (proportionality). Subsidies under this definition therefore are subject to unilateral measures (which does not exclude mandatory consultations to take place before steps may be taken). Unlike today, they will not be open to procedures to rebut the presumption of nullification and impairment (including material injury) for the following reason: to prohibit a subsidy per se, but still to require, in addition, nullification and impairment to the party affected is hardly consistent. Instead, rights and obligations are violated by the very fact of using subsidies defined prohibited at the very outset. Signatories are therefore entitled to apply appropriate countermeasures without an obligation to engage, eventually, into long and complex procedures dealing with the existence or absence of nullification and impairment. It is submitted that specific regulation in GATT should take up this conclusion which is in accordance with the principles of general international law.

It will be a matter for negotiations to define those types of national subsidies falling under this classification (Cf. para. 4). Evidently, not all, but many export subsidies already prohibited today could come under this heading.

The absence of an injury test and the authority of parties to impose measures unilaterally under this category, however, does not limit GATT to state mere prohibitions. The problem of harassment and arbitrary impositions, contrary to GATT, will require specific procedural guarantees, discussed below (para. 5).

2.2. Actionable Subsidies Subject to Requirement of Material Injury

A second class of subsidies follows traditional approaches in GATT. They are not prohibited at the outset, whether or not they are recommended to be avoided. But negative effects caused by them to international trade will be actionable, i.e. subject to complaint and to countermeasures by parties affected based upon standards of GATT. As today, the essential feature of this group consists of a mandatory requirement of serious prejudice (material injury), or threat thereof, to the importing country. As presently, proof of such requirement needs to be established by the complaining party.

In essence, the injury test will demonstrate to what extent subsidies are trade related or not within this group. It will be necessary to develop and elaborate strict criteria for this test in order to limit countermeasures, in particular countervailing duties, to subsidies which truly effect trade distortion on foreign markets.

Again, it will be a matter for negotiations to define the types of national subsidies belonging to this class. Most of them may be allocated here, since lawfulness of subsidies subject to an injury, of course, is the standard pattern already today.

2.3. Non-actionable Subsidies

Finally, a third class of subsidies is defined non-actionable. Subsidies qualified under these terms are not subject to measures, neither countervailing duties nor other potential forms of action. Nor are they, logically, subject to any injury test. In other words: even if contracting parties are negatively affected by subsidies qualified non-actionable, they are under a mutual obligation of GATT to tolerate such effects.

As above, the allocation of subsidies to this group will be a matter for negotiations. As a matter of clarification, it may comprise subsidies which from the very outset are very unlikely

to cause any harm to third parties (such as subsidization of local public transport). But more importantly, it may comprise measures taken for structural adjustment. They need to be tolerated for the sake of the cure and must not be countervailed even in case of injury.

3. The Scope for Defining Subsidies

Obviously, the problem of defining subsidies is not resolved by the mere fact of establishing three different classes and replacing existing distinctions under articles VI, XVI and the Code. Yet, it is submitted that the problem may become more manageable, since it allows for different approaches at the same time.

It will be necessary to define prohibited subsidies - in light of effective remedies attached - in a strict sense. The same holds true for non-actionable subsidies. They need narrow and precise definition, since contracting parties have to tolerate possible negative effects in these cases. GATT has to provide sufficiently clear and predictable substantive rules since procedures cannot remove uncertainties here in appropriate time. Thus, it is conceivable to link these types of subsidies to a narrow definition from the very outset, e.g. by relying on direct governmental costs and specific application as constitutive elements.

On the other hand, a more flexible definition, not necessarily limited to cost and specificity of measures, may be adopted for the class of actionable subsidies. Incentives for production may be included. A broader definition is acceptable because the requirement of injury and procedures to establish such requirement provide additional guarantees if the test is defined in sufficiently concise and operational terms. Main efforts need to be directed to establish efficient procedures and precise and predictable criteria.

In conclusion, it is not a matter of defining subsidies in GATT as such and by a single term. Instead, notions may vary and need to be designed in the light of legal effects attached to them.

4. Effects on the Negotiating Process

Defining classes on the basis of legal effects attached to them allows for more flexible combinations than the present concept based on sectorial classification. Thus, it provides wider room for negotiations which could progress in two, subsequent operations:

Firstly, negotiations will have to establish the legal framework, i.e. to define different classes and legal effects attached to them. Importantly, however, this phase will not be dealing with particular types of subsidies defined by objectives and purposes, though the process will, of course, be influenced by goals to be achieved in the second phase. In essence, it is limited to the preparation of the negotiating tools.

Secondly, and based on the legal framework and the three classes or baskets established, parties will embark on detailed negotiations in order to allocate different and existing types and forms of national subsidies to the different baskets of GATT.

Importantly, subsidies relating to a particular sector of the economy no longer need to be put into one particular basket. In full recognition of specificity of agriculture, agricultural subsidies, for example, may be partly prohibited [e.g. export subsidies displacing directly particular competitors from the market, cf. art. 10(2)(a) of the Code]. Partly, they may be tolerated (e.g. for purposes of structural adjustments). Finally, the bulk of them may be subject, as actionable subsidies, to the requirement of the injury test 1/. The same holds true for the other sectors of the economy as well.

1/ This illustration is without prejudice to the activities of the negotiating Group on Agriculture, cf. also sec. G(iii) of the Declaration of Punta del Este. Also, it does not express a negotiating position of this delegation.

Given the need for tight definitions both of prohibited and non-actionable subsidies, it may be best to draw up an **exclusive list** (numerus clausus) of particular types of subsidies for both of these classes. As to the general class of actionable subsidies, it is conceivable to operate on the basis of an **illustrative list**. In fact, if not specifically defined to belong to the classes either of prohibited or of non-actionable subsidies, all subsidies could fall within the general class of actionable subsidies subject to requirement of material injury. Thus, there is a presumption for this class.

This presumption equally exists for newly emerging types of subsidies, provided they fall within the general, legal definition of that class. Of course, this allocation of a particular type of subsidy is open to change. It can be shifted in subsequent negotiations, amending the list of prohibited and non-actionable subsidies, respectively. Such negotiations could regularly take place in an appropriate body.

5. Dispute Settlement

Classification of subsidies on the basis of legal effects will require efficient instruments of dispute prevention and settlement. This is particularly important with regard to prohibited subsidies. The right to impose unilateral measures without the requirement of an injury test asks for particular guarantees. Mandatory obligation to consult (for all classes) will continue to provide important safeguards. But any contracting party affected by unilateral determination should be in a position to call upon a **standing body** at GATT in order to challenge such unilateral action imposed by a government. The body will make immediate determination of the lawfulness of the measure. It has the right to recommend to the Council that a decision should be taken to suspend actions temporarily, as long as the matter is pending, if there is reason to believe these countermeasures are illegal. Similar procedures are essential in cases of non-actionable subsidies. As to the bulk of ordinary, actionable subsidies, ordinary instruments of dispute settlement (panel) may suffice, provided that GATT will prescribe a sufficiently strict injury test and minimal procedural rights to be respected in domestic procedures.

6. Remedies

So far, countervailing duties are the main device available under GATT to respond to violations of obligations in the field. While they remain an essential tool, a wider scope of instruments should be examined. Based on nullification and impairment, art. 18(9) of the Code introduced the general notion of appropriate countermeasures, including withdrawal of GATT concessions and obligations (as authorized by the Committee). Yet, it is not merely a matter of finding new tools of retorsion. It is equally a matter of offering additional forms of compliance. Parties in violation of GATT obligations should first of all be obliged to remedy that situation. Failure to do so includes the remedy of countervailing duties and other countermeasures; yet it seems conceivable that before imposing sanctions of this kind, parties are under an obligation to accept equivalent concessions offered by the subsidizing signatory. Also, the group is invited to study to what extent the imposition of financial compensation could become both an instrument to deter and to accelerate the rollback of unlawful subsidies. The problem of compliance and remedies should be addressed in cooperation with the Negotiating Group on Dispute Settlement.

The Swiss delegation is prepared to explain and develop the present concept in more detail. It also recognizes the importance of the issues identified in the Checklists established by this Negotiating Group (MTN.GNG/NG10/W/9 Rev 1 and W/10 Rev. 1). It reserves the right to further elaboration of these issues, in particular with regard to the criteria of the injury test, procedural safeguards (both of which need to be strengthened) and possible remedies.