

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

RESTRICTED

MTN.GNG/NG10/6

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Group of Negotiations on Goods (GATT)

Negotiating Group on Subsidies
and Countervailing Measures

MEETING OF 1-3 FEBRUARY 1988

Note by the Secretariat

1. The Group held its sixth meeting on 1 and 3 February 1988 under the Chairmanship of Mr. Michael D. Cartland (Hong Kong). The Group adopted the agenda set out in GATT/AIR/2533.

General discussion of fundamental objectives and concepts of Articles VI and XVI of the General Agreement and of the relationship between these two Articles

2. The view was expressed that the subsidies/countervail system, as embodied in the Code, was not achieving the fundamental objectives of Articles XVI and VI. There continued to be massive subsidization by governments across a broad range of sectors including agriculture, as well as continuous friction over the use of countervailing measures with frequent questioning by the affected country of the justification for such actions. The use of countervailing duties as a mechanism to control subsidization was not likely to be more effective in the future than it had been in the past. First, governments were frequently willing to take the risk associated with the threat of countervail rather than stop subsidization; second, the effectiveness of countervail was limited because it did not deal with some of the fundamental trade distortions caused by subsidization, i.e. subsidized goods entering third markets and the displacement of imports by subsidized domestic products. There was therefore a need to accept meaningful new disciplines on the use of all kinds of subsidies which should make it easier to improve the countervail rules and help to prevent countervail from being used for harassment or protectionist purposes. Both Articles XVI and VI were intended to constrain the unilateral rights of governments to act in ways that inhibit trade liberalization. These constraints should be turned into firm obligations.

¹ See MTN.GNG/NG10/W/18.

2. One participant proposed to redefine existing categories and to introduce three different classes of subsidies: prohibited subsidies, actionable subsidies and non-actionable subsidies. The distinctions were drawn on the basis of different legal effects attached to each class. The use of prohibited subsidies would allow, subject to procedural safeguards, for unilateral countermeasures without the legal requirement of material injury. Actionable subsidies would be lawful, but subject, as today, to countermeasures to the extent they caused material injury. Finally, non-actionable subsidies would have to be tolerated, even if they caused negative effects to trading partners. This approach would allow for new combinations: subsidies related to a particular sector of the economy no longer needed to be treated all alike. The allocation of different types of national subsidies to the three classes or baskets would be a matter of subsequent negotiations.¹

3. Another participant said that the nature of the connection between the subsidies and countervailing measures side could be illustrated using the example of problems relating to definitions of domestic industry and like product. Narrow definitions were sought by those who considered that trade-distorting effects of countervailing actions had to be circumscribed, but that approach had to be weighed against the capacity of unfair subsidy to distort trade. There came a point when the distorting effects of a subsidy became worse than the arbitrariness of application of countervailing measures. Consequently, any attempt to reinforce the countervailing measures side would have to begin with redressing that balance. Regarding the question of cumulative injury assessment, the pressure to evaluate injury on a cumulative basis could be explained by the widespread use of subsidies, which made it difficult to distinguish between trade distorting and non-trade distorting subsidies. It followed that a resolution of these problems which were normally perceived as problems in the area of countervailing measures, required that there be more discipline on the use of subsidies.

4. This participant said that a real problem with the present disciplines was that they were too effect-oriented in the sense of trying to deal with the effects of a subsidy rather than with the subsidies themselves. He would be in favour of effect-oriented rules in another sense, namely that disciplines should be applied to the subsidies which had effects, i.e. which were more than de minimis. In this context the negotiations had to deal with the differential treatment of primary product subsidies. The Group would also have to work on general availability/specificity criteria with a view to disciplining effectively trade distorting measures as a class. Should the Group fail to do so, there would be more problems on the countervailing duty side, because importing countries would devise ad hoc anti-subsidy disciplines. Similar considerations applied over how to approach coverage of "subsidies". There seemed little point in arguing in the abstract that a particular practice was, on the grounds of a narrow

¹ This proposal has been circulated in MTN.GNG/NG10/W/17.

definition, not actionable. The real question was whether this practice would, in any given case, compel the importing country to take measures against it. Finally, all of this had to be viewed in the light of the inadequacy of the rules for dealing with subsidies as they affect competition in third markets as well as replacing imports in the importing country.

5. One participant considered that it would hardly be possible to define non-actionable subsidies and that even if such a definition were agreed, it would not improve the existing situation and would not prevent competitive subsidization. It was, therefore, very important to have a possibility to offset negative effects of any subsidy and the best approach in this regard was an effect-oriented approach, coupled with a strict obligation to notify all subsidies. Another participant also stressed the importance of looking at the trade effects. The broad objectives of Articles XVI and VI of the GATT were to protect against damaging subsidies. It was, therefore, essential to the Group to deal effectively with measures which were damaging or destroying international trade. The problem was not only export subsidies, including those in third country markets, but also domestic subsidies which would undermine existing tariff concessions. There should be no doubt that all participants would benefit from increased disciplines on subsidies, and such increased disciplines would allow increased disciplines on the countervailing duty side. One should look at possible benefits not from a narrow view of a sector or industry but globally, at the multilateral level.

6. Several participants considered that any global approach to the question of subsidies/countervailing measures should include special treatment for developing countries. One participant said that, although he recognized the need to examine disciplines on subsidies, the focus should be on countervailing measures in order to prevent their use for harassment and protectionist purposes. Countervailing measures should be applied only in a clear-cut case of subsidization and resulting injury. Another participant emphasized the fact that multilateral disciplines provided the best insurance of weaker trading nations against unilateral actions. As far as subsidies were concerned, it was obvious that stronger economic powers had bigger potential for subsidization. He therefore supported the view that disciplines of both Articles VI and XVI should be considered, with a greater emphasis on Article VI of the GATT. Another participant considered that there was a strong link between Articles VI and XVI and that subsidies should be judged from the point of view of their effects on international trade. Not all subsidies had adverse effects and new disciplines should take this fact into account. There was a need to strike a better balance and it should not be envisaged to strengthen the rules on subsidies without appropriate strengthening of the rules on countervailing duties.

7. One participant, referring to a proposal to classify subsidies in three categories, said that a very important question was who would decide if there were trade-distorting effects; this decision should not be taken

unilaterally. He noted that the effect-oriented approach was predominant. Importing countries resorted much more frequently to Track I countermeasures (countervailing duties) than to Track II. Although it was true that Track II action was much more complicated and time-consuming, there seemed to be a lack of balance between these two tracks. Subsidies permitted under the relevant provisions of the GATT or of the Code should not be actionable. If such a permitted subsidy caused injury, this should not result automatically in a countervailing duty action but rather a Track II action should be used. Another participant noted that subsidies were usually granted for the purpose of improving or increasing efficiency and achieving equity. On the negative side, however, were those subsidies which gave the recipients an unfair advantage, e.g. more than an equitable market share. It was, therefore, important to elaborate rules and disciplines leading to the liberalization and expansion of trade. As a result of this expansion, the balance of rights and obligations must provide for special and differential treatment for developing countries, to allow them to acquire an equitable share in production and trade. Additionally, the goals and objectives of the negotiations should be to ensure predictability for producers, to provide for an effective dispute settlement mechanism and to provide remedies where subsidies nullify or impair the rights of other contracting parties.

8. One participant said that although there were some shortcomings in the operation of the Code, the total balance was not so negative as some participants had implied. The Code represented significant progress as compared with the previous situation. In the field of countervailing measures, the injury test had been introduced in one major country and an agreement on a number of procedural issues had been reached, which reduced or eliminated existing arbitrariness. On the subsidies side, the prohibition of export subsidies on non-primary products had been reconfirmed. On the other hand, a number of disputes affecting various important provisions had not been resolved and Track II had not operated as well as it had been anticipated. The existing disequilibrium between Track I and Track II resulted from the lack of agreed notions and definition of subsidies. In this situation countries preferred to resort to Track I actions where they could define themselves what was meant by subsidies. It was, therefore, indispensable for any progress to reach an agreement on these notions, in particular what was an actionable subsidy. Other important issues were the calculation of the amount of a subsidy, the application of lesser duties if such duties would be adequate to remove the injury and the introduction of a sunset clause. His delegation was favourable to strengthening disciplines in all areas and was determined to co-operate to this end. However, any improvement of the existing disciplines implied, in the first place, better definitions. As to further procedures, it seemed that general discussions, even if important, would not move forward the negotiating process. This would be done only by specific proposals.

9. Another participant said that strengthened disciplines relating to subsidies were the sine qua non of the subsidies and countervailing measures negotiations. The major issues on which work had to be done were

agriculture, targeting and the graduation of advanced developing countries. Moreover, the Group must find a more appropriate level of disciplines for domestic subsidies. He saw only a limited relationship between Articles VI and XVI. Both articles dealt with subsidies, but beyond that they diverged sharply in their intents and purposes. This divergence was most apparent with respect to domestic subsidies. Article XVI provided very limited restraint over the use of domestic subsidies by a contracting party, recognizing that domestic subsidies could be provided for legitimate reasons that are unrelated to trade. At the same time, Article VI recognized that domestic subsidies, while having some legitimate purposes, could also injure producers of another contracting party. Hence, Article VI gave a contracting party the right to apply countervailing duties to offset the injurious effects of subsidized imports, even though Article XVI permitted domestic subsidies. In short, the disciplines of Articles VI and XVI were not and were never meant to be parallel. This participant categorically rejected any approach to the negotiations which would start with the definition of a subsidy. The work of the Group was to strengthen subsidies disciplines, not to engage in a lengthy, preliminary debate over definitions or exemptions from countervailing measures that would divert attention from the overriding issues at hand.

Continuation of consideration of proposals by participants on issues to be taken up in the negotiations

10. The representative of India introduced his proposal regarding issues to be taken up in the negotiations. This proposal has been circulated in document MTN.GNG/NG10/W/16 and it will be reflected in subsequent revisions of MTN.GNG/NG10/W/9 and 10.

Arrangements for the next meeting of the Negotiating Group

11. At the end of the meeting the Group agreed to the following proposal by the Chairman:

- "(i) At the next meeting, to be held on 1-3 June 1988, the Negotiating Group will continue its discussion on fundamental objectives and concepts of Articles VI and XVI of the General Agreement as well as the relationship between the two provisions.
- (ii) The Negotiating Group will also consider and review the list of issues proposed for the negotiations, contained in MTN.GNG/NG10/W/9/Rev.2, MTN.GNG/NG10/W/10/W/10/Rev.1 and subsequent revisions.
- (iii) The Negotiating Group will at the same meeting begin its consideration of specific drafting proposals (including explanatory texts) on particular issues, which participants are invited to submit as soon as possible in time for the next meeting. It is understood that these proposals would be

submitted on a preliminary and non-committal basis, and their distribution as non-papers would be limited to members of the Group.

- (iv) The Chairman will arrange for the transmission to the negotiating group of the relevant texts that have been under consideration in the Group of Experts, which will be circulated in a working document as soon as possible in time for the next meeting."