

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

RESTRICTED

MTN.GNG/NG10/8

11 July 1988

Special Distribution

Group of Negotiations on Goods (GATT)

Negotiating Group on Subsidies
and Countervailing Measures

MEETING OF 28-29 JUNE 1988

Note by the Secretariat

1. The Group held its eighth meeting on 28-29 June 1988 under the Chairmanship of Mr. Michael D. Cartland (Hong Kong). The Group adopted the agenda set out in GATT/AIR/2624.

Discussion of proposals contained in MTN.GNG/NG10/W/17 AND W/20

MTN.GNG/NG10/W/17

2. Some delegations expressed their doubts about what they called the "basket approach" underlying this proposal. They mentioned some problems relating to the identification of subsidies belonging to each category, the necessity of constant amendments to take account of new subsidy practices and the danger of relabeling some subsidies in order to circumvent prohibitions or actionability. It was pointed out that these problems might be attenuated by establishing criteria for each category but some doubts were expressed as to whether such criteria were really workable. Referring to specific examples of subsidies, several participants considered that incentives should be non-actionable, in particular in the light of the approach in W/17 that structural adjustment subsidies should be in this category. Some other participants were of the view that an a priori non-actionability of structural adjustment subsidies was not acceptable. A concern was expressed that the proposal seemed to suggest that a prohibited category might not contain some of the export subsidies already included in the illustrative list of the Subsidies Code.

4. Some delegations were concerned about the possibility of countervailing duty actions without injury test and, more generally, that unilateral remedies could lead to harassment and protectionism rather than being used as legitimate mechanisms for the enforcement of rights. Some other delegations welcomed the concept of prompt remedies in case of violation by another country of its subsidy obligations and stressed the importance attached to working out effective remedies to deal with subsidies that result in import substitution or displacement in third country markets. It was also pointed out that the proposal should be further elaborated to give, inter alia, equal weight to disciplines regarding countervailing measures.

5. The participant having submitted this proposal recalled that its main objective was to provide a general and coherent framework for negotiations and any inclusions or non-inclusions of specific subsidy practices in one or another category should be considered as examples. He recognized the difficulties in working out effective remedies for import substitution and third country displacement but noted that these difficulties were inherent in any possible framework short of ban on all subsidies. As to the problems relating to the identification of subsidy categories, he considered that a combination of illustrative lists, notional criteria and some quantitative criteria should resolve most of them. Finally he pointed out that although disciplines regarding countervailing measures could be further developed, his proposal already in its present form ensured a balanced approach. Indeed the question of actionability covered the important question of countervailability and the question of remedies inherent in each category constituted a framework for dealing with all problems on the countervailing measures side.

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6. Many delegations noted that this proposal was entirely devoted to the strengthening of disciplines on subsidies and recalled that the negotiating mandate given to this Group called also for imposing disciplines on countervailing measures. They were concerned about the approach which, instead of building on the basis of existing disciplines, sharply departed from them and started from totally new concepts. They were also concerned that the proposal seemed to rely on an open-ended definition. They considered that to propose an extension of strengthened subsidies disciplines and the application of countervailing measures to "other forms of government intervention substantially equivalent to a subsidy" would create the risk of transforming the Subsidies Code in a sort of general remedy for all measures which may affect international trade. This would go well beyond the mandate of the Group and the results of such a development would be at the very least unpredictable and would increase the risk of disputes, which were at the very roots of the poor functioning of the present Code.

7. Some other delegations, while agreeing that countervailing duty issues were lacking from this proposal, welcomed its broad objectives, namely clear, effective and precise set of rules on subsidies. They pointed out that improving rules on the use of countervailing measures would be possible only in the light of strengthened disciplines on subsidies. They also recalled that the lack of such disciplines was at the root of many disputes which seriously undermined the credibility of the multilateral trading system.

8. Several participants supported the idea of effective prohibition of all export subsidies regardless of the product or the level of development of the country providing the export subsidy, while a number of others considered that export subsidies were playing an important rôle in development policies of developing countries and therefore such a

prohibition was not justified. In this respect it was pointed out that developing countries had to concentrate their limited financial means on export subsidies which - under the proposal - would be prohibited, while developed countries could pay much larger domestic subsidies which often had similar trade effects but were allowed. It was also pointed out that the special treatment of developing countries' export subsidies under the Code had not resulted in any surge of their exports.

9. Some participants welcomed, and some said that they would not exclude, in principle, tighter disciplines on certain domestic subsidies on the basis of objective and verifiable criteria. In particular, reference was made to subsidies causing import substitution in the subsidizing country market, or export displacement in third country markets, or having de facto effects of export subsidies. However, many of these participants found the criteria proposed in W/20 not workable or not appropriate. A view was expressed that as domestic subsidies were generally recognized in economic theory to be a more appropriate instrument of protection than tariffs, there was no economic justification to prohibit them when nobody had ever proposed in the GATT to prohibit the latter. Regarding the idea of prohibiting domestic subsidies that exceed a specific size or amount, it was pointed out that the level of distortion or trade effect was not always related to the amount of money spent. Furthermore, it was not clear how this threshold would be calculated, i.e. whether it would be in absolute terms or relative to the value of the product concerned or in relation to GNP. As to another criterion under which a subsidy would be prohibited when an industry was engaged in exports of more than a given share of its output or more than an average industry in the exporting country, it was pointed out that this would penalize countries with small domestic markets, while leaving those with a large domestic market free to subsidize to a substantial extent. A view was also expressed that the assessment of those criteria depended too much on self-incriminating notifications, an approach which was not realistic given the experience with notifications under Article XVI:1.

10. Some delegations considered that the issue of industrial targeting went well beyond the mandate of the Group. Possible problems in this field should be dealt with in specific areas such as research and development or structural adjustment. It was also pointed out that any attempt to express the effects of targeting in terms of an amount of a subsidy would be in many cases arbitrary if not impossible.

11. The proposal that the distinction in present rules between primary and non-primary products should be eliminated and that all subsidies which affect trade in agriculture should be prohibited was welcomed by some delegations, while some others reiterated their view that this Group would have to tackle the issue of agricultural subsidies only once agreement had been reached in the Negotiating Group on Agriculture. As to the issue of natural resource subsidies, some delegations were ready to discuss it as long as the subject for discussion was exactly subsidies and not all forms of government intervention in this field. It was pointed out by several

participants that governments should be free to take advantage of comparative advantages they might enjoy in this field and that government intervention in pricing policies should not be considered as a subsidy.

12. Some participants shared the view that developing countries should be encouraged to participate more fully in future subsidies/countervailing measures disciplines, in particular those countries which already played a substantial rôle in international trade. In this respect they were prepared to re-examine the relevance of Article 14 of the Subsidies Code to these latter countries. Some other participants insisted that the question of economic development must be incorporated in any negotiating approach and that subsidies were necessary to correct distortions which existed in developing economies. It was pointed out that in many cases developing countries had to use subsidies to maintain their competitive position vis-à-vis subsidized products from developed countries. A view was expressed that the more immediate problem was to create conditions for fuller participation of developing countries in the Subsidies Code and to protect them against unfair competition from subsidizing developed countries.

13. Several participants agreed that an effective and credible dispute settlement mechanism was essential in enforcing any new disciplines. Some considered, however, that giving national governments a right of unilateral initial action and reserving only the review of such actions to multilateral scrutiny was not the appropriate response to the difficulties experienced in respect of dispute settlement procedures. There were also doubts as to the changed rôle of panels, in particular regarding determination of the amount of the trade loss and corresponding compensation. In particular, it was unclear how such a loss could be measured and whether welfare given to consumers would not compensate or even outweigh the loss to producers. Furthermore, the very occurrence of a loss in an expanding market situation was questionable. Finally it was unclear how compensation could be consistent with the existing rule that off-setting measure should not be higher than the amount of a subsidy. Some participants expressed the view that the concept of compensation was relevant not only in relation to subsidy effects but also to the trade loss resulting from unjustified countervailing duty investigations. Several participants were of the opinion that the efforts under way in the Negotiating Group on Dispute Settlement would be relevant for the work of this Group and questioned any need for a separate dispute settlement system in the subsidies/countervailing duty context.

14. The participant having submitted this proposal recalled that his government believed strongly in the need for substantial reforms of GATT subsidies disciplines. This would not be easy since subsidies had become a widely-used instrument. He was therefore not under any illusion that this proposal would be strongly welcomed but his intent had been to put forward a thought-provoking paper that focussed attention on the real issue, namely subsidy disciplines. Countervailing measures were a response to the proliferation of trade-distorting subsidies and the Group

must deal with the subsidy problems if any progress was to be made or if any agreement in this area was to emerge from the Round. Some participants had criticized his proposal as unbalanced but their proposals were subject to the same criticism since they contained little or nothing on subsidies disciplines. The proposal to tie disciplines on domestic subsidies to objective criteria reflected the problems of the Subsidies Code in dealing with subsidy rules. To achieve effective and enforceable disciplines, it may be necessary to be somewhat arbitrary to ensure clarity. He expressed his disappointment at the continuing refusal of some participants to even discuss subsidies affecting trade in agriculture. With respect to dispute settlement he pointed out that there was a precedent for specialized subsidies dispute settlement mechanisms namely the relevant Code rules. In closing he noted that the Subsidies Code had broken apart and that there was an urgent need to restore credible GATT disciplines.

A possible framework for negotiations

15. One participant referred to a number of proposals submitted to the Group and said that these proposals needed to be woven into a comprehensive negotiating framework under which discussions could take place and the negotiations could advance. His comments were designed to provide a skeleton for such a negotiating framework and he intended to submit a more detailed proposal before the next meeting of the Group. The proposed framework would start with grouping issues under the four categories of: subsidy disciplines, parameters for the scope and application of countervail, remedies and dispute settlements. No priority would be attached to any one issue and they could all be dealt with in parallel. As to the category of subsidy disciplines, it would be important to accept the basic premise that subsidies should not be used in ways that distort comparative advantage in any sector. Export subsidies and subsidies increasing production were the worst offenders in this respect. This was most apparent in the agricultural sector where the provisions of subsidies had reached crisis proportions but similar problems existed in other sectors. There was therefore a need to examine strengthened subsidy disciplines including prohibitions on subsidies having obvious and direct negative trade and production effects. Under the category of parameters for the application of countervail, there was a need for establishing outside limits on what is actionable. Furthermore, precise criteria should be developed with respect to certain subsidy practices (e.g. infrastructure, R&D, regional development) which, if met, would preclude the application of countervailing duties as these subsidies would be considered not to cause trade distortion. The category of remedies would deal with unilateral actions (countervail) and the main issues here would be procedural improvements to prevent harassment and improvements to a number of elements (e.g. definition of industry, de minimis levels, cumulation, sunset provisions) and with multilateral actions (concerning subsidies causing import replacement and third country displacement). This latter sub-category would also deal with such issues as compensation, retaliation and mechanism needed to evaluate degree of adverse effects.

Finally, an effective and fair dispute settlement mechanism was necessary to generate confidence in the system and ensure that obligations would be upheld if countries were to give up sovereign rights.

16. A number of participants expressed their preliminary view that the outlined framework deserved further examination and looked forward to obtaining more detailed explanations before the next meeting of the Group.

Arrangements for the next meeting

17. The Group will meet on 3-4 October 1988. The agenda for the next meeting will include:

- (a) continuation of the discussions of proposals made so far as well as any other proposals which would be submitted in time for the meeting;
- (b) discussion on a possible basis (framework) for the negotiations;
- (c) consideration of specific drafting proposals which would be submitted in accordance with the procedures agreed at the February 1988 meeting of the Group (MTN.GNG/NG10/6, paragraph 11(iii)).