

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

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Negotiating Group on Subsidies
and Countervailing Duties

ELEMENTS OF THE FRAMEWORK FOR NEGOTIATIONS

Submission by the United States

Introduction

In document MTN.GNG/NG10/W/20, the United States expressed its view that the lack of effective disciplines over the use of trade-distorting subsidies in conjunction with an ineffective dispute settlement mechanism undermines the credibility of the GATT and the international trading system. This document builds upon the earlier submission by delineating more clearly U.S. objectives for the Subsidies Negotiating Group and proposed mechanisms to achieve those objectives, the ultimate aim of which is to restore confidence in the use of multilateral rules on subsidies.

The United States, objectives for the negotiations are to develop clear, objective, and precise rules on subsidies designed to:

- o Extend those disciplines to practices that may have similar trade-distorting effects. In particular, the artificial distinction between primary and non-primary products should be eliminated and the current Illustrative List of export subsidies strengthened. Domestic subsidies that have trade effects as damaging as export subsidies must be disciplined in a similar manner. Finally, the disciplines should cover the so-called "new practices" of targeting and natural resource subsidies.
- o Restore credibility to the multilateral dispute settlement process through the development of both enforcement mechanisms that discourage the use of prohibited subsidies and through mechanisms to resolve disputes more effectively.
- o Establish clear and administrable disciplines which will reduce the likelihood of unnecessary disputes among trading partners.

To this end, the United States presents the following proposals. These proposals do not address all areas identified in the Framework for Negotiations approved by the TNC. Emphasis has been placed on those areas that bear the greatest need for improvement. This should not be seen, however, as an unwillingness to seek improvement in the other areas covered by the Framework. The United States reserves the right to present additional views at a later point in these negotiations.

Building upon the Framework:

I. Prohibited Subsidies

1. Identification. The GATT recognizes a hierarchy in the use and misuse of subsidies. In particular, the GATT recognizes that certain types of subsidies, specifically those which by their very nature distort trade flows, should be prohibited. The General Agreement has long recognized that export subsidies give rise to trade effects. Because export subsidies automatically and by definition encourage exports, they are prohibited.

It has become increasingly clear since 1979, when the current disciplines over the use of export subsidies were established, that the trade-distorting effects associated with government subsidization are not limited to export subsidies.

A second category of subsidies that gives rise to a clear distortion may be termed "trade-related" subsidies. These subsidies include those whose receipt is contingent upon the use of domestic inputs over imported inputs. This type of subsidy is as effective as any tariff in protecting domestic input-supplying industries and distorting the flow of resources internationally. Similarly, subsidies whose receipt is contingent upon production performance clearly lead producers to manufacture more or different output than they would in the absence of the distorting subsidy.

Another type of trade-related subsidy arises when subsidies are provided to a firm and/or firms which are predominantly engaged in export trade. As is the case with export subsidies, the effects of these subsidies are felt directly in export markets. If a subsidy is provided to such a firm or collection of firms, it can be presumed that the trading interests of another signatory will suffer as either sales in the domestic or third country markets are displaced. There is no way to distinguish the effects on trade of domestic subsidies provided to these "exporter" firms from the effects associated with export subsidies.

Finally, distortion can result from other domestic subsidies. These distortions may not be as readily evident in international markets when the subsidized firms sell predominantly in their home market. Nevertheless, the granting of domestic subsidies to these firms places them at a clear competitive advantage in their export markets and especially in their home markets. In this situation, it is reasonable to assume that the size of the distortion is commensurate with the size of the subsidies received. Whatever form the subsidy takes, the larger it is the more it has to affect and distort the magnitude and direction of resulting production. Indeed, where government intervention in support of the enterprise reaches certain levels, it is questionable whether there is any market justification for the enterprise's existence.

Given the broader trade effects that can be related to the use of subsidies in these instances, the United States proposes that the participants agree to the following prohibitions.

1.a. Export Subsidies. While the Illustrative List of export subsidies has generally proven to be effective in deterring the use of such subsidies for non-primary products, we would propose a number of modifications to strengthen these disciplines. First, the artificial distinction which currently exists with respect to export subsidies on primary and non-primary products should be eliminated. Second, we propose building on the current Illustrative List through the following revisions:

- o Item (d). Eliminate the "exception," which permits governments to provide goods and services for exported products at lower prices than if the good or service were used for domestic sales, so long as the lower price does not fall below the world market price. Clearly, the two-tiered pricing systems sanctioned by current item (d) promote trade in the input products that would not otherwise exist.
- o Item (j). Create a prohibition against governmental provision of exchange rate risk programs and insurance or guarantee programs against increases in the costs of exported products. As these types of programs are not typically available from commercial sources, exporters able to use them are protected from exchange rate fluctuations to the competitive disadvantage of sellers in other countries.

With respect to export credit guarantees and insurance, the duration of the guarantee should conform to normal commercial practice or an appropriate international undertaking or agreement. Moreover, the Negotiating Group should examine the concepts of "manifestly inadequate" and "long-term" to ensure that these types of programs are self-sustaining over a reasonable period.

- o Item (k). Amend the first paragraph of item (k) to prohibit the grant by governments of export credits on terms and conditions more favorable than the borrower otherwise would receive. Also, amend the second paragraph of item (k) to delete the reference to "interest rate" provisions, so that lending practices covered by this paragraph must conform in all respects with the provisions of the international undertaking on official export credits.
- o Item (l). To capture more clearly the full extent of the subsidy, replace the "charge on the public account" standard with a "benefit to recipient" standard.

1.b. Trade-Related Subsidies

- o Any subsidy if the decision to grant the subsidy takes into account any of the following factors: the use of domestic in lieu of imported goods (####, domestic content or local sourcing requirements); the attainment of certain net trade surpluses; the imposition of restrictions or requirements on the goods manufactured at, or marketed from, facilities in the bestowing country or the technologies associated with such manufacturing; export performance.
- o Any subsidies to a firm and/or firms* predominantly engaged in export trade, i.e., whose exports exceed [X] percent of total sales.
- o Domestic subsidies to a firm and/or firms, where such subsidies exceed [X] percent of the firm,s and/or firms, total sales.

With respect to the category of trade-related subsidies, the United States recognizes that different circumstances and variances may be appropriate in some cases. For example, in some cases it may be appropriate to evaluate programs taking into account their linkage to specific types of behavior, regardless of the size of the payments. In other cases, it may be desirable to prohibit specific subsidy instruments (e.g., grants, equity, infusions, loans), again regardless of their size. There are practical possibilities in this

* The designation of "a firm and/or firms" for purposes of identifying prohibited subsidies is not meant to prejudge certain allocation issues. For example, subsidies provided in support of one line of products produced by a firm should, generally, be allocated according to the activities to which the funds were directed.

regard and the United States will be exploring them. These alternatives, however, should in no way undermine the general improvements in discipline described in this proposal. Also, any disciplines developed for such cases must be compatible with the overall need for improved multilateral disciplines and an improved, effective means for dispute resolution.

The steel sector is one area where such an approach could be possible. The United States has recently concluded agreements with most of its key trading partners in the steel sector. These agreements contain prohibitions on specific domestic subsidies and other government supports prevalent in the steel sector including: grants (including cash outlays and debt forgiveness); tax benefits; preferential provision of goods and services; and certain equity infusions, loans and loan guarantees. The United States expects that multilateral commitments to ensure the full implementation of these disciplines can be negotiated.

2. Remedies. As important as the assignment of practices to the prohibited category are the means of disciplining the use of these prohibited subsidies. It is the view of the United States that the maintenance of a prohibited subsidy should be considered a per se violation of the subsidizing party's obligations. The proposed remedies against such subsidies are as follows:

Prohibited Subsidies/Domestic Market of the Importing Country

Imported products benefiting from prohibited subsidies would be subject to countermeasures imposed by the importing country. As a response to a per se violation of the subsidizing party's obligations, the importing country could impose countermeasures in the form of a duty equaling the amount of the subsidy. Such actions must be notified to the contracting parties. Moreover, the imposition of such countermeasures would be subject to multilateral review to determine, whether, in fact, the subsidy was a prohibited subsidy.

At the same time, the importing country may wish to initiate multilateral review of the practice. Prompt elimination of the program shall be recommended if it is determined that a prohibited subsidy is being provided. If the program is not eliminated within a reasonable time period, countermeasures in addition to those which may already have been imposed can be authorized.

Prohibited Subsidies/Third Country Markets and the Home Market of the Subsidizing Country:

Parallel with the remedies for prohibited subsidies that affect sales in the domestic market of the importing country, countermeasures would also be available against prohibited subsidies that affect

trade in third country markets or the home market of the subsidizing country. Where it has been determined that a party is maintaining a prohibited subsidy after multilateral review, it is incumbent upon the offending party to eliminate or to amend the practice in accordance with the finding of the reviewing body. Until such elimination or amendment occurs, affected parties would be entitled to take countermeasures to compensate for import substitution in the home market of the subsidizing country and/or displacement in third country markets.

It is recognized that rebalancing of rights under these circumstances will be inherently difficult. While the specific mechanisms related to the imposition of countermeasures will need further elaboration, the United States believes that effective relief should exist in this situation as well as when prohibited subsidies affect sales into the domestic market.

II. Actionable Subsidies

1. Identification: Identification involves two components, definition and valuation.

1.a. Definition: A subsidy is any government action or combination of government actions which confers a benefit on the recipient firm(s). Actionable subsidies are all subsidies which are not prohibited subsidies or non-actionable subsidies.

1.b. Valuation: The value of a subsidy is necessarily measured by reference to the benefit to the recipient. Unsubsidized firms cannot be expected to compete with firms which are permitted to obtain funds at their government's cost of funds, for example. The benefit to recipient approach to valuation is the only means of assigning a value which is commensurate with the distortions caused by the subsidies.

Beyond this principle, valuation procedures should take into account that the benefits conferred by certain subsidies can extend beyond the year in which the subsidy is received:

- o Benefits arising from subsidies which are of a recurring nature should be allocated to the year of receipt.
- o Benefits arising from subsidies which are non-recurring may be allocated to periods beyond the year of receipt. To the extent possible, allocation periods for firms producing the same merchandise will be identical.

Finally:

- o In no case shall the amounts countervailed exceed, in real terms, the face value of the benefit in the year of receipt.

2. Remedies: Signatories are authorized to use both national countervailing duty laws and multilateral dispute settlement to address the distortions associated with the use of actionable subsidies.

Actionable subsidies that affect sales in the domestic market:

Products benefiting from actionable subsidies would be subject to countervailing duties imposed by the importing country where the imports cause or threaten material injury to the domestic industry in the importing country. While the current Subsidies Code rules are largely satisfactory as they deal with the processing of countervailing duty proceedings, some possible areas for improvement are:

- o The definition of "industry" should be clarified to take into account the situation where producers of raw agricultural products can be injured by reason of imports of the agricultural product in its processed form. This would occur where (i) the processed agricultural product is produced from a raw agricultural product through a single continuous line of production; and (ii) there is a substantial coincidence of economic interest between producers of the raw agricultural product and producers of the processed product. The Negotiating Group should also seek a clarification of similar issues in the context of manufactured goods.
- o Similarly, in calculating the amount of subsidy on processed agricultural products, subsidies to the producer of the raw agricultural product will be deemed to be bestowed on the processed agricultural product where (i) the demand for the raw agricultural product is substantially dependent on the demand for the processed product; and (ii) the processing operation adds limited value to the raw agricultural product.
- o Express provision should be made for periodic reviews of the level of subsidy included in a countervailing duty finding, upon request of the parties involved.

Actionable subsidies that affect trade in third country markets or the home market of the subsidizing country:

It is recognized that the bestowal of actionable subsidies can give rise to adverse effects. Therefore, where an affected party can demonstrate the adverse effects (e.g., a decline in sales or market

share, or in other indicators of the condition of the industry, or price suppression, price depression, or price undercutting) of such subsidies in the home market of the subsidizing country or in third country export markets, the subsidy should be eliminated and, if it is not, appropriate countermeasures should be authorized.

The first obligation of the subsidizing country is to terminate the violative program immediately upon a finding that the program gives rise to adverse effects. If the subsidizing country does not agree to terminate the program immediately, the complaining country may demand compensation or seek authority to retaliate based on the finding of the existence of the program and the adverse effects.

III. Non-Actionable Subsidies

1. Identification: Given the fungible nature of money, it is not at all clear that any subsidies should be non-actionable. For example, providing a firm with grants for research and development simply means that the money the firm would otherwise have spent for that purpose is now available for other uses including, perhaps, expanding production.

Moreover, identifying non-actionable subsidies is inherently a dangerous task. As soon as one subsidy is declared non-actionable while others are listed as prohibited, it is reasonable to expect that subsidies will be renamed so they can be moved from the prohibited to the non-actionable category. For these reasons, the United States sees merit in the concept advanced by Switzerland whereby non-actionable subsidies could become actionable or even prohibited under certain circumstances.

Despite the possible drawbacks in identifying non-actionable subsidies, the Negotiating Group may wish to consider the following practices:

- o governmental provision of basic human services (education, health services, and natural disaster relief) and national defense;
- o governmental provision of unemployment insurance and adjustment assistance for workers, provided that the government is not assuming costs that would otherwise be borne by the employer;
- o governmental provision of extraction/exploitation rights for natural resources, so long as the right to extract or exploit the natural resource is sold through an auction bidding process open to all parties;

- o governmental provision of processed natural resource products, i.e., natural resources which have been extracted and undergone primary processing by the government or government-owned entities, so long as the processed natural resource product is offered to all parties on the same terms and conditions;
- o basic infrastructure where there are no de jure or de facto limitations on use;
- o de minimis subsidies.

Addressing Research and Development: The activities of governments to support research and development involve complex and important issues. In establishing the necessary scope for discipline over government involvement in research and development activities the Negotiating Group will have to consider a number of issues. These include, but are not limited to, the following: What is the magnitude of the government support for a research and development program? Is the funding oriented towards basic research, applied research, or development? Is the funding for generic research and development or to support technologies that might not otherwise be realized? Are the results of the research and development publicly available and easily accessible by all on a timely basis?

In considering this very difficult area, effective parameters should be established to determine how government support to a wide variety of civilian research and development functions can be channeled into non-trade-distorting directions.

IV. Special and Differential Treatment for Developing Countries

It is the view of the United States that all countries will benefit from a new, more predictable, and more effective international regime regarding government subsidization. The United States also recognizes that the immediate ability to abide by all of the new provisions may be difficult for certain developing countries (the least developed countries, for example). The United States is prepared to consider practical proposals for a transition to the new rules where a need for differences in adherence can be demonstrated.

V. Dispute Settlement

Specific discussion should await fuller articulation of the rules and procedures for dispute settlement being negotiated in NG-13. In the meantime, however, the Group may wish to begin consideration of whether there are aspects of disputes involving subsidies and countervailing measures that require special consideration. The

United States believes that there are aspects of a dispute settlement panel's review of countervailing duties taken pursuant to national legislation that require special consideration -- scope of review, standard of review and record for review, and burden of proof.

1. Scope and Timing of Review.

(a) The purpose of a dispute settlement panel reviewing countervailing duty actions taken pursuant to national legislation is to assess whether actions taken by the administering authorities of the importing country in a specific proceeding were in accordance with the obligations of that country under the new SCM legal instrument.

(b) It is not appropriate for a panel to review issues that were not properly presented to the investigating authorities for resolution during the administrative proceeding under national legislation.

(c) It is not appropriate for a panel to review issues before the conclusion of the administrative proceeding under national legislation. (Prior to such final administrative action one cannot say that the investigating authorities have taken an action inconsistent with the obligations of that country under the new SCM legal instrument.)

2. Standard of Review and Record for Review.

The dispute settlement panel would review countervailing duty actions taken pursuant to national legislation to assess whether the investigating authorities had not acted reasonably in implementing the obligations of that country under the new SCM legal instrument. The panel must not substitute its own judgment for that of the investigating authorities.

Because the panel is a reviewing body, it is not appropriate for a panel to conduct an independent de novo investigation. For this reason, the review must be based on evidence before the investigating authorities which is presented to the panel.

3. Burden of Proof.

The United States believes that the Negotiating Group should define clearly the burden of proof. While detailed discussion must await more definitive articulation of the disciplines and rules, the United States believes that the burden should be on the exporting country to demonstrate by clear and convincing evidence that the investigating authorities have not acted reasonably in implementing the obligations of that country under the new SCM legal instrument.