

**MULTILATERAL TRADE
NEGOTIATIONS
THE URUGUAY ROUND**

RESTRICTED

MTN.GNG/NG10/W/39

27 September 1990

Special Distribution

Original: English

Group of Negotiations on Goods (GATT)

Negotiating Group on Subsidies
and Countervailing Measures

ELEMENTS OF THE NEGOTIATING FRAMEWORK

Submission by the United States

Introduction:

In November 1989, the United States submitted to this Negotiating Group a proposal (MTN.GNG/NG10/W/29) which was aimed primarily at strengthening the current discipline on the use of subsidies and at providing adequate mechanisms to enforce that discipline. The keystone of that document was the outright prohibition of certain "domestic" subsidies, with the consequence that if such subsidies were used, multilateral or unilateral action could be taken to offset the subsidies without regard to their effects.

Since November 1989, the Negotiating Group has had the benefit of additional proposals, a negotiating text proposed by the Chairman, and lengthy debate on the issues we are here to address. This work has helped to advance the negotiations. We all hopefully have a clearer understanding of each others' views and, with that understanding, there may have been some narrowing of our differences.

Nevertheless, it is the view of the United States that one crucial area of these negotiations must be addressed more ambitiously. Indeed, over the course of these negotiations, it seems to have become a secondary issue which some participants appear to believe can be swept aside - but it cannot. This issue, of course, is the prohibition of certain domestic subsidies.

The purpose of this submission is twofold. First, the United States wishes to restate its view that increased discipline over domestic subsidies is imperative. In furtherance of this objective, we would like to augment our November 1989 proposal to underscore our interest in finding a basis for agreement within this Group on the prohibition of certain domestic subsidies. In addition, we provide reactions to some of the points and elaborations contained in the Chairman's discussion paper on quantitative disciplines in the light of further thoughts which we have had on this topic.

Normative prohibitions:

Throughout the negotiations in the SCM Negotiating Group, the United States has relied primarily on quantitative rules to define the subsidies that governments could or could not give. Quantitative rules were seen to provide the advantage of clearer discipline because subsidies to certain firms (those predominantly engaged in exporting) are outright prohibited, while subsidies to other firms are governed not by the type of subsidy, but by its magnitude.

At the same time, however, we recognize that certain normative rules can be added to quantitative rules. These normative rules would serve to prohibit specific practices which we all find to be particularly egregious. In particular, the normative rules we are proposing generally focus on the provision of funds at less than the cost of those funds to the subsidizing government.

This Negotiating Group is familiar with the debate surrounding the benefit-to-recipient versus the cost-to-government approaches to defining and valuing subsidies, and well aware that the United States has long favoured the benefit-to-recipient approach. This submission does not reflect a change in the US position on this issue. We continue to believe that the only proper method for defining and measuring subsidies is by reference to whether and what extent the recipient of a subsidy is benefited.

However, most subsidies which result in a net cost to the government will also confer a benefit on the recipient. In other words, a loan which is provided at less than cost-to-government would be identified as a subsidy under either standard. Thus, the cost-to-government standard is useful in establishing a subset of subsidies, a subset which most of the participants in these negotiations seem willing to recognize as objectionable. Moreover, because the granting of subsidies at less than cost-to-government represents an obvious and direct transfer of wealth from the public to the subsidized firm, it should be condemned.

Based on this, the United States has developed a list of specific practices which we believe should be prohibited:

- Grants to cover operating losses.
- Direct forgiveness of debt, i.e., forgiveness of government-held debt, and grants to cover debt repayment.
- Loans at interest rates which are less than the government's cost of obtaining the funds plus any costs in administering the loans.
- Provision of equity capital where the expected rate of return is less than the government's cost of obtaining the funds plus any costs incurred in administering the equity investment.

- Loan guarantee programmes where the premium rates are inadequate to cover the long-term operating costs and losses of the programme.
- Subsidies contingent upon production performance.

Thus, the United States proposes that Article 1.1 of the Chairman's text be amended to include these practices.¹ The programmes and circumstances listed above are far from comprehensive in citing the conditions in which trade distortions will occur. What we have done is to identify those in which the subsidy element is greatest and the interference by the government in the marketplace is most egregious, and which, therefore, create the most extreme trade distortions.

Quantitative prohibitions:

While the particularly egregious practices listed above should be prohibited outright, the United States continues to be of the view that the quantitative rules described in our November proposal offer the best means of disciplining domestic subsidies. These quantitative rules are based very simply on the beliefs that: (1) subsidies to firms that are engaged predominantly in exportation will necessarily have effects similar to export subsidies and, hence, like export subsidies, should be prohibited; and (2) big subsidies necessarily distort the allocation of resources and the commerce that results from those resource allocations. The bigger the subsidy, the bigger the distortion. The bigger the distortion, the more reason to expect that it will have trade effects.

In discussions about the quantitative proposals, parties have raised certain questions and concerns about how the rules would work in practice. The United States believes the Chairman's discussion paper contains some useful ideas for how the quantitative disciplines might be operationalized.

For example, the Chairman's paper suggests that sales in the previous year be used as the basis for determining the level of discipline. This formulation will help to provide predictability, as a government will be able to know for certain whether the intended recipient is predominantly engaged in exportation or whether the proposed subsidy will exceed [X] per cent of sales. Thus, the subsidizing government will know in advance whether or not its action would be prohibited. Such a basis would avoid the speculation necessary to using a projection of either costs or sales values, and it would be a relatively easy figure for parties not involved in the subsidization process to confirm.

¹In developing these disciplines, the Negotiating Group will need to consider how to accommodate enterprises of populations with whom a government has a pre-existing permanent caretaker or trust relationship.

Moreover, in recognition that there are certain situations in which use of the previous year's sales may not provide an appropriate basis for determining whether subsidies would be prohibited, the Chairman's paper also proposed special formulations to deal with circumstances in which the recipient firm is in a "start-up" situation and/or is located in a country whose economy is experiencing hyperinflation. By basing a start-up firm's discipline on total funds invested, and by providing for an inflation-adjusted denominator in hyperinflationary circumstances, we believe the Chairman's paper offered the Negotiating Group a workable alternative means of establishing the prohibition threshold in cases where the previous year's sales would either be non-existent or undervalued in real terms.

Finally, the United States would like to signal its agreement that establishing quantitative prohibitions on a firm-specific basis is the most practical and effective way to operationalize this discipline. It avoids the problem of having first to define who comprises the recipient group - be it an "industry" or a "sector" - that is subject to the discipline. We believe that application of a firm-specific rule will enhance the transparency and enforceability of this discipline from the perspective of both governments which wish to subsidize and governments which wish to see the quantitative rule strictly enforced.

The United States is ready, indeed eager, to participate in the Negotiating Group's detailed discussion of these ideas and suggestions. We wish to make clear, however, that we continue to take the position that these quantitative rules should serve as prohibitions on the use of subsidies. We do not share the view of some of our negotiating partners that sovereign rights and responsibilities preclude any prohibitions on granting domestic subsidies.

Conclusion:

The United States believes that negotiations in the subsidies area can lead to genuine improvements in international trade for all concerned. The most important improvements, from our point of view, would be to prohibit certain domestic subsidies and to establish workable mechanisms to enforce those prohibitions. Without such improvements, we cannot even consider proposals which would make certain domestic subsidies non-actionable.

To achieve enhanced discipline, we have augmented our earlier proposal which prohibited subsidies according to quantitative rules. Now, in addition to the quantitative rules, we propose certain normative prohibitions. These normative rules would fit together with the quantitative rules to ensure that specific practices, as well as "big" subsidies and subsidies to firms predominantly engaged in exportation, would be condemned. In this way, we can achieve the comprehensive subsidies discipline necessary for the successful conclusion of these negotiations.