# WORLD TRADE ORGANIZATION

**TN/RL/W/30**
21 November 2002

(02-6476)

**Negotiating Group on Rules** Original: English


## WTO NEGOTIATIONS CONCERNING THE WTO AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES

Proposal by the European Communities

## I. INTRODUCTION

### 1. Innovations introduced by the Uruguay Round

The Agreement on Subsidies and Countervailing Measures (ASCM) was one of the major achievements of the Uruguay Round. A definition of a subsidy, and the circumstances in which it would be actionable, were outlined for the first time. A "traffic light" classification of subsidies was also introduced.

A subsidy was essentially defined as a financial contribution from a government which confers a benefit. A subsidy was subject to disciplines only if specific, the specificity aspect referring to the fact that it was targeted at certain beneficiaries. The "traffic light" concept was based on the premise that some subsidies were trade distorting *per se* while others were benign or even noble, and ranged through several colours from prohibited red at one end of the spectrum (e.g. export subsidies) to non-actionable green at the other (e.g. subsidies for environment).

Finally, Members agreed on new rules for CVD investigations (increased initiation standards, sunset provisions, etc.) and the concept of special and differential (S&D) treatment for developing countries and economies in transition to a market economy.

### 2. The ASCM in practice

The creation of the "traffic light" system has focussed actions overwhelmingly on the "red" or prohibited category (i.e. export and "local content" subsidies), with most WTO dispute settlement under the ASCM being opened to combat such subsidies.[1] Not surprisingly, this concentration on disciplining prohibited subsidies means that less attention was given to less detectable types of "actionable" subsidy.

The main reason for the concentration on the "red" category is that the rules for certain types of actionable subsidies (particularly those not granted directly to a certain product) are much less explicit and therefore less operational and effective than those for direct export subsidies. Similarly, the non-actionable or "green" subsidy category (R&D, environment and regional aid) has proven to be

[1] Indeed, all but one of the eight dispute settlement cases brought since 1995 against subsidy practices involved exclusively export subsidies.

ineffective and, because of its negligible impact on the actual application of subsidy disciplines, its expiry in 1999 has gone almost unnoticed.[2]

As for the main CVD innovations introduced by the Uruguay Round, experience since 1995 has shown that, despite increased initiation standards, cases can still be opened without the necessary justification and though the "sunset" provisions have led to slightly fewer measures, the overwhelming tendency is still to maintain measures.

## II. DOHA DEVELOPMENT AGENDA AND MULTILATERAL SUBSIDIES DISCIPLINES

The Uruguay Round introduced disciplines to deal with most types of subsidies but it is clear that only some of these rules can already be considered operational. Indeed, the "traffic-light" approach has proven to be in need of streamlining through establishing clear and uniform rules for all specific subsidies. Therefore, the main objective in this new Doha Development Agenda ("DDA") should be focused on the essential disciplines set out in the current Agreement and make them workable and effective. This objective closely follows the Doha mandate.[3] The following improvements would go some way towards meeting these objectives. Nothing in this proposal prejudges, however, in any way, the specific rules on agricultural subsidies, existing or to be established following the DDA negotiations on agriculture.

### 1. Definition - More operational rules for "disguised" subsidies

The definition of a subsidy established in Article 1 is, in general, satisfactory. However, clarification is required in two areas.

Significant amounts of financial support are increasingly granted by governments for ostensibly general activities which in fact directly benefit the production of certain products. These "disguised" subsidies can have equally severe trade-distorting effects and they are potentially much more harmful than more direct subsidies since they confer benefits in a largely non-transparent manner. The same applies to similar financial support granted through certain government-controlled entities.

In view of this, the EC propose to clarify the definition of a "subsidy" in Article 1 ASCM as follows:

(a) "Disguised" subsidies

Although the existing rules already apply to specific **"disguised" subsidies**, e.g. apparently general support - financial contribution by a government - which in fact confers benefits only to the commercial activities of the recipients, this is not always spelt out in enough detail for effective implementation. The link between the subsidy and the recipient or product is often concealed and therefore much more difficult to establish than in cases where the funding is more up front. In other words, this support benefits all of the commercial activities of the recipient rather than being in line

[2] Pursuant to Article 31 ASCM, Article 6.1 ASCM (subsidies presumed to cause serious prejudice) and Articles 8 and 9 (non-actionable subsidies for R&D, environment and regional aid) expired on 1 January 2000. The "green list" under Article 8 of the Agreement proved to be of very limited use since the definitions and procedures were so complicated that no Member could make serious use of it. "Dark amber" subsidies carrying the presumption of serious prejudice under Article 6.1 ASCM (e.g. subsidies above 5% *ad valorem*) have only been invoked once in dispute settlement.

[3] "In the initial phase of the negotiations, participants will indicate the provisions, including disciplines on trade distorting practices, that they seek to clarify and improve in the subsequent phase." (emphasis added).

with its stated "general" purpose. To the extent that this kind of funding in an industrial sector is significant and leads to effective circumvention of the subsidy disciplines, it is a problem that needs to be tackled. Therefore, the subsidy rules for industrial products should be made more operational in order to bring these subsidies more clearly within the disciplines of the ASCM.

(b) State-controlled entities

Furthermore, the terms of the current Agreement also make it extremely difficult to act against **entities which may be providing the "subsidy" under the covert direction of governments** (e.g. the granting of loans and other financial support through financial institutions which are acting on non-commercial terms). Current rules could be construed to only cover such actions if there is a clear and unambiguous showing of "direction" by the government. Such a link is often very difficult to prove. To cover this "grey zone" in subsidy disciplines, consideration could be given to clarifying Article 1 ASCM, so that entities which are effectively controlled by the state and acting on non-commercial terms are covered by this provision.

An alternative would be to clarify the rules so as to cover situations where the public direction is less apparent but nevertheless led to non-commercial behaviour in terms of the financial operation in question. Article 1.1. ASCM does not *per se* apply to public enterprises acting under commercial terms in the market.

While it is obviously not the case that all state-owned entities or enterprises should be considered part of the government, there is a need to develop workable rules in order to prevent the circumvention of subsidy disciplines, taking into account the WTO jurisprudence.

## 2. Clearer rules for "local content" subsidies

Though the rules on prohibited export subsidies (Article 3.1(a) ASCM) are reasonably effective, as demonstrated by the number of cases initiated for this category, there are improvements that can be made, in particular for the rules on "local content" subsidies (Article 3.1(b) ASCM), which are difficult to use effectively with regard to the industrial sector. Currently, these rules do not provide appropriate disciplines (especially as regards "value-added requirements"), given that it is necessary not only to show that an import substitution programme exists, but also to explicitly demonstrate that, in order to obtain the subsidy, the actual use of domestic over imported goods is required on a case by case basis (which is a higher standard than **required** for an Article III:4 GATT 1994 violation).[4]

This very high threshold of proof makes it very difficult to counteract subsidies linked to value added conditions under the ASCM prohibited subsidy disciplines, especially where a local content requirement is only one of several alternative conditions for obtaining the subsidy. Moreover, the widespread lack of transparency, in particular with respect to *de facto* local content subsidies, calls for improved rules in this area. Rules should be clarified and made operational so that any subsidy linked to the use or purchase of domestic industrial products, and thus in breach of Article III:4 of GATT 1994, is covered by the prohibition. Of course, the fact that subsidies are available only to domestic producers would not, by itself, put them in the prohibited category (Article III:8 b of GATT 1994).

[4] See *Canada - Certain measures affecting the Automotive Industry* - complaint by the EC and Japan , Report by the Appellate Body(DS139/142).

### 3. Clarification on export financing

The ASCM does, in fact, contain rules which address export financing but again these are, on their own, not set out in sufficient detail to be operational. Therefore, the ASCM also refers to rules on official support for export credits, which are currently elaborated in detail in the OECD Arrangement. This effectively provides a "safe harbour" for this type of export financing, i.e. that the export credit support can in no case be considered a prohibited export subsidy in the meaning of Article 3.1(a) ASCM as long as the OECD interest rate provisions on export credits are complied with. But this "safe harbour" does not apply for all types of official support for export credits covered by OECD rules.[5]

There is therefore a need to establish clear and consistent rules for all types of export financing. However, this will not prejudice in any way the specific rules on export financing existing or to be established under the Agreement on Agriculture.

In this regard, the EC consider the OECD regime on official support for export credits to be a tested and workable set of rules. Some Members have already indicated that WTO rules should set out clearly the rules applicable to this area. The EC take note of the concerns of developing countries who have argued that the fact that they are not members of the OECD puts them at a disadvantage. The EC are prepared to address the legitimate concerns of developing countries in this regard.

### 4. More effective notification rules

The notification process for specific subsidies has completely broken down. Only a few WTO Members regularly notify subsidies even though there is an absolute obligation to do so under Article 25 ACSM. This lack of transparency needs to be urgently addressed since without notifications it is difficult for the rules of the ASCM to be fully operational and effective. This failure is particularly damaging as regards "less visible" subsidies, whatever their form. A workable and effective notification system would be hugely beneficial for enabling these subsidies to be identified.

In view of this, we propose to explore the possibility of **penalising partial or non-notifications**. A mechanism would have to be devised through which the quality and scope of notifications could be scrutinised and if failings were found or suspected a review procedure could be generated through an expedited WTO dispute settlement procedure similar to the one envisaged for spurious initiations or by referring the matter to an empowered Permanent Group of Experts.

### 5. Subsidies and the environment

The DDA has reaffirmed the commitment to the general objective of sustainable development and to the necessary mutual supportiveness between trade and environment. Certain subsidies may have a negative impact on the environment, but others can have a positive effect, by for instance encouraging reductions in pollution or furthering research into cleaner environment. In view of this it may be necessary to address the environmental dimension of subsidies and, in particular, to consider further how to approach subsidies aimed at the protection of the environment, following the expiry of the "green box".

## III. DDA AND COUNTERVAILING DISCIPLINES

Under this heading, we propose changes along the lines included in the negotiating proposal for the Anti-Dumping Agreement:

[5] The safe harbour of item k of Annex I ASCM applies only to interest rate provisions of export credits but does not apply to export guarantees, risk premia and "matching".

- Strengthen rules
- Increase effectiveness
- Reduce the cost of CVD investigations

The EC also propose to focus on solving some of the problems shown up by the application of the innovations of the Uruguay Round, in particular, with regard to **initiation standards** where e.g. successive cases are opened in respect of subsidies which have been found to have already expired or no longer used.

Moreover, the application of the **sunset provisions** also gives cause for concern. The presumption in current rules towards expiry after 5 years is being circumvented with unsubstantiated reviews being initiated thus prolonging life of measures. Hence, there is a need to spell out more clearly the requirements for extending the life of a measure for a further 5 years.

## IV. DDA AND DEVELOPING COUNTRIES

As a general principle, we propose to maintain the line that rules on multilateral subsidy disciplines should apply without exception. In our view, tight disciplines on trade distorting subsidies are in fact in the interests of all participants in the world trading system, including developing countries.

Nevertheless, the Communities recognise that certain types of subsidies can contribute to development, and would be willing to give positive consideration to a package of S&D treatment provisions for developing countries on the understanding that this would be for a strictly temporary period and would be drawn up only following an agreement on rules for non-exempted countries. S&D treatment (based on the existing Article 27 ASCM) could be considered in clearly defined circumstances, for **remedies, including countervailing duties, against certain prohibited and actionable subsidies given by developing countries**. The Communities will also review the existing Article 27 provisions in the light of any changes in the ASCM, to make sure that effective remedies remain against injurious subsidies.

For least developed country members (and perhaps other low income and small economies), we could envisage to relieve them of their notification obligation for specific subsidies under Article 25 ASCM. Instead, the review of this aspect of their trade policy could be conducted in the context of the Trade Policy Review Mechanism, which already now partly covers the subject of subsidies. In this process, the relevant parts of the review could be conducted in the Committee on Subsidies and Countervailing Measures.