Working Group 1.
Committee on Trade in Industrial Products

DRAFT REPORT OF WORKING GROUP 1
Examination of Items on the Illustrative List

(Note: It is suggested that in the final report the secretariat be authorized to insert in each section a paragraph headed "GATT Relevance", giving a resumé of relevant provisions and procedures).

1. Working Group 1 was established by the Committee on Trade in Industrial Products in December 1969 to examine the following subjects in the Illustrative List (Annex 1 to document L/3298): Trade diverting investment, export subsidies, countervailing duties, government procurement and state-trading enterprises in market economy countries. The task of the Group was to explore possibilities for concrete action, both with regard to reducing or removing notified barriers within its competence, and to developing possible rules of conduct. The work was to be conducted on the understanding that it was exploratory and preparatory in nature, and involved no commitment on the part of any member of the Working Group to take or join in any action under discussion. Special attention was to be given to the interests of the developing countries, which had submitted a number of notifications on subjects within the competence of the Group.

2. The Working Group met from 12 to 2 January 1970 under the chairmanship of Mr. Latimer (Canada). In undertaking its task of exploring possibilities for concrete action to solve the problems identified in the portion of the Illustrative List assigned to it, this Group adopted, as a method of work, the procedure of first running rapidly through all of the items within its competence, exploring the issues only sufficiently to identify the nature and extent of the problem and the kind of solution which appeared suitable. In formulating views on suitable solutions the Group took into account the question whether particular problems appeared to be pervasive in their occurrence or whether, even if difficulty arose only in a few instances, the effects were yet of concern to many countries.
A third possibility was that both the causes and the effects were confined to a few countries only. These characteristics were considered to have a bearing on the type of solution which would be appropriate, even though it might not necessarily be the case that a general problem, in either of the two senses indicated, would call for a generalized solution.

3. In the next and second stage of the Group's work, an effort was made to define in each case the main headings or topics to be covered, especially if some form of multilateral arrangement appeared to some or most members to be indicated. The Group not only had in mind the general terms of reference in regard to the exploratory nature of its work, but wished to emphasize in this connexion that in many cases the views recorded are only tentative at this stage.

I. Trade-diverting aids other than export subsidies

Type of solution: Most members of the Group tended to favour, as explained below, a wider concept for consideration of the Illustrative List item "Trade-diverting investment" as reflected in the heading above. Some felt that the problem of serious trade-diverting effects of government aids to production and investment was general both in occurrence and in effects on other countries as most countries grant some sort of financial assistance to general or regional production. Others doubted at this stage whether the number of present and prospective cases of difficulty arising out of such aids met these criteria. One member doubted, moreover, that incentives had been shown in any case as decisive in creating a problem of serious trade diversion. There was, however, rather general agreement that the essential element which would justify GATT attention to domestic aids was serious prejudice to trade interests through trade diversion, and that this rather than any additional standards such as transfer of industry from one country to another, or aid to investment rather than production, should be the key test. Even though no class or kind of subsidy would be banned (if not an export subsidy), particular situations such as research and development requirements, the need for assistance to depressed regions or possibly other considerations might be mentioned as offering some a priori case for sympathetic consideration by others. Equally, situations in which reconversion of an industry
was being assisted could perhaps be distinguished from cases where establishment of new industry or expansion of a new industry was the object. Those members which considered to be a problem of general concern favoured a set of rules, whether in the form of an Interpretative Note to Article XVI, or a code of good conduct. Among those which doubted the need for such an approach, the question was raised whether a code would contribute to solution of the specific problem notified, to which it was after all the first obligation of the Group to address itself. Inquiry into reasons why existing consultation procedures on subsidies had not been used might, for example, offer a more useful approach.

**Main headings:** As a working hypothesis it was proposed by some delegations which had already taken positions on the matter, that a set of rules might contain the following main headings:

(i) **The Note would build on the existing provisions of the GATT.** It would not envisage new GATT commitments although this possibility should not be precluded if further discussion among the contracting parties indicated that additional obligations would be appropriate.

(ii) **Improved notification of domestic aids having trade-diversionary effects was considered to be desirable,** since relatively few contracting parties report, and most of those reporting do so less frequently than required and tend to omit domestic production and investment aids. The danger that increased pressure for complete notifications might inundate the secretariat and the contracting parties with information largely irrelevant to their real concerns was noted. Both as a means of eliciting the desired information and as a safeguard if countries were to enjoy continued discretion to the scope of their reports, it was further suggested that opening the way to requests by interested countries, through the secretariat, for prompt special reports by countries giving domestic aids would improve the coverage of aids of real international concern whilst avoiding the danger mentioned.
(iii) Specific provision for consultations upon request, either among interested parties or with the CONTRACTING PARTIES as a whole, along the lines of Article XXII or, if no satisfactory solution is found, as provided for in Article XXIII, to determine whether serious prejudice to a contracting party's trade interests had occurred or was likely to occur through trade diversion caused by such aids.

(iv) Adjustment, in the event of a decision by the CONTRACTING PARTIES finding such serious prejudice

(a) Preferably by elimination or reduction of the aid to the point where prejudicial effects were eliminated;

(b) Failing that, the grant of compensatory new concessions to the injured party or parties; and

(c) If neither solution proved feasible, authorization by the CONTRACTING PARTIES for the suspension of the application of concessions or other obligations by the injured party or parties toward that party.

II. Export subsidies

Type of solution: Most members of the Group considered that the problem of export subsidies was general in nature, in that many countries appeared to maintain aids of various kinds which had been mentioned in one context or another as export subsidies, notwithstanding that the major developed countries had agreed in paragraph 4 of Article XVI to limitations on use of export subsidies in regard to non-primary products. Some felt that the major element should be an effort to strengthen existing obligations through clarification of obligations and supplementary procedures. Others favoured consideration of certain new obligations as well. It was recognized that there was a certain relationship between the work of this Group and that of the Working Party on Border Tax Adjustments, but the lines of responsibility seemed to be sufficiently clear to avoid duplication.

Attention was drawn to paragraph 5 of Article XVI which calls for a review of the operation of the provisions of Article XVI.
Main headings: A possible interpretative note or set of guidelines might cover the following main headings:

(i) One part of the problem derives from the fact that some contracting parties have greater obligations under GATT than others through full acceptance of the obligations of Article XVI:4, which forbids use of subsidies resulting in two-price situations on the export of non-primary products. A solution to this problem would be for those contracting parties, particularly developed countries, not having accepted the obligation to do so.

(ii) In addition, it was suggested that there was a need to refine and elaborate some of the measures that countries regard as constituting export subsidies. It was proposed that consideration be given to the following suggestions:

(a) Clarification of the scope of measures presently covered by the provisions of paragraph 4.

(b) Procedures, including notifications and reviews, should be elaborated to ensure improved and continuing implementation of the obligations of paragraph 4.

Some members of the Group also favoured giving consideration to the following possible extensions of existing obligations:

(iii) There may be need to include in the obligations of paragraph 4 export subsidies having trade-diverting effects, even though they do not result in sale for export below the comparable domestic price.

(iv) Consideration should be given to more comparable treatment as between export subsidies on primary and on non-primary products.
III. Countervailing duties

Type of solution: The predominant view was that the injury question was the main problem, where the solution was to be sought in action by articular countries.

As regards the general question of the application of countervailing duties, several representatives suggested that there was need for a code along the lines of the anti-dumping code, although the adoption of such a code should not be envisaged until all contracting parties had the same obligations. Any code might include, inter alia, determination of the subsidy and its amount, determination of injury and the trade effect for third countries.

The view was expressed that export subsidies rather than countervailing duties were the real problem because it was the export subsidies themselves in the first instance, and not the countervailing duties, which resulted in uneconomic trade distortion. It was further suggested that any solution to this problem could be considered only in the broad context of export subsidies and countervailing duties on primary and non-primary products, and that these might be dealt with by the Working Group which the twenty-fourth session agreed to establish. It was pointed out that the present GATT rules relating to export subsidization are unsatisfactory since third countries are not obliged to impose countervailing duties to offset export subsidization that causes or threatens injury to an export industry of another contracting party. It was suggested that it might be preferable to permit the injured party, in Article VI cases, specifically to withdraw concessions on products of interest to the export-subsidizing country.

It was suggested alternatively that the root of the problem lay in the fact that the Protocol of Provisional Application had been in force for over twenty years, thus permitting some contracting parties to be legally exempt in certain circumstances from obligations arising out of Part II of the General Agreement. This problem was aggravated by the fact that prior existing mandatory requirements in certain countries removed all discretion as to the imposition of countervailing duties. As for the suggestion that the problem was really one of export subsidies, it was pointed out that this argument would be valid only after all contracting parties had signed the Declaration prohibiting export subsidies, a step which seemed unlikely in the case of some developing countries. Furthermore, it was stated that the lack of a precise definition of what constitutes an export subsidy enables contracting parties to by-pass the provisions of Article VI; and that
even if a better definition were agreed upon there would remain the problem of acceptance by all contracting parties. It was pointed out that the distinction between primary and non-primary products was a fundamental one in that it had been a part of Article XVI from the outset and had been confirmed during the Review Session in 1955.

IV. Government procurement

Type of solution: It was felt that the solution to the problems related to government procurement, which appeared to be of a general nature, lay in the formulation of a code or set of guidelines that would apply to the contracting parties' government procurement operations. Note was taken of the situation created by the fact that the OECD is addressing itself to this problem and that the work there is in a fairly advanced stage. Several representatives expressed the view that, inter alia, the guidelines should incorporate the following elements:

Main headings:

(i) Objectives and principles
(ii) Definitions
(iii) Procurement entities
(iv) Elimination of existing discrimination
(v) Exceptions
(vi) Purchasing procedures
(vii) Publication of government procurement regulations
(viii) Reporting, review, complaint and confrontation procedures

V. State-trading in market economy countries

Type of solution: It was generally agreed that the existing rules of Articles XVII and II:4 regarding non-discrimination and limitation of protection seemed reasonably adequate as far as basic principles were concerned, and that the problems appeared to lie in the area of implementation, where some elaboration of procedures might be considered. Some countries suggested that specific solutions might be worked out, and the view was expressed that this might be on a product-by-product basis. It was noted that the notifications named in this section of the Illustrative List related primarily to state-trading enterprises in developed market economy countries.
Main headings: The following ideas were expressed, inter alia, with regard to the principal elements towards a solution:

(i) With a view to strengthening the effectiveness of Article XVII, consideration should be given to improving the quality, frequency and coverage of reports by contracting parties on state-trading enterprises. (It was noted that only a handful of contracting parties report with anything like the prescribed regularity and that reports were in some cases incomplete as to coverage or failed to respond in the detail envisaged by the questionnaire). A possible device, which might be applicable here, would be to invite countries who consider their trade interest affected to obtain, through the secretariat, notifications on subjects not covered by regular notifications. It was noted that lack of information regarding the margin by which prices are increased (mark-ups) in state-trading, including failure to state whether a country is meeting full demands for imported products in accordance with Article 31 of the Havana Charter, made it difficult for foreign firms and trade partners to determine the extent of discrimination.

(ii) Inclusion of specific reference to the possibility of bilateral and multilateral consultation along the lines of Articles XXII and XXIII might be useful on the understanding that, if no satisfaction were obtained through such consultation, the injured country could be granted compensatory concessions or, failing that, be authorized to suspend the application of equivalent concessions or obligations.

(iii) The view was expressed that the effectiveness of the provisions on state-trading might be enhanced if countries sought to negotiate to a greater extent than heretofore, concessions — including possible global purchase commitments — on state-traded products in which they have a trade interest.
It was suggested that the secretariat should make a review of the effectiveness of procedures in Article XVII:4 and make recommendations for improving them. Where concessions were in operation, the review might cover the question whether countries had observed the rules of Article II:4. Further light might be shed on the notifications by a study to determine to what degree the problems involved in the notifications had been caused by governmental restriction of quantity purchased rather than by the nature of state-trading as such. This would narrow the problem somewhat by showing separately the degree to which, and ways in which, state-trading as such created problems, as distinct from the effects of other objectives which might also be involved, such as the protection of particular sources of supply, revenue considerations or social policy.