I. INTRODUCTION

The framework for negotiations agreed upon by Ministers at the Montreal meeting commits the present Negotiating Group to improve, in a balanced way, GATT rules and disciplines relating to all subsidies and countervailing measures affecting international trade. The new rules to be elaborated on the basis of this framework rely upon the definition of three categories of subsidies having different legal effects. At this stage, further consideration should be given to the criteria of allocation (normative and others) of subsidies and to possible remedies capable to offset their trade-distorting effects.

The allocation of subsidies mainly relies, in this communication, on normative criteria. However, the paper takes into account that an allocation exclusively based on such criteria, as in the present rules, is not sufficient in practice. This paper therefore includes proposals related to the use of quantitative criteria as an additional safeguard to prevent circumvention of normative criteria. The system of quantitative criteria is explained in chapter III.

The Swiss delegation is aware that focusing on classification does not encompass all the elements listed in the framework for negotiation. It therefore reserves the right to submit further proposals.

Switzerland reiterates that the negotiation on agricultural subsidies shall take place in the Negotiating Group on agriculture. A solution on agricultural subsidies therefore has to be found in that forum. Yet, the same framework might apply to agricultural subsidies as well, provided that non-trade factors are taken into account. In such a case, different criteria of allocation would have to be developed in the Negotiating Group on agriculture. The Swiss delegation reserves the right to present its views on such
criteria in the negotiating Group on agriculture. This submission does not prejudice the Swiss position on agricultural subsidies.

II THE THREE CATEGORIES

As the category of actionable subsidies is defined by default, the communication first deals with the two categories requiring specific criteria of allocation (prohibited and non-actionable subsidies) for the purpose of practical convenience.

1. PROHIBITED SUBSIDIES

Subsidies defined under this heading are per se prohibited, independently of their effects. Violations of such prohibitions therefore constitute a violation of multilateral rules. A contracting party affected by such a violation can take appropriate measures. Subsidies under this definition therefore are subject to action within GATT without requiring an injury test. However, mandatory consultations under the auspices of a multilateral body shall take place within the system of GATT prior to the imposition of countervailing measures.

1.1. Notion

The prohibited category should comprise measures which result directly or indirectly in a net transfer of funds (public expenditure or loss of public income) from public sources to the recipient. Subsidies under that category should be those which are very likely to cause trade distortion: they are *prima facie* cases of nullification and impairment of the benefits of the agreement. In identifying the measures falling under this category, a distinction should be drawn between export subsidies falling under an exhaustive list and which are per se prohibited, and all other types of subsidies not falling under the exhaustive list which may become prohibited by means of quantitative criteria set forth in chapter III of this submission.

1.2. Criteria for Export Subsidies (Exhaustive List)

Export subsidies are defined as net transfers of funds from the public sources to any recipient, directly or indirectly contingent on an
export performance. They are actions deliberately taken by public authorities with the intention to improve export capacity of domestic producers and, as such, constitute trade-distorting measures. They should fall under the prohibited category.

In accordance with the definition above, an exhaustive list of export subsidies should be established essentially on the basis of the existing illustrative list of the 1979 MTN Agreement, following appropriate revision. The list, as amended, could eventually be subject to adaptation in order to cope with newly emerging types of export subsidies. The allocation or the withdrawal of particular practices to the prohibited class could regularly take place in successive amendments of the list with procedures to be defined. Such a process could in addition be inspired by the cases put forward by contracting parties in dispute settlement procedures.

For the time being, Switzerland wishes to propose some preliminary amendments to the illustrative list. They are set out in the Annex.

Participants to this negotiating group are invited to submit further amendments to the list of prohibited subsidies.

1.3. Quantitative Criteria Having for Effect the Prohibition of Subsidies not under the Exhaustive List

Prohibited export subsidies are generally those laid down in the exhaustive list. In exceptional cases, in order to prevent circumvention, subsidies not on the list could become prohibited according to quantitative criteria (see chapter III).

1.4. Remedies to Prohibited Subsidies

1.4.1. Domestic Markets

Whenever a contracting party demonstrates that subsidies falling into the prohibited category are granted to products exported in its domestic market, it shall have a right to impose, and without the requirement of an injury test, countervailing duties offsetting the subsidy effect. Countervailing duties should be imposed only if no mutually
acceptable solution has been found, after consultation have been exhausted. Such duties shall respect the principle of proportionality (1).

1.4.2. Third markets

If a contracting party demonstrates that a prohibited subsidy is granted to a firm operating in a third country market on which this contracting party also has export interests, countermeasures without requiring an injury test should be provided for under the GATT. In such a case, and if consultations failed, the injured party should be authorized to take appropriate measures which would revoke benefits to the subsidizing country accruing under the GATT, or to ask for appropriate compensation. Such measures should be defined by the Negotiating Group.

1.4.3. Prior Notification and Procedural Safeguards

As the countermeasures available to offset the adverse effect of prohibited subsidies are rather permissive (action without injury test), the right to resort to such measures calls for particular safeguards.

Countermeasures without an injury test should be subject to mandatory prior notification to all contracting parties. Any contracting party affected by such determination should be in a position to call upon a standing body in GATT in order to challenge the subsidy involved as to its prohibitive character and the proportionality of the potential countermeasure. Therefore, if so requested, the standing body should assess, on the basis of quick findings, the nature of the subsidy involved and the proportionality of the envisaged countermeasure. Upon examination, the body shall recommend to the Council for decision whether the countermeasure is lawful or should be cancelled. The body shall also have the right to recommend to the Council that a provisional injunction should be imposed to suspend the operation of a countermeasure temporarily, as long as the matter is pending, if there

(1)The countermeasure must not go beyond what is necessary to offset the negative effect.
is reason to believe that the subsidy is not covered by the exhaustive list or the notified countermeasure is contrary to the principle of proportionality. The parties affected shall abstain from blocking a consensus in both cases.

2. NON-COUNTERVAILABLE, NON-ACTIONABLE SUBSIDIES

Subsidies under this heading are not subject to countermeasures, neither countervailing duties, nor other forms of action.

2.1. Notion

Subsidies belonging to this category are domestic subsidies (2) which directly or indirectly result in a net transfer of funds from public sources to the recipient. In order to minimize their trade-distorting effect, domestic subsidies should be submitted to clear disciplines defined under the GATT legal instruments, meeting both

1) normative criteria referring to defined objectives of national policies and/or the conditions of application of a domestic subsidy;

2) quantitative criteria defining the trade impact of domestic subsidies.

The use of additional quantitative criteria is justified because experience has shown that domestic subsidies can be a nearly perfect substitute for export subsidies, and sometimes adversely affect international trade. The exhaustive use of normative criteria has proven insufficient; for that reason domestic subsidies should simultaneously meet other verifiable and objective (quantitative) criteria in order to be non-actionable (see chapter III).

(2) Domestic subsidies are subsidies other than export subsidies as defined under section 1.2.
2.2. Normative Criteria for Domestic Subsidies Having Effect of Non-Countervailability

The following normative criteria constitute mandatory conditions that should be met by any domestic subsidy programme and be respected by any contracting party wishing to support economic agents without risking countermeasures. A distinction should be made between specific and non-specific domestic subsidies.

2.2.1. Specific Domestic Subsidies (Exhaustive List)

An exhaustive list of the following specific domestic subsidies is proposed which are exempted from countervailing action:

(i) Structural Adjustment Schemes

In order to enjoy the principle of non-actionability, domestic subsidies granted for the purpose of structural adjustment should stimulate investment and meet the following cumulative conditions:

(a) the subsidized industry must be in difficulty, showing losses over a period of at least [X] years, and private sector efforts have proven to be insufficient or not sufficiently accessible;

(b) structural adjustment subsidies should necessarily be of such a nature as to improve the competitive capacity of the industry (e.g. investment credit facilities), and not the conditions under which it operates (e.g. by lowering of the selling price through subsidies, or by way of contributions to salary or social security payments to the industry);

(c) structural adjustment programmes should be strictly limited in duration and degressive;

(d) structural adjustment subsidies should be capable of producing effects outlasting the payment of the subsidy. The conformity of a subsidy scheme with this principle could be assessed through periodical review in the light of the degree to which the objectives set out in the adjustment programme have been achieved; measures
whose effects only last as long as they remain in force would not be covered.

(ii) Environmental Aid Schemes

Environmental policies should be based on the polluter-pays-principle. Where this principle is complemented by governmental assistance specifically designed to reduce pollution, the subsidy should not exceed more than a particular percentage (to be negotiated) of the total costs, in order to be non-actionable.

(iii) Research and Development Aid Schemes

Aid to research, development and innovation should be non-actionable, provided that the research findings are rapidly published or otherwise made freely available, or can be licensed by firms of foreign nationality on the same basis as domestic firms. In addition, assistance should not exceed more than 50% of the total costs of the research programme.

(iv) Regional Development Aid Schemes

Regional development aid should be non-actionable to the extent its purpose is to offset geographical disadvantages and to put all branches of industries or enterprises in regional development areas on an equal economic footing with industries not subsidized but favoured by their very location in other parts of the country. However, they should not increase capacity in sectors already suffering from problems of overcapacity; when evaluating problems of overcapacity, the international situation as a whole and not merely in the country in question should be taken into account.

(v) Aid Schemes for the Promotion of Cultural Values

Aids schemes available to enterprises, industries or public authorities for the promotion of activities related to the preservation and the development of cultural values, in particular the arts, should be non-actionable.
(vi) Employment Adjustment Schemes

Assistance provided to support employment adjustment and vocational training in order to cope with structural unemployment due to overcapacities should be non-actionable.

2.2.2. Generally Available, Non-Specific Domestic Subsidies

Subsidies other than those listed above can only be deemed non-actionable if they are not specific, i.e. generally available. Non-specific subsidies do not favour particular industries or enterprises by granting them an advantage not accruing or available to other industries or enterprises. Non-specific subsidies should be tolerated and should not be actionable.

In order to define non-specific subsidies, attention should be drawn to the notion of specificity of a domestic subsidy as it is set out in the draft guidelines for the application of the concept of specificity in the calculation of the amount of a subsidy other than an export subsidy submitted by the Group of Experts on the calculation of the amount of a subsidy (GATT-Doc. SCM/W/89, April 25, 1985). Based on the work of the Group of Experts, the Negotiating Group should undertake to develop an explicit definition of non-specific subsidies.

In determining whether a domestic subsidy is generally available or not, it is of fundamental importance to look beyond the nominal non-specificity of a measure. A subsidy scheme which de facto merely grants an advantage to certain enterprises or industries despite its general formulation is not considered to be generally available.

Examples of generally available subsidies are:

- Tax measures that are a part of the national tax legislation, available to all enterprises, and uniformly applied in a country.

- General aid to export promotion such as national weeks or fairs, provided that such aid is not company specific.
- Aids in the form of general public services to trade and industry on terms and under conditions not favouring certain sectors or particular enterprises.

2.3. Prior Notification and Dispute Settlement

In order for a particular subsidization programme to enjoy the benefits of non-actionability, the subsidizing contracting party should have the obligation to notify the domestic subsidization programme to the GATT. Such notification would serve as a basis for other contracting parties to challenge the alleged non-actionable status of a programme. If a contracting party fails to notify a scheme, it would automatically be presumed to belong to the actionable category as long as it has not been examined by a GATT body.

If a domestic subsidy notified under the non-actionable category gives raise to countermeasures (with or without an injury test) by another contracting party, the affected party should be in a position to bring the case before a standing body in GATT which would determine whether or not such countermeasures are in conformity with GATT rules. This body should function in the same way as in the context of export subsidies (see 1.4.3. above).

3. NON-PROHIBITED BUT COUNTERVAILABLE OR OTHERWISE ACTIONABLE SUBSIDIES

Subsidies qualifying under this category follow traditional approaches in GATT. They are not prohibited unless they cause negative effects related to international trade. In that case, the subsidies will be actionable, i.e. subject to complaint and to countermeasures by parties affected. The essential feature of this group consists of a mandatory requirement of serious prejudice (material injury), or threat thereof, to the importing country. Proof of such requirement needs to be established by the complaining party.

3.1. Notion

Actionable subsidies are all measures which result directly or indirectly in a net transfer of funds (expenditures or loss of income)
from public sources to the recipient, and which do not constitute a
prohibited or a non-actionable subsidy.

This category therefore comprises subsidies not specifically defined
and not allocated to the above defined two categories of prohibited or
non-actionable subsidies. They may include export as well as domestic
subsidies:

- Domestic subsidies that have not been notified under the scheme of
  non-actionable subsidies;

- Domestic subsidies and certain export subsidies not falling under the
  exhaustive lists or which, due to quantitative criteria, are al­
  located to this category (see chapter III).

3.2. Remedies

The prerequisite to countervailing actions taken against a subsidy
attributed to this group is the mandatory demonstration by the
importing country of a material injury. The injury test as it exists
today should be reexamined. In particular, injury proceedings should
be simplified and harmonized in order to increase the transparency of
investigations and to facilitate the task of GATT panels when they
have to determine the existence of material injury. Moreover, it will
be necessary to design an injury test which can be applied in cases of
subsidization programmes causing import substitution on third markets.

III. QUANTITATIVE CRITERIA

1. Introduction

Next to qualitative criteria, quantitative criteria should also be taken
into account. The Swiss delegation suggests to rely, for these purposes,
upon two variables: the subsidy rate and the import rate. The higher the
subsidy is as compared to the value of the product, and the higher the
exports from a subsidizing country are as compared to total consumption in
an importing country, the more the allocation of the subsidy to one of the
preceding categories based on qualitative criteria might have to be
corrected. The system only applies to subsidies which, due to normative
criteria, fall into the actionable and non-actionable categories, since prohibited subsidies are per se excluded. However, a non-actionable subsidy may be moved into the category of actionable or even prohibited subsidies. Similarly, an actionable subsidy may shift into the category of prohibited subsidies.

2. The Relevant Variables

The relevant variables to determine whether the quantitative criteria have an effect on the classification of subsidies with respect to a particular market are the subsidy rate (S) and the import rate (X).

The subsidy rate (S) is the amount of subsidy related to the value of the subsidized product. This parameter, should be determined by the investigating authority on the basis of objective criteria.

The import rate (X) is the quantity of the subsidized product exported to an importing country as compared to the total consumption of any like product in that particular importing country. By relating exports to the domestic consumption of the importing country due account is given to the displacement effect of the subsidization on foreign markets. X is also an easily verifiable variable for an investigating authority.

The classification of a subsidy should be based on a combination of the variables S and X, allocating it to one of three areas contained in the chart below:

(i) A domestic subsidy associated to values of S and X not exceeding S1 and X1 (area III) should be tolerated by the contracting parties provided it also meets the criteria laid down under section 2.2. In such a case, a domestic subsidy is deemed to cause no harmful trade impact and does not give raise to any countermeasure.

(ii) Above this de minimis threshold, up to the bench marks S2 and X2 (area II), the subsidy is supposed to belong to the actionable category. It is therefore subject to the usual disciplines, i.e. evidence to demonstrate its harmful effect should be brought by the affected party (injury test).
(iii) Above $S_2$ and $X_2$ (area I) the subsidy is allocated to the prohibited category. Subsidization in excess of $S_2$ and $X_2$ (area I) constitute a prima facie case of nullification and impairment and is submitted to the disciplines and procedures of prohibited subsidies.

The levels of the parameters $S_1$, $S_2$, $X_1$, $X_2$, would be established by negotiation.

**ALLOCATION OF SPECIFIC DOMESTIC SUBSIDIES ACCORDING TO SUBSIDY RATE ($S$) AND IMPORT RATE ($X$)**

3. Effects of Quantitative Criteria

The effects of the quantitative criteria might best be explained by an example:
Let us assume that an aid to structural adjustment, meeting all the normative criteria set forth above, is subsidized to the extent that the subsidy rate lies between the thresholds of S1 and S2. At the same time, the import rate of the subsidized product lies between the thresholds of X1 and X2. Consequently, it would fall into area II. In other words, the subsidy changes form a non-actionable to an actionable one, open to countervailing duties after the injury test has been met. If the rates exceed S2 and X2 the subsidy even turns into a prohibited one.

The following table summarizes how non-actionable, and actionable subsidies may move to more restrictive categories:

<table>
<thead>
<tr>
<th>SUBSIDY ACCORDING TO QUANTITATIVE CRITERIA</th>
<th>AREA I</th>
<th>AREA II</th>
<th>AREA III</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ACCORDING TO NORMATIVE CRITERIA</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Export subsidies on the list</td>
<td>PROHIBITED</td>
<td>PROHIBITED</td>
<td>PROHIBITED</td>
</tr>
<tr>
<td>Export subsidies not on the list</td>
<td>PROHIBITED</td>
<td>ACTIONABLE</td>
<td>ACTIONABLE</td>
</tr>
<tr>
<td>Domestic subsidies in conformity with the normative criteria</td>
<td>PROHIBITED</td>
<td>ACTIONABLE</td>
<td>NON ACTIONABLE</td>
</tr>
<tr>
<td>Domestic subsidies not in conformity with the normative criteria</td>
<td>PROHIBITED</td>
<td>ACTIONABLE</td>
<td>ACTIONABLE</td>
</tr>
</tbody>
</table>

**IV SPECIAL CIRCUMSTANCES**

Switzerland is aware that the introduction of the new system will require adjustment in subsidization regimes. In order to take into account such circumstances, in particular of developing countries, it is conceivable to adapt the implementation schedule of the generally accepted rules to the
special situation of such countries. Similarly, it is conceivable to use particular subsidy and import rates in order to define quantitative allocation. Such suspension or modification, however, shall be limited in duration and subject to periodical review within GATT.
ANNEX

AMENDMENTS TO THE ILLUSTRATIVE LIST OF EXPORT SUBSIDIES
of the 1979 MTN Agreement on Interpretation
and Application of Articles VI, XVI and XXII
of the General Agreement on Tariffs and Trade

Item (d) This item permits dual pricing for inputs resulting in a net transfer of funds from governmental sources. The present formulation authorizes any public entity to charge lower prices for inputs integrated in production destined to be exported than for the same input used in production for the domestic market, provided the prices charged are not below the world market prices. Such practices should be considered export subsidies and fall under the prohibited category.

Item (h) and item (I) Item (h) points out to the question of the exemption, remission or deferral of prior stage cumulative indirect taxes levied on goods that are physically incorporated (making normal allowance for waste) in the exported merchandise. The same condition appears in item (i) that relates to the remission or drawback of import charges. According to the guidelines on physical incorporation (SCM/68, October 24, 1985), inputs are physically incorporated if they are used in the production process and are present in the product exported, though they need not be present in the final product in the same form in which they entered the production process. This clause is not fully compatible with the notion of net transfer of funds because all indirect taxes and import charges on services, such as transportation and communication, as well as on machinery, and on fungible inputs such as fuel and electricity used in the manufacturing process are not physically incorporated in the final product. Consequently the rules on indirect taxes and remissions or drawbacks should apply to all inputs.