



CHAPTER 10

SUBSIDIES

The Agreement on Subsidies and Countervailing Measures (ASCM) governs the use of subsidies and regulates the actions that countries can take to counter their trade impact. The ASCM builds on the Tokyo Round subsidy code (issued in 1979) but takes the important step of defining what a subsidy is, making it the first international agreement on acceptable levels of government support for production and trade.

Depending on its purpose, the ASCM defines a subsidy as prohibited, actionable or non-actionable. The ASCM does not apply to agricultural subsidies during the implementation period of the ‘peace clause’ of the Agreement on Agriculture—that is, until the end of 2003. Although the ASCM contains concrete measures providing developing countries with special and differential treatment, many of them believe that it has created an imbalance on measures that can be taken by industrial and developing countries. Developing countries also feel that the ASCM does not take into account their development needs. Thus they have made many proposals for improving it.

DEFINITION OF AND LIMITS ON SUBSIDIES

Like tariffs, subsidies support industrial promotion. But subsidies distort trade less than tariffs do because they affect only the production patterns of certain products, whereas tariffs affect both production and consumption. Multilateral trade negotiations, starting with the 1947 General Agreement on Tariffs and Trade (GATT), sought to discipline the use of subsidies. Initially weak provisions were tightened in 1955 with the addition of provisions on export subsidies. Then, in 1961, industrial countries accepted the prohibition of subsidies for industrial exports.

The Tokyo Round subsidy code imposed more stringent rules and, though optional, was accepted by many developing countries because acceptance was required for countries to benefit from the injury criterion in the US law on countervailing duties. During the 1980s subsidies persisted as an area of tension in international trade relations. By the launch of the Uruguay Round in 1986 it was evident

that subsidies and the actions that could be taken against them needed to be more precisely defined (Sajjanhar, 2000).

The ASCM defines a subsidy as a government financial contribution that confers a benefit, whether directly or through an intermediate party. This definition includes such practices as government provision of goods and services, government forgoing of revenue that otherwise would have been collected and government provision of income or price support.

Specificity is a key concept in the agreement. To be actionable, a subsidy must be specific—targeted at an enterprise, industry or group of enterprises or industries. If a specific subsidy is determined to cause injury to domestic industries in an importing country, countervailing duties can be applied. If such subsidies displace exports in third country markets and cause serious prejudice to exporters, an accelerated dispute settlement mechanism is available. Prohibited subsidies include those contingent on export performance or on the use of domestic goods instead of imported goods. Prohibited subsidies are also subject to accelerated dispute settlement procedures. If the procedure confirms that the subsidy is prohibited, it must immediately be withdrawn, and there is no need to demonstrate injury or prejudice. (The restrictions on industrial subsidies in the ASCM are far more aggressive than those on agricultural subsidies in the Agreement on Agriculture; see chapter 5.)

The ASCM also defines certain subsidies that, although specific, are non-actionable—meaning that they cannot be challenged and that countervailing duties cannot be imposed. These include subsidies for industrial research and pre-competitive development activities, assistance to disadvantaged regions and certain types of assistance for adapting facilities to new environmental laws and regulations. These provisions, spelled out in article 8 of the agreement, were to apply for five years after its signing (through 1999 for WTO founding members), at which point a review was to occur to determine whether the category of non-actionable subsidies should be maintained. Because the review did not take place, these provisions have technically expired. But given the political importance of such subsidies in some industrial countries, there seems to be an unspoken agreement not to challenge them.

To apply countervailing duties, a country must follow ASCM provisions for establishing cases and investigation parameters. The agreement sets out the relevant economic factors to be included in assessing the state of the industry and requires that a causal link be established between the subsidized imports and the affected industry. If the subsidy is worth less than 1 per cent of the value of the imports, the investigation should be terminated. But cumulative assessment of injury is permitted, meaning that relatively small suppliers can be subjected to countervailing duties on the basis that they are contributing to the injury of the industry concerned. If countervailing duties are warranted, they can be imposed at a rate no greater than the amount of the subsidy benefit. Moreover, they must be removed within five years of their imposition unless a review determines that doing so would cause further injury.

Box 10.1 SUBSIDIES—A CRUCIAL TOOL FOR DEVELOPMENT

Large direct and indirect export subsidies were essential to the rapid growth of many of today's most successful developing economies at the early stages of their development. In East Asia's tiger economies—the Republic of Korea, Malaysia, Singapore, Taiwan (province of China)—subsidies played an important role in the export promotion policies used to develop new local industries. Korea's subsidies included export credits and long-term loans with negative real interest rates for firms able to meet export quotas (see chapter 1). Such policies enabled these economies to become world-class exporters of modern industrial products such as electronics, semiconductors and ships, moving well beyond the limits of their comparative advantages. Even countries that have tried to develop industries in line with their comparative advantage in international trade have used export subsidies. In the mid-1980s, for example, Chile instituted tax rebates to support exports of non-traditional goods—primarily processed natural resources—now considered a catalyst for the country's thriving wine, grapes and cellulose industries.

Source: Amsden, 1989; Helleiner, 1994; Silva, 1999; Wade, 1990.

ISSUES FOR DEVELOPING COUNTRIES AND HUMAN DEVELOPMENT

The ASCM provides special and differential treatment to developing countries through a series of time limits and through criteria related to income thresholds, trade values and subsidy levels. WTO members that are among the least developed countries or that have GNP per capita of less than \$1,000 a year are not subject to the prohibition on export subsidies. As a result of the decision on Implementation-Related Issues and Concerns issued at the WTO's 2001 ministerial conference in Doha, Qatar, a developing country will receive this treatment until its per capita GNP exceeds this level for three consecutive years. In addition, countries that lose this treatment as a result of achieving higher GNP per capita are covered again if their GNP per capita falls back below this level. Other developing countries were given eight years (until the end of 2002) to meet the new obligations.

Developing countries also benefit from different thresholds in the application of countervailing duties. Imports from developing countries enjoy higher thresholds in terms of subsidies per unit and the volume of imports benefiting from a subsidy.

Still, developing countries perceive that significant imbalances remain in the ASCM's treatment of industrial and developing countries. Given the importance of subsidies in early stages of industrial development (box 10.1), these imbalances will likely accentuate human development problems in developing countries, causing further divergence in countries' development levels. Moreover, many developing countries have not been permitted to use even the flexibility mechanisms they enjoy under the ASCM, because international financial institutions' loan conditions require the reduction and elimination of the generally applicable, non-specific subsidies that are non-actionable under the agreement. Such conditions ignore the rights enjoyed by developing countries under the WTO agreement, requiring these countries to make, in effect, additional trade concessions that go

Box 10.2 SMALL ECONOMIES, EXPORT SUBSIDIES AND COUNTERVAILING ACTIONS

To operate efficiently and not rely unduly on domestic markets, world-scale plants in small developing countries must export a large portion of their production—typically 45–85 per cent. Also quite typically, the bulk of such exports may go to just one of the country's larger trading partners. When such exports are subsidized, they are liable to inspire countervailing duties in larger trading countries. Because such action is usually applied to a large portion of the plant's output, it can be extremely damaging.

By contrast, a similar plant receiving similar subsidies in a larger trading country generally exports a small portion of its production, meaning that its profits will not be seriously affected by countervailing duties applied on its exports to a small country. Thus countervailing duties may encourage investors to locate production in larger trading countries that often resort to countervailing duty action.

Source: UNCTAD, 1994.

far beyond their WTO obligations and commitments. This set-up illustrates the lack of coherence in global economic policy making.

While the Tokyo Round subsidy code allowed developing countries to maintain export subsidies when necessary for development, the ASCM extends the prohibition of export subsidies to most developing countries—limiting, above all, their policy flexibility. The problems facing developing countries in the application of the export subsidy provisions relate to their need to use export subsidies for development purposes and to the failure of the provisions to take into account certain characteristics of developing countries, undermining their international competitiveness.

Export subsidies have been important instruments in the development of many industrial and developing countries (Helleiner, 1994; see box 10.1). Prohibiting industrial export subsidies also inherently discriminates against smaller countries, where domestic production can be viable only if a large portion is exported. Many of these countries are not low-income and so do not qualify for the exemption from the ASCM that applies to the least developed countries and others with GNP per capita below \$1,000 a year (box 10.2).

Encouraged by a coalition of transnational corporations, many developing countries perceived that the end-2002 expiration of the transition period under which they were permitted to apply export subsidies would undermine the operations of their free trade zones. Thus these countries successfully sought an extension in the context of the Doha decision on implementation-related issues and concerns. Some developing countries opposed this extension, however, arguing that it was granting permission for poor people in developing countries to subsidize rich investors and consumers in industrial countries.

In East and Southeast Asia, for example, up to 80 per cent of the workforce in export processing zones is female (UNIFEM, 2000). While the evidence on gender wage inequality and gender wage gaps are mixed, there is clearer evidence that labour market deregulation weakens workers' rights in general and women's in

particular. Working conditions in export processing zones are good examples, as many are exempt from local labour laws. (Sen, 1999).

Furthermore, contrary to the Tokyo Round code—which prohibited only export subsidies—the ASCM prohibits both export subsidies and subsidies contingent on the use of domestic over imported goods (Sajjanhar, 2000). In practice this means that countries cannot use subsidies to support import substitution policies.

Non-actionable subsidies, as defined in article 8 of the ASCM, are also significantly biased against developing countries. The subsidies used primarily by industrial countries—for research and development and to support disadvantaged regions—are non-actionable. Yet subsidies to promote the development of national industries—the tool used most often by developing countries to diversify and upgrade their export industries—are either prohibited or actionable. The concept of non-actionable subsidies should be further developed, however, because it could give developing countries the flexibility needed to pursue human development policies.

In several areas the rules do not take into account the inherent characteristics of developing countries. An example is the high cost of capital in these countries, which was a major element in Canada's successful challenge to Brazil's support to its aircraft industry. Another is the difficulty that many developing countries have in administering an effective value added tax system. This means that many taxes on inputs cannot be rebated when the products are exported, resulting in an effective tax on exports.

Because economic policies tend to be biased towards male breadwinners, women are often left with more work (the triple burden; see chapter 1) and less pay. Given women's importance in agriculture and food security (see chapter 5), this has led to biases in agricultural policies and affected consumption patterns. Thus trade-related allocations for export subsidies and export credits, as well as other subsidies and allocations in national budgets, should bear in mind gender and other biases. Likewise, interest rate subsidies (in the context of monetary policies) should be formulated to recognize, reduce and eventually eliminate such biases. Viet Nam has tried to address this problem by maintaining a subsidy programme, notified in the context of its WTO accession negotiations, that enables firms to obtain a reduction in corporate income tax for expenses incurred promoting the health and upgrading the skills of female employees.

The more favourable treatment of agricultural (as opposed to industrial) subsidies is seen as creating another major imbalance between industrial and developing countries. Current rules permit industrial countries to retain massive export subsidies on agricultural products but effectively prohibit those used by developing countries. Moreover, the subsidies from industrial countries dwarf those from developing countries. Under the Agreement on Agriculture the US can provide \$363 million in export subsidies for wheat and wheat flour, and the EU can provide

Box 10.3 FISHING FOR SUBSIDIES

Although the fisheries sector shares many characteristics with agriculture—particularly as a major provider of employment and export earnings in developing countries—it is not covered by the Agreement on Agriculture. Yet the ASCM fails to address the massive subsidies provided to the fishing industries of certain major industrial countries. This subsidization has led to excess fishing capacity around the world. This, in turn, has led the fleets of subsidizing countries to overfish in the high seas and motivated their governments to negotiate imbalanced agreements for access to the territorial waters of developing countries. The result has been a depletion of fish stocks, reduced incomes for poor fishers in developing countries and threats to their food security. Fishery subsidies have been recognized as a priority item under the WTO rules and trade and environment mandates in the Doha declaration.

Source: UNEP, 2000; ICTSD, 1999; Deere, 2000.

\$1.4 billion (Cairns Group, 2000). By comparison, in 1996 Chile's entire non-traditional export subsidy program cost \$126 million (Macario, 1998)—and most other developing countries have much less capacity to provide subsidies. Another problem arises from fisheries subsidies in some industrial countries (box 10.3).

THE WAY FORWARD

The Doha work programme gives developing countries the opportunity to advance their proposals for changes to the ASCM (Das, 2002). These proposals—including in the 'Compilation of Outstanding Implementation Issues Raised by Members'—can be addressed in negotiations on WTO rules, with the objective of achieving greater policy space for human development.

Given the successful use of subsidies by the East Asian 'tiger' economies, the revised agreement should provide other developing countries with the option of using this policy instrument for industrial development. Subsidies should be examined from the perspective of domestic policy space. A new category of non-actionable subsidies essential to the development of developing countries would be an important step forward, providing these countries with more flexibility to implement export subsidies.

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