WTO Agreement on Subsidies and Countervailing Measures

(Subsidy Rules and WTO Jurisprudence)

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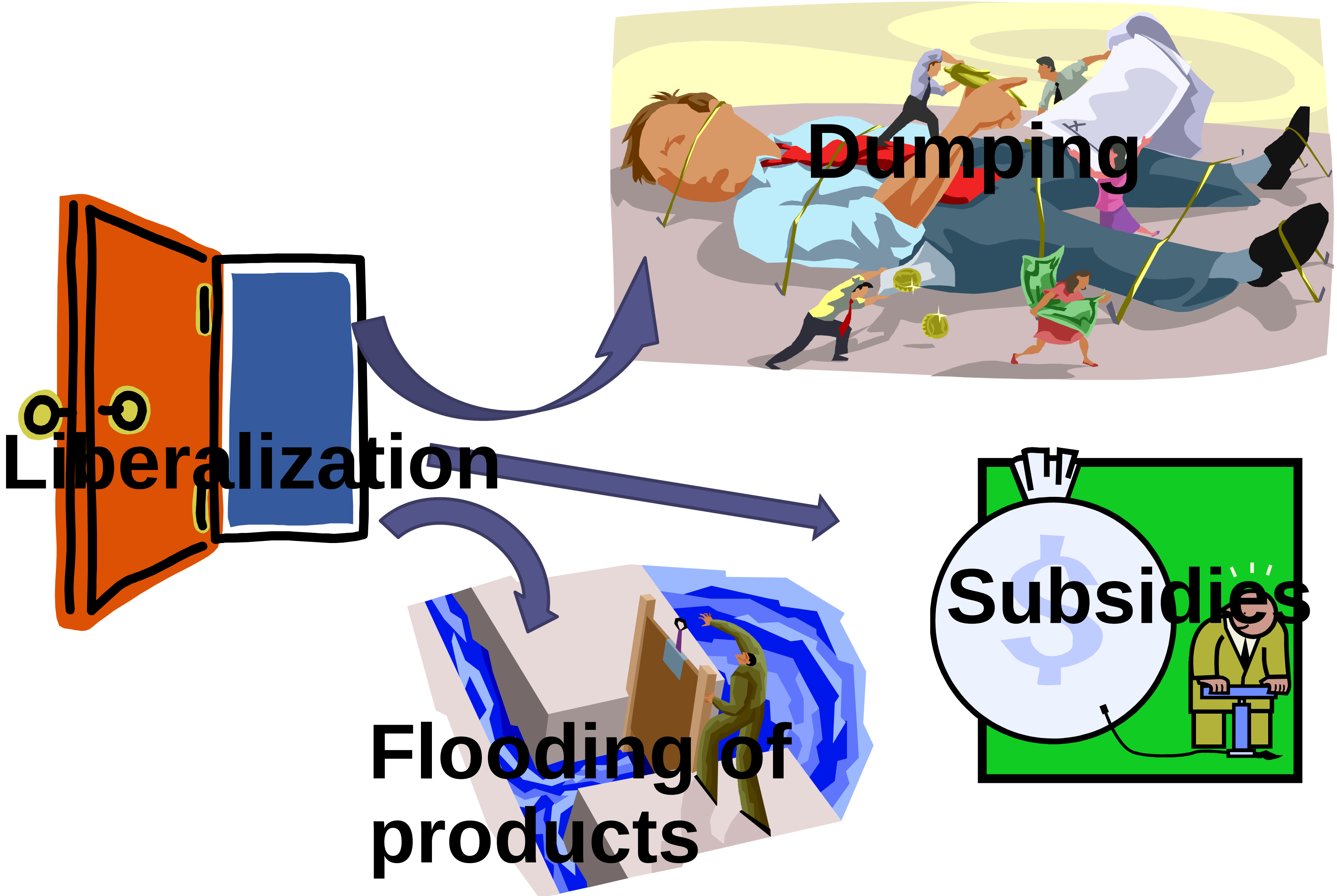
SCM Agreement: context



Subsides…

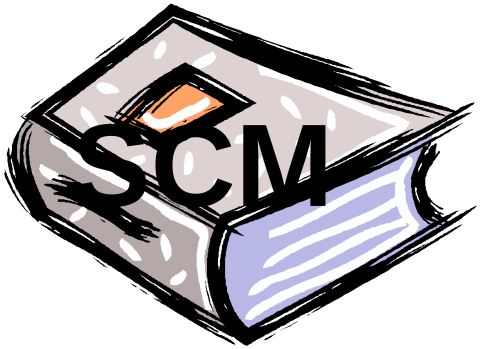
- Very sensitive matter in international trade relations
    - On one hand, subsidies evidently used by governments to pursue legitimate objective of economic and social policy.
    - On the other hand, subsidies may have adverse effects on the interests of trading partners, whose industries may suffer from unfair competition
- Subsidies: can distort trade flows if they give an artificial competitive advantage to exporters or import competing industries.
- Example of subsidies: aid to the poor, aid for technological development, special aids for education, aid to disadvantaged groups and regions etc.

COVERAGE OF THE SCM AGREEMENT

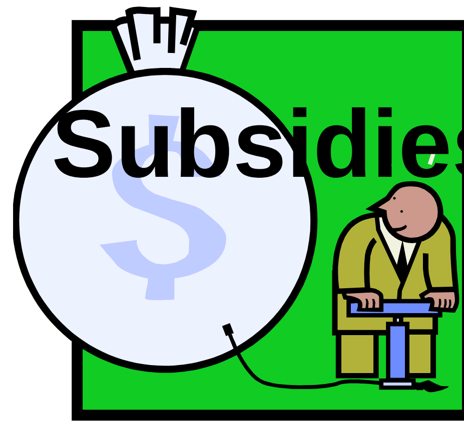
The SCM Agreement regulates:

- **Subsidisation by WTO Members**
- **Use of countervailing measures**

Structure of the SCM Agreement: Two Tracks



SCM



Subsidies

Countervailing measures

Different rules!

SCM Agreement: Subsidies

- Traffic light approach
- Subsidies are put into various baskets/categories:

i. Red ("prohibited")
ii. Yellow or amber ("actionable")
iii. Green ("non-actionable")

Broad Scheme of SCM Agreement

- Uruguay Round Subsidies Text is extensive and detailed
  - Part I – General Provisions (definition and specificity)
  - Part II – Prohibited subsidies (red light)
  - Part III – Actionable subsidies (yellow or amber light)
  - Part IV – Non-Actionable subsidies (green light)
  - Part V – Countervailing duty measures

Subsidy Defined

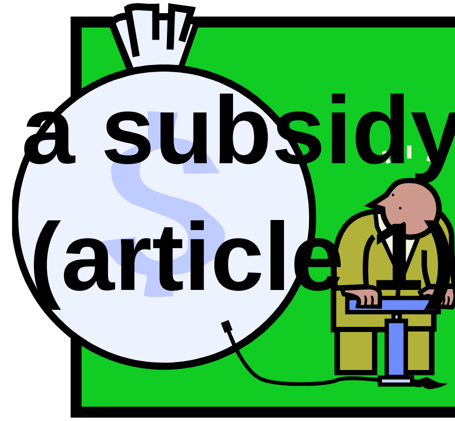
- **Three key** elements when examining whether a programme, scheme, etc. constitutes a subsidy are:

  i. **Financial contribution / income or price support**
  ii. **By a Government or any public body**
  iii. **Which confers benefit**

- If any of the three elements is missing, then the programme, scheme, etc. is **NOT** a subsidy under SCM Agreement.

Coverage of the SCM Agreement

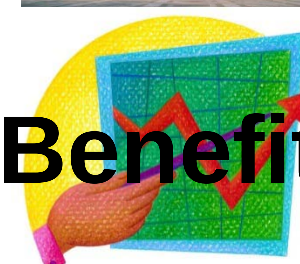
Applies to a measure that is



a subsidy (article 1)

- Financial contribution

- Government

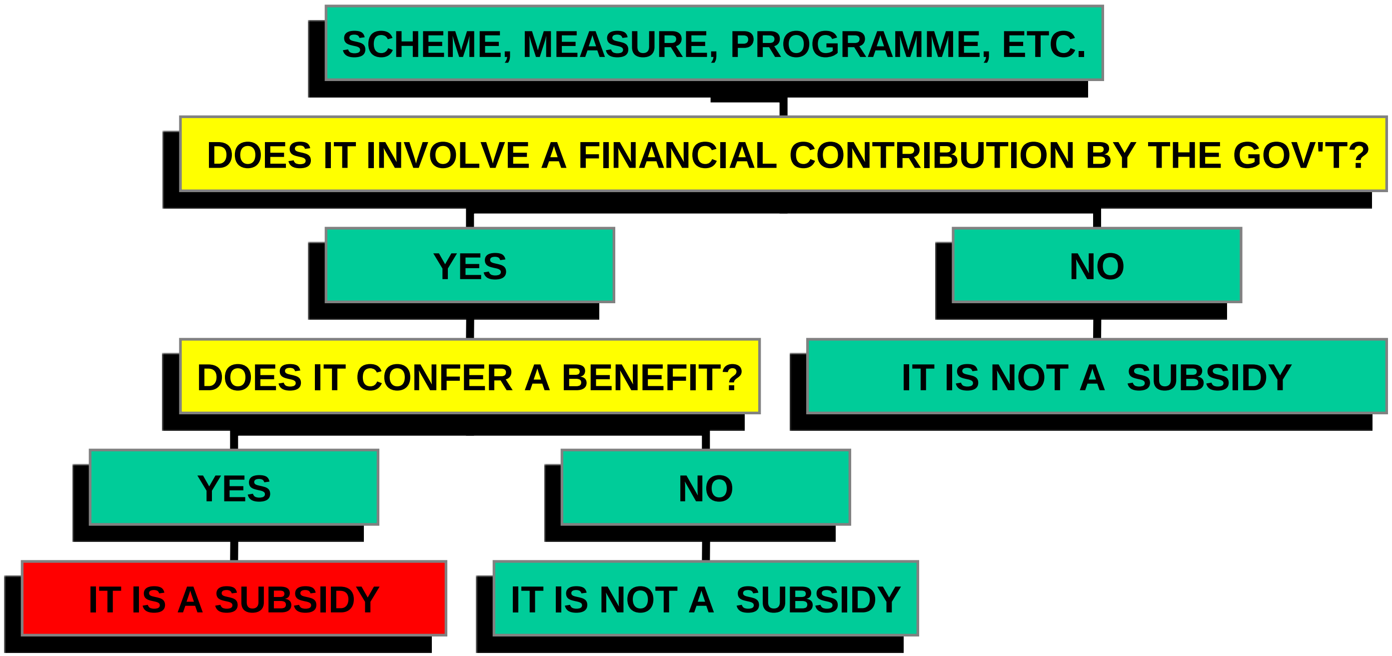


- Benefit

and

Specific (article 2)

Elements of a Subsidy



Financial Contribution

- **Direct transfer of funds** (grants, loans, equity infusions)
- **Potential direct transfer** of funds or liabilities (loan guarantee)
- Government revenue, that is **otherwise due if foregone or not collected** (tax credits, import duty exemption)
- **Provision of goods or services** other than general infrastructure
- **Purchase of goods**

By a Government or any Public Body

- Financial contribution granted by **a** Govt. (e.g. Federal, Regional or Municipal Govt.) **OR** by a public body (e.g. National Bank, National Power Company, etc.)

- Within the territory of a Member

Or

Government **entrusts or directs** a private body to make the financial contribution

Concept of Benefit

- **Benefit** = advantage (to recipient), <u>not</u> cost to Govt:
  - "Whether the financial contribution places the recipient in a more advantageous position than would have been the case, but for the financial contribution"
- **Basis for comparison** = Market place:
  - Is the financial contribution "provided on terms which are more advantageous than those that would have been available to the recipient on the market"

Concept of Benefit (Contd.)

- **Govt. equity infusions** do not confer a benefit unless: "the investment decision can be regarded as inconsistent with the usual investment practice (including ...risk capital) of private investors in the territory of that Member"

- **Govt. loans** do not confer a benefit unless: "there is a difference between the amount that the firm receiving the loan pays on the Govt. loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market."

Concept of Benefit (Contd.)

- **Govt. loan guarantees** do not confer a benefit unless: "there is a difference between the amount the firm receiving the guarantee pays on a loan guaranteed by the Govt. and the amount the firm would pay on comparable commercial loan absent the Govt. guarantee.

- **Govt. provision of goods or services** does not confer a benefit unless for less than adequate remuneration based on prevailing market conditions

Concept of Benefit (Contd.)

- **Govt. purchase of goods** does not confer a benefit unless: for more than adequate remuneration based on prevailing market conditions.

Footnote 1 – Important Exemption

- Exemption of an exported product
- From duties or taxes borne by a like product destined for domestic consumption
- Not deemed a subsidy

Types of Specificity

- Enterprise specific
- Industry specific
- Group of enterprises or industries
- Region specific
- Prohibited subsidies are **deemed** to be specific
- Setting or change of generally applicable tax rates by all levels of govts. entitled to do so are not specific subsidy

Types of Specificity (Contd.)

- Specificity will not exist where granting authority or legislation concerned establishes objective criteria or conditions for extending the subsidy- these criteria should be neutral, economic in nature and horizontal in application

- Two broad categories:

i. *De-jure* specific subsidies

ii. *De-facto* specific subsidies

Specific Subsidies – *de-jure*

- A subsidy is de-jure specific if
  - Access to the subsidy explicitly limited to certain enterprises. If access is limited based on objective criteria then it would not be a specific subsidy

- To be determined with reference to the jurisdiction of the granting authority

De-facto Specificity (Art. 2.1(c))

- Notwithstanding any appearance of non-specificity, the subsidy may in fact be specific. Following factors may be considered:

  - Use by a limited number of enterprises
  - Predominant use by certain enterprises
  - Granting of disproportionately large amounts to certain enterprises
  - Manner in which discretion has been exercised

Specificity : Implications

- **<u>For Members as providers of subsidies:</u>**
  - Specific subsidies are subject to the rules/disciplines under Article 4 and 7 of the SCM Agreement, in case of prohibited and actionable subsidies, respectively **(under the MULTILATERAL TRACK)**; and can be countervailed (Part V) **(under the NATIONAL TRACK)**
  - Must notify specific subsidies to the SCM Committee
- **<u>For Members affected by others' subsidies:</u>**
  - Can challenge **(MULTILATERAL TRACK)** or countervail **(NATIONAL TRACK)** other Members' specific subsidies

Subsidies – Categorization: Recap

i. Prohibited Subsidy

ii. Actionable Subsidy

iii. Non-actionable Subsidy

Subsidy Types: Prohibited Subsidy

- Certain subsidies are regarded as outright trade distortive – hence prohibited

- These are:

i. **Export subsidies** – subsidies that are contingent on export performance , except as provided in the Agreement on Agriculture

ii. **Import substitution subsidies** – contingent on use of domestic over imported goods

Export Subsidy

- Subsidies contingent, in law or in fact, whether wholly or as one of several other conditions, upon export performance are called export subsidies

- Examples (set out in Annex-I):
  - provision of goods or services for use in the production of exported goods in terms more favorable than those for the production of goods for domestic consumption;
  - export related exemption, remission or deferral of direct taxes; excess exemption, remission, or deferral of indirect taxes or import duties;
  - provision of export credit guarantee or insurance programmes at premium rates which are inadequate to cover the operating costs and losses of the programmes

Export Subsidy: Permissible Duty Exemptions

- Exemption or remission of indirect taxes on export products- Footnote 1

- Remission, Exemption & Deferral (RED) of prior stage cumulative indirect taxes on inputs used in production of the exported product provided this does not exceed corresponding RED on inputs used in the production of domestically sold like products – item (h), Annex I

- RED on prior stage cumulative indirect taxes on inputs consumed in production of the exported product. To be interpreted in accordance with guidelines in Annex II – item (h), Annex I

- Remission or drawback of import charges on imported inputs consumed in the production of the exported product. Substitution drawback schemes are permitted in accordance with guidelines in Annex III – item (h), Annex I

Conditions for RED of Cumulative Indirect Taxes

- Inputs must have been **consumed** in the production process
  - Physically incorporated inputs
  - Energy, fuel, oil and catalysts
- There must be a reasonable and effective verification system in place to confirm which inputs are consumed and in what amounts.

Remedy against Prohibited Subsidy

- Remedy through DSU
- It can be challenged in WTO on the basis of special accelerated procedures
- Complaining Member not obliged to show trade effects as these are regarded as trade distorting subsidies
- Defaulting member required to ***withdraw the subsidy <u>without delay</u>*** *or face counter - measures*

Special and Differential Provisions

- No derogation for import substitution subsidies except for fixed transition periods which is already over
- For "Annex VII countries" i.e. LDCs and 21 listed developing countries whose GNP per capita is below $1000 per annum, **prohibition on export subsidies not applicable** - India one of them (others include Bolivia, Egypt, Indonesia, Kenya, Nigeria, Pakistan, Philippines, Sri Lanka etc.)
- Other developing countries to phase out export subsidy in a 8 year period

Export Competitiveness

- Articles 27.5 and 27.6
- If an Annex VII developing country's export of a specific product has reached "export competitiveness" i.e.

- A share of at least 3.25% in world trade (of that product)
- For two consecutive years

That Annex VII developing country must phase out its export subsidies for such products over a period of 8 years

Subsidy Types: Actionable Subsidy

- Subsidy is actionable if:
  - It is **specific**
  - Causes **adverse effec**ts (injury, serious prejudice, nullification and impairment)

Adverse Effects - examples

- **Serious prejudice** – effect of subsidy is:
  - Imports displaces or impeded in the market of the subsidizing member
  - Exports displaces or impeded in third country market
  - Significant price undertaking, price suppression, price depression or lost sales of another member
  - Increase in world market share of the subsidizing country
  - Serious prejudice claim cannot be invoked against developing country Members

Serious Prejudice

Serious Prejudice **deemed to exist** (Art 6.1) where:

i. Total ad valorem subsidization of a product exceeds 5%;
ii. Subsidies cover operating losses sustained by an industry;
iii. Subsidies to cover operating losses sustained by an enterprise – exception: one-time measures which are non-recurrent and given to develop long term solutions and to avoid acute social problem;
iv. Direct forgivenenss of debt

These provisions lapsed in 1999

Nullification or Impairment

- This arises where the improved access to a market that is presumed to flow from a bound tariff reduction is undercut by subsidization in that market
- This can serve as a basis for a complaint related to harm to a Member’s exporting interests in an importing country market

Types of Injury

- There are three types of injury:

i. Current material injury;
ii. Threat of material injury;
iii. Material retardation of the establishment of a domestic industry

Current Material Injury

- Its determination is to be based on positive evidence
- There should be objective examination of both the volume of subsidized imports and the effect of these imports on prices in the domestic market for like product
- Consequent impact of such imports on the domestic producers of such products

Threat of Material Injury

- It must be based on facts and not merely on possibility
- Factors to be considered are :
  - Nature of subsidy and trade effects likely to arise therefrom;
  - Significant increase of subsidized imports;
  - Sufficient freely disposable capacity or
  - An imminent substantial increase in capacity of the exporter, indicating likelihood of substantially increased subsidized exports

Material Retardation of the Establishment of a Domestic Industry

- The agreement is silent regarding criteria for evaluation of material retardation of the establishment of a domestic industry

Actionable Subsidy - Remedy

- Action and DSU panel process in all cases and through countervailing duty investigation for imports:
  - Serious prejudice and nullification or impairment can be challenged at the multilateral level only

- Remedy:
  - Removal of adverse effects of the subsidy or
  - Withdrawal of subsidy or
  - Imposition of countervailing duty on imports

Subsidy Type: Non-actionable Subsidy

- No action can be taken against subsidies that are non-specific – determined on the basis of:
  - Criteria are neutral, economic in nature and horizontal in application
  - No predominant use by certain enterprises
  - Eligibility based on objective criteria or conditions
  - Eligibility automatic, criteria strictly adhered to

- Up to 1999 a specific subsidy given for R&D assistance, to disadvantaged regions and for environmental purposes were non-actionable. Now lapsed

Remedies

- Subsidy that causes injury can be challenged at two levels:
  i. Unilateral level through countervailing action;
  ii. Multilateral level through the WTO's Dispute Settlement Mechanism
- Countervailing action can be taken only where there is injury
- Serious prejudice and nullification or impairment can be challenged at the multilateral level only

Countervailing Measures

- SCM Agreement contains detailed rules regarding initiation and conduct of investigations, imposition of preliminary and final measures and the duration of measures
- These rules are meant to ensure that investigations are conducted in a transparent manner, all parties have full opportunity to defend their interests, and investigating authorities explain the basis of their determination
- Most of procedural rules are similar to those applied for Anti-Dumping Agreement

Special & Differential Treatment

- *De minimis* - if overall subsidy level by a DC does not exceed 2% of the value of the product, countervailing investigation to be terminated immediately
- *De minimis* of 3% for Annex VII Members and DCs which have eliminated their export subsidies before the end of the 8-year transition period
- For other Members, *De mimimis* level is 1%

Special & Differential Treatment (contd.)

- If volume of subsidized imports from a DC is less than 4% of the total imports of the like product in the importing Member, countervailing investigation has to be terminated
- The cut-off percentage is 9% where collective imports from more than one DC is under investigation and share of each DC is less than 4%

Thank you