

WORKING PAPER
**INDUSTRIAL SUBSIDIES' REFORM:
THE DEVELOPMENTAL STATE UNDER SIEGE**

Mukesh Bhatnagar and Pallavi Arora



August 2020
**CENTRE FOR WTO STUDIES
INDIAN INSTITUTE OF FOREIGN TRADE**
Delhi

CONTENTS

Abstract	1
SECTION I: INTRODUCTION	2
SECTION II: JOINT STATEMENT OF THE TRILATERAL MEETING OF THE TRADE MINISTERS OF JAPAN, THE UNITED STATES AND THE EUROPEAN UNION	3
SECTION III: DRAFT GC DECISION ON NMEs	11
SECTION IV: CONCLUSION	15
ABOUT THE AUTHORS	16
ABOUT THE CENTRE	17

Industrial Subsidies' Reform: The Developmental State under Siege¹

Mukesh Bhatnagar² and Pallavi Arora

ABSTRACT³

As the call for WTO reform gathers steam, the issue of subsidies' regulation under the Agreement of Subsidies and Countervailing Measures has taken centre stage. Early this year, the United States, the European Union, and Japan issued a joint statement criticising the SCM Agreement for falling short in disciplining industrial subsidies. Soon after, the US tabled a Draft General Council Decision to rein in on non-market economy practices. The above set of reforms appear to be principally targeted at China, whose industrial subsidies have allegedly distorted global trade. However, the paper argues that the proposed reforms are likely to curtail the regulatory space of other developing countries as well. To this end, the paper takes a critical look at key reforms put forth by the Trilateral Statement and Draft GC Decision on NME, establishing how they undermine the role of the developmental state.

Keywords: Agreement on Subsidies and Countervailing Measures, Industrial Subsidies, Non-market Economy Practices, Developmental State

¹ The authors are grateful to Professor Abhijit Das, Head, Centre for WTO Studies; Professor James Nedumpara, Head, Centre for Trade and Investment Law; and Ms. Stuti Toshi, Senior Research Fellow, Centre for WTO Studies, for their valuable comments and assistance through the course of conceiving and writing this paper.

² Corresponding author's email: mukeshb@iift.edu.

³ Views are personal.

I. INTRODUCTION

The distortion of the global trading system by non-market economies and industrial subsidies has come in sharp focus in recent times, especially because of China's economic ascent on the back of state-capitalism. The United States (US), the European Union (EU), and Japan have long been critical of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) for its purported inadequacy in regulating trade-distorting subsidies. In 2020, they concluded a joint statement proposing reforms to '*strengthen the existing WTO rules on industrial subsidies*'.⁴ In parallel with this pursuit, the US tabled the Draft General Council Decision on the "Importance of Market-Oriented Conditions to the World Trading System" (Draft GC Decision on NMEs).⁵ The Draft GC Decision on NMEs reaffirms the market-oriented nature of the WTO, while delegitimizing '*non-market-oriented policies and practices that have resulted in damage to the world trading system...*'.

It is generally believed that the Joint Declaration and Draft GC Decision on NMEs came about to target China's state-led economic model.⁶ Be that as it may, their codification into WTO law will have profound implications for other developing countries, who might want to retain a certain degree of policy autonomy to incentivise their domestic industry. This issue has acquired greater salience today because of COVID-19, which has left in its wake a beleaguered global economy. States need policy space – perhaps now more than ever – to revitalize their industries and rebuild their economy. At this critical juncture, ceding sovereign economic space to the WTO, by way of

⁴ JOINT STATEMENT OF THE TRILATERAL MEETING OF THE TRADE MINISTERS OF JAPAN, THE UNITED STATES AND THE EUROPEAN UNION, 14 Jan 2020, available at <<https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/joint-statement-trilateral-meeting-trade-ministers-japan-united-states-and-european-union>> (last accessed 26 July 2020) [hereinafter Trilateral Statement].

⁵ Draft General Council Decision, THE IMPORTANCE OF MARKET ORIENTED CONDITIONS TO THE WORLD TRADING SYSTEM, Communication from the United States, 20 Feb 2020, WT/GC/E/796.

⁶ See generally D Gerstel & J Caporal, TRADE TRILATERAL TARGETS CHINA'S INDUSTRIAL SUBSIDIES, Center for Strategic & International Studies, 22 Jan 2020, available at <<https://www.csis.org/analysis/trade-trilateral-targets-chinas-industrial-subsidies>> (last accessed 26 Jul 2020); TP Stewart, WTO REFORM – JOINT STATEMENT OF JANUARY 14, 2020 OF JAPAN, THE US AND THE EU, Current Thoughts on Trade, available at <<https://currentthoughtsontrade.com/2020/01/14/wto-reform-joint-statement-of-january-14-2020-of-japan-the-u-s-and-the-eu/>> (last accessed 26 Jul 2020); TP Stewart, WTO REFORM – ADDRESSING THE DISCONNECT BETWEEN MARKET AND NON-MARKET ECONOMIES, Current Thoughts on Trade, available at <<https://currentthoughtsontrade.com/2020/02/22/wto-reform-addressing-the-disconnect-between-market-and-non-market-economies/>> (last accessed 26 Jul 2020).

the Trilateral Statement and Draft GC Decision on NMEs, is likely to cost developing countries dearly.

Given this context, the paper sets out to analyse the implications of the Trilateral Statement and Draft GC Decision on NMEs for developing countries. Section II of the paper is devoted to an analysis of the Trilateral Statement, with a close eye on the repercussions of sweeping amendments to prohibited and actionable subsidies among others, under the SCM Agreement. Section III focuses on the Draft GC Decision on NMEs and its impact on developing countries.

II. JOINT STATEMENT OF THE TRILATERAL MEETING OF THE TRADE MINISTERS OF JAPAN, THE UNITED STATES AND THE EUROPEAN UNION

The US, the EU and Japan have long criticised the current SCM Agreement for being unresponsive to the trade-distorting effects of industrial subsidies. Since the 11th Ministerial Conference, 2017, they have been discussing reforms to the SCM Agreement, which in 2020 culminated in the Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the US and the EU. The Trilateral Statement proposes an initial set of reforms to put in place an ‘*SCM Plus*’ framework with tighter disciplines on industrial subsidies.

While presently, the statement is a joint understanding reached between the US, the EU, and Japan, efforts are underway to plurilateralize the proposed subsidy rules amongst the Group of Seven (G7) and Group of Twenty (G20) members; and eventually, multilateralize them amongst the wider WTO membership in the next Ministerial Conference.⁷

To analyse the repercussions of the proposed amendments, we commence with an overview of the SCM Agreement. ‘*Subsidy*’, as defined under the SCM Agreement, has two essential components: (i) financial contribution by the government or a public body; or income or price support; and (ii) benefit to the domestic industry.⁸ Upon this understanding of a subsidy, the agreement goes on to characterize subsidies as prohibited, actionable, and non-actionable. While prohibited subsidies are unconditionally proscribed by the SCM Agreement,⁹ actionable subsidies are proscribed upon

⁷ See D Gerstel & J Caporal, *supra* note 6.

⁸ Art. 1, The Agreement on Subsidies and Countervailing Measures, 15 April 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 UNTS 14.

⁹ Art. 3, The Agreement on Subsidies and Countervailing Measures, *supra* note 8.

the fulfilment of certain criteria.¹⁰ The category of non-actionable subsidies, on the other hand, was permissible for a period of 5 years from the establishment of the WTO in 1995, but has now ceased to exist.¹¹

Against this background, let us examine some key reform proposals of the Trilateral Statement, and their consequences for developing countries.

1. Amendment to the List of Prohibited Subsidies and definition of ‘Public Body’

The Trilateral Statement seeks to tighten the reins on industrial subsidies by *inter alia* widening the ambit of Prohibited Subsidies. It does so in two ways: *first*, by expanding the list of Prohibited Subsidies under Article 3.1 of the SCM Agreement; and *second*, by amending the definition of ‘*public body*’ under Article 1.1. Article 3.1 classifies two categories of subsidies as unconditionally prohibited, namely: (i) export subsidies; and (ii) local content subsidies.¹² The Trilateral Statement is at odds with the current list of prohibited subsidies for its insufficiency in tackling ‘*market and trade distorting subsidization existing in certain jurisdictions*’. Consequently, it seeks to introduce the following new types of unconditionally prohibited subsidies to Article 3.1:

- i. Unlimited guarantees;
- ii. Subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan;
- iii. Subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity;
- iv. Certain direct forgiveness of debt.

The Trilateral Statement’s proposed amendment to Article 3.1 must be read in conjunction with its call for reviewing the definition of ‘*public body*’ under Article 1.1.¹³ As stated earlier, for a subsidy to attract the prohibition under Article 3.1, it must be granted by the government or a public body within the territory of a member. The interpretation of ‘*public body*’ has evolved over

¹⁰ Art. 5, The Agreement on Subsidies and Countervailing Measures, *supra* note 8.

¹¹ Art. 8 and Article 31, The Agreement on Subsidies and Countervailing Measures, *supra* note 8.

¹² *Supra* note 9.

¹³ Art. 1.1, The Agreement on Subsidies and Countervailing Measures, *supra* note 8.

the course of several Panel and Appellate Body reports.¹⁴ A notable decision for our consideration is *US Anti-Dumping & Countervailing Duties (China)*.¹⁵ In this case, the United States Department of Commerce (USDOC) had classified State Owned Enterprises (SOEs) and State Owned Commercial Banks (SOCBs) operating in China as public bodies under Article 1.1(a)(1), SCM Agreement. Upholding the determination by the USDOC, the Panel interpreted ‘*public body*’ to mean ‘*any entity controlled by a government*’.¹⁶ The Appellate Body, however, reversed the finding of the Panel, and ruled instead that that the term ‘public body’ covers entities that possess, exercise or are vested with governmental authority.¹⁷ The Appellate Body further clarified that this criterion is not in itself sufficient to characterize an entity as a ‘*public body*’. A relevant extract of the AB report is in order:

A public body within the meaning of Article 1.1.(a)(1) of the SCM Agreement must be an entity that possesses, exercises or is vested with governmental authority. Yet, just as no two governments are exactly alike, the precise contours and characteristics of a public body are bound to differ from entity to entity, State to State, and case to case. Panels or investigating authorities confronted with the question of whether conduct falling within the scope of Article 1.1.(a)(1) is that of a public body will be in a position to answer that question only by conducting a proper evaluation of the core features of the entity concerned, and its relationship with government in the narrow sense (emphasis added).¹⁸

Thus, the Appellate Body held by implication that China’s SOEs did not qualify as ‘*public body*’ under the SCM Agreement.

Another pertinent decision is *US-Carbon Steel (India)*,¹⁹ where the Appellate Body ruled that while government control is an important factor, it cannot be the sole basis to treat an enterprise as a ‘*public body*’. The Appellate Body elaborated:

In determining whether or not a specific entity is a public body, it may be relevant to consider ‘whether the functions or conduct are of a kind that are ordinarily classified as governmental in the legal order of the relevant Member.’ The [...] classification and functions of entities within

¹⁴ See WTO Analytical Index, SCM Agreement – Article 1 (Jurisprudence), pp. 6-8, available at <https://www.wto.org/english/res_e/publications_e/ai17_e/subsidies_art1_jur.pdf> (last accessed 26 Jul 2020).

¹⁵ Appellate Body Report, *United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R, adopted 25 Mar 2011.

¹⁶ Panel Report, *United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/R, circulated 22 Oct 2010, para. 8.94.

¹⁷ *Supra* note 15, para. 317.

¹⁸ *Ibid.*

¹⁹ Appellate Body Report, *United States — Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India*, WT/DS436.

WTO Members generally may also bear on the question of what features are normally exhibited by public bodies.²⁰

On this basis, the Appellate Body reversed the Panel's decision, and went on to hold that the USDOC "erroneously concluded that National Minerals Development Corp. (NMDC) is a public body" under Article 1.1(a)(1), SCM Agreement.²¹

The Trilateral Statement takes issue with the WTO jurisprudence for an overly narrow interpretation of 'public body', letting subsidization programmes of State Enterprises fall through the cracks of the SCM Agreement. This disaffection is largely attributable to China's state-controlled subsidizing entities, that do not fall under the strict interpretation of 'public body', and therefore, do not make the threshold of subsidy under the SCM Agreement. This has frustrated past efforts of WTO members to remedy financial contributions, through provision of inputs at less than adequate remuneration by state-controlled Chinese enterprises. The Trilateral Statement, thus, calls for an expansive interpretation of 'public body', that goes beyond entities that possess, exercise or are vested with governmental authority. On this basis, the Trilateral Group has resolved to continue working on a stronger definition of 'public body'.

In what follows, the paper analyses the implications of these developments for developing countries. Our central argument is that the introduction of new categories of prohibited subsidies coupled with an expanded definition of 'public body', is likely to implicate, and render prohibited, several financial support programmes undertaken by various Government Ministries, Public Sector Banks and Public Sector Enterprises (PSE) in developing countries.

First, a broader, more flexible, definition of 'public body' is likely to bring within its fold several entities that are owned in part by the government or function under some modicum of direction from the government. Various Public Sector Banks and PSEs in developing countries would qualify as public bodies, if the definition of 'public body' were to stretch beyond entities that possess, exercise or are vested with governmental authority. *Second*, the inclusion of new categories of prohibited subsidies is likely to outlaw financial contributions by various Government Ministries, Public Sector Banks and PSEs. Several subsidy programmes are likely to be classified as prohibited subsidies, of the following types: (i) unlimited guarantees (para. 1.a,

²⁰ Ibid para. 4.9.

²¹ Ibid para. 4.55.

Trilateral Statement); (ii) certain direct forgiveness of debt (para. 1.d, Trilateral Statement); and (ii) subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity (para. 1.c, Trilateral Statement).

Furthermore, the proposed categories of prohibited subsidies (in their current form) are highly nebulous, vesting a wide margin of discretion in the Investing Authority (IA) and the Dispute Settlement Body (DSB) that eventually interprets its scope. Take for instance, the interpretation of ‘credible restructuring plan’ under Para. 1.b of the Trilateral Statement. Based on a close reading of the AB report in *US- CVD on certain Hot Rolled Lead and Bismuth*,²² it can be concluded that the assessment of ‘credibility’ of a restructuring program is, to a substantial extent, subjective, as it is based on multiple parameters. With different perspectives of examiners in question relying on differentiated parameters, the assessment could sway in the direction desired by the examiner. Likewise, ‘certain’ direct forgiveness of debt, under para. 1.d, does not clarify what forms of ‘debt forgiveness’ would qualify as prohibited subsidies, vesting substantial discretion in the hands of the IA or the DSB in adopting an expansionist interpretation and classifying the debt forgiveness in question as prohibited subsidy.

2. Reversal of Burden of Proof vis-à-vis certain Actionable Subsidies

The Trilateral Statement suggests that the burden of proof (BoP) be reversed on certain categories of actionable subsidies that are likely to cause significant harm to competing producers in other countries. As per the proposal, the subsidizing Member should bear the burden of demonstrating “*that there are no serious negative trade or capacity effects and that there is effective transparency about the subsidy in question*”.²³ The tentative categories of actionable subsidies subjected to the reversal of BoP include:

- i. Excessively large subsidies;
- ii. Subsidies that prop up uncompetitive firms and prevent their exit from the market;

²² Appellate Body Report, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, WT/DS138/AB/R, adopted 25 March 2011.

²³ *Supra* note 4, para. 2.

- iii. Subsidies creating massive manufacturing capacity, without private commercial participation; and
- iv. Subsidies that lower input prices domestically in comparison to prices of the same goods when destined for export.

It is apprehended that several subsidy programmes of developing countries will get covered under the proposed reversal of BoP. Developing countries are required to pursue developmental policies in several sectors that require support for enterprises facing global competition and to support employment. Treating an enterprise as ‘uncompetitive’ is highly subjective. Several factors impact the competitiveness of enterprises, such as the current market situation and the changing dynamics of the market. Oftentimes the labour laws of the country may not allow the enterprise to exit from the market.

3. Expansive Understanding of Serious Prejudice

The Trilateral Statement also makes a case for reviewing the circumstances that constitute ‘*serious prejudice*’ under Article 6.3 of the SCM Agreement. It calls for adding a provision to the SCM Agreement that classifies capacity distorting subsidies as causing serious prejudice.²⁴ The proposal aims to discipline economies with a large state role, in particular China. Admittedly, excess capacity in China’s steel sector has been a subject of discussion even in the Organization for Economic Cooperation and Development. However, an expanded scope of the serious prejudice criteria is likely to bring within its fold other developing countries as well, that need policy space to incentivize their domestic industry.

4. Stringent Notification Requirement

The Trilateral Statement seeks to address the problem of inadequate notifications by proposing that any non-notified subsidy be treated as a prohibited subsidy where other WTO Members provide a counter-notification, unless the required information is furnished by the subsidizing Member within a certain period of time.²⁵ It is submitted that the proposed requirement of counter-notification will be highly onerous for capacity-constrained member states.

²⁴ *Supra* note 4, para. 3.

²⁵ *Supra* note 4, para. 4.

5. Adoption of External Benchmarks

Another contentious issue that the Trilateral Statement seeks to tackle is the adoption of out-of-country benchmarks under the SCM Agreement.²⁶ The proponents of the Trilateral Statement favour recourse to external benchmarks in a countervailing duty (CVD) investigation, when the home market under question is distorted. External benchmarks are seen as an effective tool against countries with distorted input prices, particularly China.

Admittedly, this is a well-reasoned proposal of the Trilateral Statement – one that has found support in both scholarly and trade-policy circles. It is believed that countries endowed with natural resources should be subjected to higher countervailing duties by adopting external benchmarks. Various studies analyzing the AB reports in *US-Softwood Lumber IV*²⁷ (for CVD investigation) and *EU Biodiesel (Argentina)*²⁸ (for anti-dumping investigation), have concluded that IAs enjoy far greater flexibility to use external benchmark prices in a CVD investigation, as compared to an anti-dumping investigation.²⁹ In a CVD investigation, an IA can resort to an alternative benchmark (including an external benchmark) where:

- i. Government is the sole supplier of a good or service;
- ii. Government administratively controls the prices; and
- iii. Government is the predominant supplier of a good or service; provided that on account of the predominant role of the government, the private suppliers have no option but to align their prices with those of the government-provided goods.

Consequently, IAs would find it preferable to overcome challenges of state intervention and price distortion through the adoption of an external benchmark in a benefit-benchmark analysis in a CVD investigation, instead of tackling the same through anti-dumping measures.

²⁶ *Supra* note 4, para. 5.

²⁷ Appellate Body Report, *United States – Final Countervailing Duty Determination with respect to certain Softwood Lumber from Canada*, WT/D257/AB/R, adopted 17 Feb 2004.

²⁸ Appellate Body Report, *European Union – Anti-Dumping Measures on Biodiesel from Argentina*, WT/DS473/AB/R, adopted 26 Oct 2016.

²⁹ See for example W Zhou, *Appellate Body Report on EU-Biodiesel: The Future of China’s State Capitalism under the WTO Anti-Dumping Agreement*, 17 WORLD TRADE REV. (2018).

6. Forced Technology Transfer

Forced technology transfer has been another sticking point for Japan, the EU, and the US. While the Trilateral Statement reviews the harm such actions have on other trading partners, it does not provide a proposal on remedial steps just yet. As far as China is concerned, these concerns have been at the centre of the Section 301 investigation by the US authorities³⁰ and have also been addressed in the US-China Trade Deal.³¹ Article 2.3 of the US-China Trade Deal *inter alia* prohibits forced technology transfers: (i) by adopting or maintaining administrative and licensing requirements (*clause 1*); or (ii) as a condition precedent to (*a*) approving any administrative or licensing requirements, (*b*) operating in the concerned Party's jurisdiction or having access to its market, (*c*) receiving advantages by the concerned Party (*clause 2*). Clause 3 of Article 2.3 goes on to prohibit Parties from pressurizing persons of the other Party to use or favour technology owned or licensed to its persons as a condition precedent to the situations outlined in clause 2. However, as T Stewart notes, it is not clear if the EU and Japan will be willing to multilateralize provisions that the US has negotiated with China into the WTO.³²

7. Items under Review in the Trilateral Statement

In addition to the foregoing, Japan, the EU and the US have also agreed to cooperate on the following four reform issues:

- i. The importance of market-oriented conditions for a free, fair, and mutually advantageous trading system;
- ii. Reform of the WTO, to include increasing WTO Member compliance with existing WTO notification obligations and pressing advanced WTO Members claiming developing country status to undertake full commitments in ongoing and future WTO negotiations;
- iii. International rule-making on trade-related aspects of electronic commerce at the WTO; and

³⁰ GC Hufbauer & Z Lu, SECTION 301: US INVESTIGATES ALLEGATIONS OF FORCED TECHNOLOGY TRANSFERS TO CHINA, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS, 3 Oct 2017, available at <<https://www.piie.com/commentary/op-eds/section-301-us-investigates-allegations-forced-technology-transfers-china>> (last accessed 28 Aug 2020).

³¹ Arts. 2.1 and 2.3, Economic and Trade Agreement Between the Government of the United States of America and the Government of the People's Republic of China, 15 Jan 2020, available at <[https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic And Trade Agreement Between The United States And China Text.pdf](https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic%20And%20Trade%20Agreement%20Between%20The%20United%20States%20And%20China%20Text.pdf)> (last accessed 26 Jul 2020).

³² *Supra* note 6.

- iv. International forums such as the Global Forum on Steel Excess Capacity and the Governments/Authorities' Meeting on Semiconductors.

The foregoing analysis has highlighted how the Trilateral Statement is likely to constrain the industrial policy space of developing countries. In the next section, we examine how the Draft GC Decision on NMEs is also aimed at relegating the state in the overall industrial design of developing countries.

III. DRAFT GC DECISION ON NMEs

The US has, for long, expressed its dismay over the inadequate regulation of Non-market Economies (NME) under the WTO framework.³³ The free rein of NMEs, the US argues, goes against the very logic of market economics underlying the WTO's rules-based system, and thereby, distorts global trade. Much of the US consternation is attributable to the rapid growth that China has accomplished as an NME, following its accession to the WTO. Adding to this concern is the emulation of the Chinese economic model by several existing members,³⁴ giving credence to attributes like state ownership of business, state planning, forced technology transfer and massive subsidization. Thus, by leading the charge against NMEs, the US seeks a reaffirmation of the market-oriented nature of the WTO, meant as a course correction to China's economic model.

In a scathing attack on NMEs, the US submitted a paper to the General Council on China's Trade-disruptive Economic Model in 2018.³⁵ The fourteen-page communication made a case against NMEs in the following four parts:

- i. Part I dealt with non-market oriented conditions set by the government and the party.

³³ For an overview of the official US position on China's NME status see *China's Status as a Nonmarket Economy (NME)*, CONGRESSIONAL RESEARCH SERVICE, IF 10385, 2019, available at <<https://fas.org/sgp/crs/row/IF10385.pdf>> (last accessed 28 Aug 2020). See generally J. Nedumpara & W. Zhou (eds.), *NON-MARKET ECONOMIES IN THE GLOBAL TRADING SYSTEM – THE SPECIAL CASE OF CHINA*, Springer, 2018.

³⁴ The US Department of Commerce treats the following countries, other than China, as Non-market Economies: Republic of Armenia, Republic of Azerbaijan, Republic of Belarus, Georgia, Kyrgyz Republic, Republic of Moldova, Republic of Tajikistan, Turkmenistan, Republic of Uzbekistan, and Socialist Republic of Vietnam. See *Countries Currently Designated by Commerce as Non-market Economy Countries*, INTERNATIONAL TRADE ADMINISTRATION, DEPARTMENT OF COMMERCE, UNITED STATES OF AMERICA, available at <<https://www.trade.gov/nme-countries-list>> (last accessed 28 Aug 2020).

³⁵ CHINA'S TRADE-DISRUPTIVE ECONOMIC MODEL, Communication from the United States to the General Council, 11 Jul 2018, WT/GC/W/745.

- ii. Part II covered non-market allocation of resources, including key means of production, industrial policies, and the use of law as an instrument of the Party State.
- iii. Part III presented the costs to WTO Members of China's economic model, recounting issues like excess capacity, forced technology transfers, and allocation of key means of production.
- iv. Part IV analysed how China benefits off its economic model.

In 2020, the US tabled a follow-up paper before the General Council, titled '*The Importance of Market-Oriented Conditions to the World Trading System*'.³⁶ The paper presents the NME issue as crucial to WTO reform, in light of its far-reaching implications on global trade. The preambular paragraphs of the Draft GC Decision on NMEs reiterate the open, market-oriented nature of the WTO, as affirmed in the Preamble to the Marrakesh Declaration.³⁷ They also instantiate the damaging effects of non-market practices viz. (i) creation of overcapacity and unfair competition; (ii) stifling innovation; and (iii) undermining the proper functioning of international trade.

The submission fleshes out the following elements, of relevance to the existence of market-oriented conditions in global trade:

- i. Decisions of enterprises on prices, costs, inputs, purchases, and sales are freely determined and made in response to market signals;
- ii. Decisions of enterprises on investments are freely determined and made in response to market signals;
- iii. Prices of capital, labor, technology, and other factors are market-determined;
- iv. Capital allocation decisions of or affecting enterprises are freely determined and made in response to market signals;
- v. Enterprises are subject to internationally recognized accounting standards, including independent accounting;
- vi. Enterprises are subject to market-oriented and effective corporation law, bankruptcy law, competition law, and private property law, and may enforce their rights through impartial legal processes, such as an independent judicial system;
- vii. Enterprises are able to freely access relevant information on which to base their business decisions; and
- viii. There is no significant government interference in enterprise business decisions described above.

³⁶ *Supra* note 5.

³⁷ MARRAKESH DECLARATION OF 15 APRIL 1994, fifth preambular paragraph, available at <https://www.wto.org/english/docs_e/legal_e/marrakesh_decl_e.htm> (last accessed 28 Aug 2020).

The elements stipulated above could significantly curtail the industrial and agricultural policy space of developing countries. Let us consider some preliminary concerns the above conditions are likely to pose. The first element requires decisions of enterprises on prices, costs, inputs, purchases, and sales to be freely determined and made in response to market signals. This is likely to implicate several ongoing financial support programmes in many developing countries, ranging from the procurement and distribution of subsidized food grains, to controlled pricing of drugs and medical equipment among others. A study by Sharma (2016) entitled, '*The WTO and Food Security*' notes that a system of administered prices for certain food stuffs is implemented by countries like China, Egypt, India, Indonesia, Jordan, Kenya, Pakistan, Tunisia, Zambia, and Zimbabwe.³⁸ The Draft GC Decision on NMEs is likely to affect such developing country programmes on minimum support price in the agricultural sector.³⁹ The same also holds true for price controls on pharmaceuticals and medical equipment in developing countries. A comprehensive study by the World Health Organisation illustrates various forms of drug price controls that are in place in low- and middle-income countries.⁴⁰ As for price controls on medical devices, one may look to developed economies like Korea, Taiwan, and Japan, as well as developing countries like China, and India, that have had a history of capping prices of medical products such as coronary stents, orthopaedic and spinal products, knee implants etc.⁴¹

The second element requires that decisions of enterprises on investments be freely determined and made in response to market signals. This will have a bearing on decisions of Public Sector Enterprises in developing countries that do not correspond to market signals. In the same vein, the last element – which bars significant government interference in enterprise business decisions – will also affect Public Sector Enterprises, that function under a certain degree of government

³⁸ SK Sharma, *THE WTO AND FOOD SECURITY: IMPLICATIONS FOR DEVELOPING COUNTRIES*, Springer (2016).

³⁹ The above conclusion is based on the understanding that the scope of the term 'certain enterprises' under Article 2 of the SCM Agreement, is broad enough to also cover farmers. And even if this was not the case, the very existence of administered prices precludes the possibility of prices for agricultural foodstuffs being determined by market forces for traders, who surely fall in the category of 'certain enterprises'.

⁴⁰ *WHO Guideline on Country Pharmaceutical Pricing Policies*, WORLD HEALTH ORGANIZATION, Geneva, 2015, available at <https://www.who.int/medicines/publications/pharm_guide_country_price_policy/en/> (last accessed 18 Aug 2020).

⁴¹ See *International Trade and Pharmaceuticals*, Joint Hearing before the Subcommittee on International Trade and the Subcommittee on Health Care of the Committee on Finance, United States Senate, One Hundred Eighth Congress, Second Session, 2004, pp. 175-178. See also *Medical Devices Trade Margins likely to be capped at 30%*, The Economic Times, 8 Feb 2020, available at <<https://economictimes.indiatimes.com/industry/healthcare/biotech/healthcare/medical-devices-trade-margins-likely-to-be-capped-at-30/articleshow/74020350.cms?from=mdr>> (last accessed 18 Aug 2020).

control. All in all, the Draft GC Decision on NMEs pushes for greater privatisation, while significantly precluding Public Sector Enterprises from the economic landscape of developing countries.

Also of concern is element three, which requires that the prices of capital, labour, technology, and other factors are market-determined. This requirement will hit at programmes aimed at making land available at concessional rates; priority sector lending at lower interest rates; and fixing minimum wages for labour among others. Notably, the 2019 Country Reports on Human Rights Practices,⁴² reveals that there is some form of statutory minimum wage requirement in many developing and least developed countries; including, for example, Argentina, Bangladesh, Brazil, China, Côte d'Ivoire, Cuba, Democratic Republic of Congo, Egypt, Ghana, Guinea-Bissau, Guyana, Haiti, Honduras, India, Indonesia, Jordan, Kazakhstan, Kenya, Mauritius, Mexico, Nicaragua, Pakistan, Peru, Russia, South Africa, Sri Lanka, Uruguay, Vietnam, Zambia, and Zimbabwe. Another study by Creehan (2014) documents the provision of priority sector lending at lower interest rates in countries across Asia⁴³ – which will also be impacted by the Draft GC Decision on NMEs. It is imperative to note that interest rate, which determines the price of capital, is generally determined by commercial banks based on policy rates decided by the Central Banks. However, governments may also influence the determination of interest rates on the basis of various considerations such as stimulating domestic investment, incentivising certain sectors of economy, inflationary situation in the country among others. Leaving it entirely to the market forces to determine the interest rate, and thereby, the cost of capital would deprive many developing countries of an important policy instrument for pursuing desirable developmental objectives.

The concerns outlined above highlight how the Draft GC Decision on NMEs is likely to stymie developing countries' aspirations for industrial and agricultural growth. Though posited against

⁴² For a cross-country analysis of approximately 140 developing and least developed countries see Country Report on Human Rights Practices, Custom Report Excerpts, BUREAU OF DEMOCRACY, HUMAN RIGHTS AND LABOUR, US DEPARTMENT OF STATE, 2019, available at <<https://www.state.gov/report/custom/fcfe76597e/>> (last accessed 21 Aug 2020). Full Report available at <<https://www.state.gov/reports/2019-country-reports-on-human-rights-practices/>> (last accessed 21 Aug 2020).

⁴³ For an overview of priority sector lending across Asia see S Creehan, *Priority Sector Lending in Asia*, Country Analysis Unit, Asia Focus, Federal Reserve Bank of San Francisco, 2014, available at <<http://www.frbsf.org/banking/files/Asia-Focus-Priority-Sector-Lending-in-Asia-September-2014.pdf>> (last accessed 18 Aug 2020).

China, the Draft GC Decision on NMEs has the potential to impact other developing countries, including India. By completely precluding the state from the organization of industrial and agricultural activity in developing countries, the Draft GC Decision on NMEs vindicates Chang's argument of '*kicking away the ladder*'.⁴⁴ However, considering recent advances from China – in the form of state-sponsored subsidies and other market-distorting policies – developing countries will have to look very carefully at the Draft GC Decision on NMEs.

IV. CONCLUSION

When the GATT came about, the developmental state was assigned a key role in enabling developing countries to '*catch up*' with industrialized economies. However, post the 1980s, we have seen a push towards more deregulation, with the developmental state being pushed to the fringes.⁴⁵ The Trilateral Statement and Draft GC Decision on NMEs exemplify this trend. By expanding the scope of prohibited subsidies, along with other reforms, the Trilateral Statement would greatly curtail the policy space of developing countries. Likewise, the Draft GC Decision on NMEs, though aimed at China, could have implications for other developing countries, where the state might have to step in to support its industrial and agricultural sector.

Admittedly, excessive government interference is an anathema to the founding principles of the GATT-WTO regime. However, this does not take away from the state's role in the advancement of domestic industries in developing countries. It follows, thus, that the extent of reforms being proposed by the US, the EU, and Japan will lead to a complete subversion of the state in ordaining the industrial framework of developing countries.

In conclusion, developing countries must carefully consider the implications of the Trilateral Statement and the Draft GC Decision on NMEs on their ability to pursue development-oriented policies. However, this cannot be an excuse for allowing countries to distort markets through measures that flout the existing rules of the WTO.

⁴⁴ Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective*, London: Anthem, 2002.

⁴⁵ RH Wade, *The Developmental State: Dead or Alive?*, 49 (2) DEVELOPMENT AND CHANGE, 2018.

ABOUT THE AUTHORS



Mukesh Bhatnagar is currently working as a Professor at the Centre for WTO Studies, Indian Institute of Foreign Trade. He has an experience of over 30 years in handling international trade-related issues. His areas of specialization include trade remedies, dispute settlement, and rules negotiations, including fisheries subsidies negotiations and the Doha Round of negotiations. Prior to joining the Centre for WTO Studies, he has worked as the Additional Director General Foreign Trade in the Trade Policy Division of the Department of Commerce, Government of India, as well as the Directorate General of Anti-Dumping and Allied Duties (DGAD).



Pallavi Arora is a Senior Research Fellow at the Centre for WTO Studies, Indian Institute of Foreign Trade. She holds an M.Phil. in Public International Law from the Jawaharlal Nehru University, India. Her main fields of research include International Economic Law and Critical Approaches to International Law. Previously, she worked as an Assistant Professor at the University of Petroleum and Energy Studies, where she taught Public International Law.

ABOUT THE CENTRE

The Centre for WTO Studies was set up in the year 1999 to be a permanent repository of WTO negotiations-related knowledge and documentation. Over the years, the Centre has conducted a robust research programme with a series of papers in all spheres of interest at the WTO. It is currently engaging itself in an exercise to back its research with an equally robust publication programme. The Centre has also created a specialized e-repository of important WTO documents, especially related to India, in its Trade Resource Centre. It has been regularly called upon by the Government of India to undertake research and provide independent analytical inputs to help it develop positions in its various trade negotiations, both at the WTO and other forums such as Free and Preferential Trade Agreements and Comprehensive Economic Cooperation Agreements. Additionally, the Centre has been actively interfacing with industry and Government units as well as other stakeholders through its Outreach and Capacity Building programmes by organizing seminars, workshops, subject specific meetings etc. The Centre thus also acts as a platform for consensus building between stakeholders and policy makers.

*Centre for WTO Studies,
5th to 8th Floor, NAFED House,
Siddhartha Enclave, Ashram Chowk,
Ring Road, New Delhi - 110014
Phone Nos: 91- 011- 38325622, 38325624
<http://wtocentre.iift.ac.in/>*

Follow us here: [Facebook](#), [LinkedIn](#), [Twitter](#)