

COLUMN: DISCUSSIONS FOR STRENGTHENING DISCIPLINES ON SUBSIDIES

1. AWARENESS OF ISSUES

Subsidy disciplines already existed in 1947 in the form of regulations related to countervailing duties mentioned in Article VI of the General Agreement on Tariffs and Trade (1947 GATT). Furthermore, in Article XVI, there are certain regulations on subsidies in general and export subsidies that cause harmful effects to other contracting parties. Subsequently, in 1979, as a result of the Tokyo Round negotiations, the “Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT” (Subsidies Code) was created. This agreement stipulated (1) an obligation not to impose export subsidies on products other than primary products, and (2) an obligation to seek to avoid causing adverse effects to the domestic industries of other members through the use of subsidies other than export subsidies. However, there were no definitions for the terms “export subsidy” or “subsidy” at the time.

Subsequently, at the GATT Uruguay Round, the definition and classification of subsidies and the elaboration of procedures for countervailing duties were negotiated, and multi-rules were consented to in the form of the Agreement on Subsidies and Countervailing Measures (“ASCM”) when the WTO was established. The ASCM was also discussed at the Doha Round after the WTO was established. Subsidy negotiations at the Doha Round were deadlocked, except for the negotiations on fisheries subsidies. Regarding fisheries subsidies, in the ministerial decision of the 11th WTO Ministerial Conference (“MC11”) held in 2001, it was agreed to “engage constructively in the negotiation, with a view to adopting an agreement on comprehensive and effective disciplines by the Ministerial Conference in 2019.” However, as presented in various parts in this report, recognition that market-distorting subsidies are the current problem has spread internationally and, as a result, an issue of overcapacity has arisen.

For example, at the 2016 G7 and G20, the international community acknowledged that the issue of excess capacity is a global problem and needs a cooperative response, and that subsidies and other supports from government and government-related organizations distort the market and cause an issue of excess capacity.

【G7 Ise-Shima Summit Leaders’ Declaration (May 2016) (Excerpt)】

We recognize that global excess capacity in industrial sectors, especially steel, is a pressing structural challenge with global implications and this issue needs to be urgently addressed through elimination of market distorting measures and, thereby, the enhancement of market functions.

【G20 Hangzhou Summit Leaders’ Declaration (September 2016) (Excerpt)】

We recognize that excess capacity in steel and other industries is a global issue which requires a collective response. We also recognize that subsidies and other types of support from government or government-sponsored institutions can cause market distortions and contribute to global excess capacity and therefore requires attention.

2. INTERNATIONAL ACTION FOR ENHANCING SUBSIDY RULES

(1) G7, G20 (OECD), GLOBAL FORUM ON STEEL EXCESS CAPACITY, GAMS, ETC.

In response to these actions in G7 and G20, at the Third Trilateral Meeting of the Trade Ministers of the United States, European Union and Japan in May 2018, it was agreed that trilateral discussions for strengthening international subsidy rules and domestic procedures for starting international negotiations would commence by the end of the same year.

Furthermore, at the G7 Summit in June 2018, it was agreed that international negotiations for strengthening subsidy rules would commence that year. In addition, at the G20 Summit in June 2019, in the statement of the meeting of the trade ministers, it was confirmed that international disciplines on industrial subsidies should be strengthened.

【Third Trilateral Meeting of Trade Ministers: Joint Statement (May 2018) Excerpt】

The Ministers therefore endorsed the attached joint scoping paper defining the basis for the development of stronger rules on industrial subsidies and SOEs. On that basis, they agreed to proceed with that work, and expressed their intention to begin their respective domestic procedures before the end of 2018 with the aim of initiating negotiations soon thereafter. The Ministers emphasized the need to ensure the participation of key trading partners in these future negotiations.

【G7 Charlevoix Summit Leaders' Declaration (June 2018) (Excerpt)】

We will work together to enforce existing international rules and develop new rules where needed to foster a truly level playing field, addressing in particular non-market oriented policies and practices, and inadequate protection of intellectual property rights, such as forced technology transfers or cyber-enabled theft. We call for the start of negotiations – this year – to develop stronger international rules on market-distorting industrial subsidies and trade-distorting actions by state-owned enterprises.

There was a discussion at the Global Forum on Steel Excess Capacity regarding the issue of steel excess capacity and subsidies. There was also a discussion at GAMS (Government/Authorities Meeting on Semiconductors) regarding the issue of subsidies for semiconductors. These are not frameworks for the direct purpose of stipulating binding regulations, but provide an opportunity for the countries to frankly discuss ideal support measures provided by governments, and to deepen mutual understanding.

【Overview of Global Forum on Steel Excess Capacity】

- The Global Forum on Steel Excess Capacity was established in December 2016 based on the 2016 G20 Huangzhou Leaders Declaration.

<G20 Huangzhou Leaders Declaration (September 2016) Excerpt>

We call for increased information sharing and cooperation through the formation of a Global Forum on Steel Excess Capacity, to be facilitated by the OECD with the active participation of G20 members and interested OECD members.

- 33 countries and regions, including Japan, China, EU, India and the United States, participated in this forum. Based on the common understanding on the significance of the steel industry, discussions regarding governmental resolution strategies were held while sharing information and conducting peer reviews regarding capacity and the government support measures of each country. Leading up to the ministerial conference in October 2019, two ministerial conferences and fourteen administrative level conferences were held. In 2019, Japan acted as the chair with Brazil and Russia as the co-chairs.

- On November 30, 2017, the first ministerial conference was held in Berlin where a year's worth of reports of results, including the six principles that each country should implement, were compiled.

<Six principles agreed to at the ministerial conference in Berlin>

- (1) Global challenge, collective policy solutions: Steel excess capacity is a global issue which requires solutions to enhance market functions and reduce steel excess capacity.
- (2) Refraining from market-distorting government support measures: Governments and government-related entities should refrain from providing market-distorting support measures (sustaining uneconomic steel plants, encouraging investments in new steelmaking capacity which otherwise

would not be built).

- (3) Fostering a level playing field: Regardless of whether an enterprise is publicly or privately owned, it should follow the same regulations including bankruptcy procedures, and fair competition conditions (level playing field) should be ensured.
- (4) Ensuring market function: New investments, production and trade flows should reflect market-based supply and demand conditions.
- (5) Promotion of structural adjustment and reduction of capacity thereby: Governments should advance policies that minimize social costs to workers and communities while promoting structural adjustments.
- (6) Greater transparency: Governments should increase transparency through regular information sharing among the members (twice a year), and reviewing (analysis, assessment and discussion) based on the information (at least three times a year).

- On September 20, 2018, the second ministerial conference was held in Paris, and the ministerial report was adopted including: (1) the necessity of joint action in initiatives to further reduce excessive production, and (2) continuous implementation of initiatives for identifying and abolishing government support measures that distort the market.

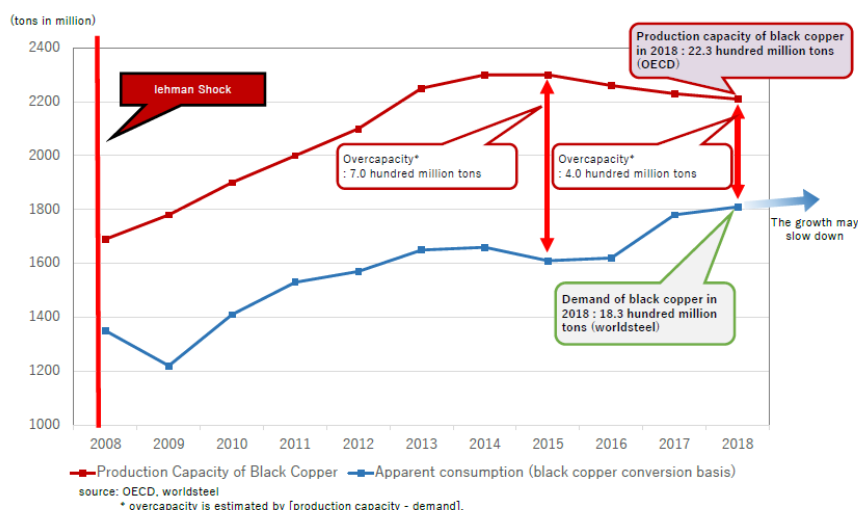
- On October 26, 2019, the third ministerial conference was held in Tokyo, and Mr. Kajiyama, the Minister of Economy, Trade and Industry, served as the chair and Mr. Makihara, the State Minister of Economy, Trade and Industry, served as the acting chair. Although most countries expressed their intentions to agree on the draft of the ministerial report which included the statement regarding the next step of the forum, China stated, “the forum has accomplished its objective and should be terminated at the end of 2019 as it was initially planned pursuant to its provisions,” and a complete agreement could not be reached among the participating countries.

- In light of the development described above, the majority of the countries decided to continue implementing the measures on this issue based on the procedures taken up to that point even after 2020. This new framework is an “open platform” and all G20 members and interested OECD members are expected to participate in the spirit of constructive dialogue and cooperation. In December of the same year, the administrative level conference was held among the majority of the countries and the structure for the coming year and activity plans were agreed on.

- The gap between global steel capacity and demand reached a record high of approximately 700 million tons in 2015. However, as a result of each country’s efforts, such as the measures taken by the forum and the reduction of capacity by China, the gap decreased to approximately 400 million tons at the end of 2018, and the market conditions improved to a certain extent during this period.

- However, excess capacity is still large and the industrial sectors of each country share the concern that the issue of excess capacity is becoming apparent again and that the steel market will experience a downturn due to a slowdown of the global economy. Japan is expected to continuously implement measures to solve the issue of steel excess capacity in cooperation with other countries, utilizing multilateral efforts and bilateral dialogue described above.

<Movement of global capacity and demand>



【Overview of GAMS】

- GAMS is a conference among governments/authorities regarding semiconductors and is comprised of Japan, the U.S., Europe, China, South Korea and Taiwan.

- It has been held every year since 1999, and involves discussions regarding the suggestions of the WSC (World Semiconductor Council) with respect to international issues on semiconductors.

- In October 2019, the 20th conference was held in the United States (Honolulu).

- Major discussions included support measures in the form of subsidies (including investments), encryption authentication regulations, expanded ITA (Information Technology Agreement: Agreement stipulating the abolition of tariffs on IT products), trade/commerce, intellectual property, the environment, etc.

- At the 2019 conference, a workshop was held regarding subsidies and other matters, and discussions were made on the consistency with the GAMS guidelines regarding programs for subsidies or investments subject to information exchanges among the countries/regions. However, China did not provide sufficient explanations on the programs, and the gap between China and the other five countries/regions in terms of the level of information disclosure was not settled.

(2) TRILATERAL MEETING OF TRADE MINISTERS

As described above, in the scoping paper for strengthening subsidy disciplines agreed at the third Trilateral Meeting of the Trade Ministers held on May 31, 2018, it was agreed that initiatives for effective subsidy rules and transparency would be taken.

【Overview of Subsidy Scoping Paper】

The following matters were agreed before starting trilateral discussions:

1. Need to have more effective subsidy rules

The most harmful types of subsidies should be prohibited outright, or the subsidizing country should be obligated to prove that the subsidy does not cause commercial harm to others.

2. Need to improve transparency

To construct direct or indirect incentives for WTO Members to fully comply with their notification obligations.

3. Need to better address public bodies and SOEs

To discuss the basis for determining whether an entity should be characterized as a “public body;” how to address state-influenced market-distorting behavior of entities not characterized as public bodies; and additional obligations and rules for public bodies and SOEs, including increased transparency.

Based on these agreements, the Ministers of Japan, the United States and Europe discussed ways to strengthen WTO rules on subsidies, and on January 14, 2020, the seventh Trilateral Meeting of the Trade Ministers was held and the Ministers agreed on the Joint Statement. In order to strengthen existing WTO rules on industrial subsidies, the Ministers agreed on the specifics of measures such as additional, newly prohibited subsidies and improving notification systems. The Ministers agreed to advance discussions with other WTO member countries based on the agreement reached at the Trilateral Meeting.

【Seventh Trilateral Meeting of Trade Ministers: Joint Statement (January 2020) Excerpt】

1. The current list of prohibited subsidies provided for in Article 3.1 of the Agreement on Subsidies and Countervailing Measures (ASCM) is insufficient to tackle market and trade distorting subsidization existing in certain jurisdictions. Therefore, new types of unconditionally prohibited subsidies need to be added to the ASCM. These are:

- a. unlimited guarantees;
- b. subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan;
- c. subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity;
- d. certain direct forgiveness of debt.

Ministers agreed to continue working on identifying the scope of prohibitions and additional categories of unconditionally prohibited subsidies.

2. Certain other types of subsidies have such a harmful effect so as to justify a reversal of the burden of proof so that the subsidizing Member must demonstrate that there are no serious negative trade or capacity effects and that there is effective transparency about the subsidy in question. Subsidies having been discussed in this category include, but are not limited to: excessively large subsidies; subsidies that prop up uncompetitive firms and prevent their exit from the market; subsidies creating massive manufacturing capacity, without private commercial participation; and, subsidies that lower input prices domestically in comparison to prices of the same goods when destined for export. If such subsidy is found to exist and the absence of serious negative effect cannot be demonstrated, the subsidizing Member must withdraw the subsidy in question immediately.

Ministers agreed to continue working on the scope of such provisions, and to identify additional instances of harmful subsidization and their scope.

3. The current rules of the ASCM identify in Article 6.3 instances of serious prejudice to the interests of another Member. However, these instances do not refer to situations where the subsidy in question distorts capacity. An additional type of serious prejudice linked to capacity should be therefore added to Article 6.3 of the ASCM. Further, work will continue on a provision defining the threat of serious prejudice.

4. The current rules of the ASCM do not provide for any incentive for WTO Members to properly notify their subsidies. Therefore, the state-of-play of subsidies notifications is dismal. Hence, a new strong incentive to notify subsidies properly should be added to Article 25 of the ASCM, rendering prohibited any non-notified subsidies that were counter-notified by another Member, unless the

subsidizing Member provides the required information in writing within set timeframes.

5. The current rules of the ASCM are insufficiently prescriptive when it comes to the determination of the proper benchmark for subsidies consisting of the provision of goods or services or purchase of goods by a government in situations where the domestic market of the subsidizing Member is distorted. Therefore, the ASCM should be amended to describe the circumstances in which domestic prices can be rejected and how a proper benchmark can be established, including the use of prices outside of the market of the subsidizing Member.

6. The Ministers observed that many subsidies are granted through State Enterprises and discussed the importance of ensuring that these subsidizing entities are captured by the term “public body.” The Ministers agreed that the interpretation of “public body” by the WTO Appellate Body in several reports undermines the effectiveness of WTO subsidy rules. To determine that an entity is a public body, it is not necessary to find that the entity “possesses, exercises or is vested with governmental authority.” The Ministers agreed to continue working on a definition of “public body” on this basis.

(3) SUBSIDY DISCIPLINES IN RECENT FTA⁴

In the USMCA⁵ signed on November 30, 2018, a new prohibition on three types of subsidies was agreed to in the State-Owned Enterprises and Designated Monopolies Chapter, Article 22.6, as described below:

- Loans or loan guarantees to an uncreditworthy state-owned enterprise provided by a state enterprise or state-owned enterprise;
- Non-commercial assistance provided by a contracting country or a state enterprise or state-owned enterprise to a state-owned enterprise that is insolvent or on the brink of insolvency, without a credible restructuring plan;
- Conversion of the outstanding debt of a state-owned enterprise to equity by a contracting country or a state enterprise or state-owned enterprise that are inconsistent with the usual investment practices of a private investor.

In the USMCA, “state enterprise” and “state-owned enterprise” are separately defined. State enterprise means an enterprise that is owned, or controlled through ownership interests, by a contracting country, and state-owned enterprise means an enterprise that is principally engaged in commercial activities, and in which a contracting country: (a) directly or indirectly owns more than 50 percent of the share capital; (b) controls, through direct or indirect ownership interests, the exercise of more than 50 percent of the voting rights; (c) holds the power to control the enterprise through any other ownership interest, including indirect or minority ownership; or (d) holds the power to appoint a majority of members of the board of directors or any other equivalent management body.

In Article 12.7 of the Subsidies Chapter of the Agreement between the European Union and Japan for an Economic Partnership signed in July 2018, it is prescribed that the following subsidies that have or could have a significant negative effect on trade or investment between the contracting countries shall be prohibited:

- Legal or other arrangements whereby a government or a public body is responsible for guaranteeing debts or liabilities of an enterprise, without any limitation as to the amount and duration of such guarantee; and

⁴ In both the USMCA and the Japan-EU Economic Partnership Agreement, coverage is provided in the agreement, and caution is required because the target ranges are different from those in the WTO subsidy agreement.

⁵ USTR, Agreement between the United States of America, the United Mexican States, and Canada Text (https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/22_State-Owned_Enterprises.pdf)

- Subsidies for restructuring an ailing or insolvent enterprise without the enterprise having prepared a credible restructuring plan.

3. PROBLEMS BEING CONSIDERED

The following is a brief description of the analysis of problematic subsidies.

In the White Paper on International Economy and Trade 2018⁶, a trend analysis of the Chinese integrated circuit industry was performed using the same method as for the steel industry, as another potential excess capacity problem. According to the 2018 White Paper, in addition to government subsidies and corporate debt in China, government resources, such as the amount of capital investment from investment funds, suddenly expanded after 2014, and with this, the amount of fixed assets increased steeply from 2015 to 2017 (for details, see pages 305-312, Column: Discussions for Strengthening Discipline on Subsidies in the 2019 Report on Compliance by Major Trading Partners with Trade Agreements – WTO, EPA/FTA and IIA –).

The granting of subsidies can bring about positive externalities. In the past, many developed countries granted subsidies in order to develop industries in the name of industrial policies. This not only fostered economic growth in such countries, but also improved global economic welfare through trade. While the United States is not in favor of such welfare brought by subsidies, the granting of subsidies was successful to a certain degree in Europe and Japan.

However, this becomes problematic if such subsidies bring about negative externalities. One example of a negative externality is the possibility of impeding fair competition.

In addition, in the White Paper on International Economy and Trade 2019⁷, by estimating interest rates on loans for major companies in prioritized industries in China including the semiconductor industry, it was revealed that loans at a rate lower than the Chinese market rate were provided to many major companies in China. Furthermore, it was pointed out that semiconductor-related companies had expanded their production capacity by repeatedly conducting foreign M&A or building large-scale plants through financial assistance from the government such as through massive investments by the China Integrated Circuit Industry Investment Fund or support from the China Development Bank. The 2019 White Paper pointed out that granting subsidies by various tools such as loans, funds and other means may have the following three impacts: (1) the government would increase its influential power to major companies engaged in an advanced industry such as the semiconductor industry through the government's financial assistance; (2) the concentration of private-sector funds, spurred by government support, could lead to a huge amount of capital flowing into certain industries, leading to over-production; and (3) a company that received such a huge amount of money could use it for acquiring a foreign company that has advanced technologies.

From another perspective, it was revealed that assistance to prioritized industries such as the semiconductor industry had been provided through loans at lower rates from state-owned commercial banks and Chinese sovereign wealth funds established or invested in by state-owned companies, suggesting that measures taken by state-owned companies had created problems in China.

Meanwhile, the domestic production of the integrated circuits industry in China is still insufficient and the rate of imports is high, and the imported value is said to exceed China's imports of crude oil⁸.

⁶ White Paper on International Economy and Trade 2018, Part II Analysis: Significant shift in the global economy, Chapter 2 Rise of emerging and developing economies, Section 2 Response to global excess production capacity (<https://www.meti.go.jp/english/report/data/wp2018/pdf/2-2-2.pdf>)

⁷ White Paper on International Economy and Trade 2019, Part II The current global economy and challenges to free trade, Chapter 2 The rise of protectionism and the need to reestablish the international trading system, Section 2 Background of imposition of trade restrictive measures (<https://www.meti.go.jp/report/tsuhaku2019/2019honbun/i2220000.html>)

⁸ Deepened disbelief for semiconductor co-operation between China and Taiwan, intensification of the trade friction

At present, investments are being made to meet the necessary demand, and more attention needs to be paid to the situation in the future and further analysis is required regarding the relationship between excessive supply and investments. However, in various industries including the steel, shipbuilding and semiconductor industries, it has been observed that ex-post and remedial subsidies cause excess capacity. It is necessary to distinguish subsidies for fostering industries from those for providing ex-post remedies to failed companies and to ensure that there is a regulatory process in place for the latter.

In addition, although the ASCM provides an obligation to notify subsidies of an identifiable nature, this notification system is not working properly. On the other hand, it is possible to identify subsidies through corporate accounting reports. At the seventh Trilateral Meeting of the Trade Ministers, the Ministers agreed that any non-notified subsidies that were counter-notified by another country should be prohibited unless the subsidizing country provides the required information in writing within certain set timeframes. It is also necessary to take initiatives to strengthen the implementation of the notification obligations and promote disclosures of subsidy information, including the use of such counter-notification.

4. REGARDING THE FUTURE

As stated above, various international initiatives related to strengthening subsidy rules are currently underway in various forums such as G20, the Global Forum on Steel Excess Capacity, GAMS and the Trilateral Meeting of the Trade Ministers.

At the WTO, from the perspective of improving the notification system for subsidies, Japan, the United States and EU proposed a penalty for the notification obligations as part of the WTO reform at the WTO Goods Council in November 2018. In addition, initiatives such as strengthening the implementation of notification obligations, including strengthening the ability to collect and analyze information through the TPR by the WTO secretariat or the monitoring functions of the Committee on Subsidies and Countervailing Measures, are necessary.

Furthermore, as seen in the USMCA or the Agreement between the European Union and Japan for an Economic Partnership, in recent years, there have been initiatives to prohibit certain types of subsidies that are likely to cause market distorting effects, beyond the WTO ASCM. These initiatives attempt to address subsidies that are not easily captured by the existing ASCM, and in the future, they will serve as a reference in discussions for strengthening disciplines on subsidies in the WTO.