CHAPTER 6 SUBSIDIES AND COUNTERVAILING MEASURES

1. OVERVIEW OF RULES

(1) Subsidies and Countervailing Measures

Subsidies have been provided widely throughout the world as a tool for realizing government policies, in such forms as grants (normal subsidies), tax exemptions, low-interest financing, investments and export credits. There are six primary categories of subsidies, divided by purpose: 1) export subsidies, 2) subsidies contingent upon the use of domestic over imported goods, 3) industrial promotion subsidies, 4) structural adjustment subsidies, 5) regional development subsidies, and 6) research and development subsidies. By beneficiary, there are two primary categories: 1) subsidies that are not limited to specific businesses or industries (non-specific subsidies), and 2) subsidies that are limited to specific businesses and industries (specific subsidies).

Although governments articulate ostensibly legitimate goals for their subsidy programmes, it is widely perceived that government subsidies may give excessive protection to domestic industries. In such cases, subsidies act as a barrier to trade, by distorting the competitive relationships that develop naturally in a free trading system. Exports of subsidized products may injure the domestic industry producing the same product in the importing country. Similarly, subsidized products may gain artificial advantages in third-country markets and impede other countries’ exports to those markets.

Because of this, for industrial goods, the WTO agreements prohibit export subsidies and subsidies contingent upon the use of domestic over imported goods, as having a particularly high trade-distorting effect. Furthermore, even for subsidies that are not prohibited, it allows Member countries importing subsidized goods to enact countermeasures, such as countervailing duties if such goods damage domestic industry and certain procedural requirements are complied with. For agricultural products, it requires obligations such as reducing export subsidies and domestic supports.

(2) Legal Framework

Concerning the legal framework for subsidies, its basic principles are provided in Articles VI and XVI of the GATT. Furthermore, there is the Agreement on Subsidies and Countervailing Measures (hereinafter the “Subsidies Agreement”) as an implementation agreement for subsidies in general. The Subsidies Agreement was negotiated during the Uruguay Round to provide new disciplines in place of the Agreement on the Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade (hereinafter the “Subsidies Code”) adopted during the Tokyo Round. Compared to the old Subsidies Code, the Subsidies Agreement provides more explicit definitions of subsidies and
stronger, clearer disciplines on countervailing duty.

The Uruguay Round also resulted in the Agreement on Agriculture, which includes provisions for reducing domestic subsidies and exports subsidies for agricultural products.

Running parallel to the Uruguay Round were negotiations on subsidy disciplines in individual industries, particularly revisions to the Agreement on Trade in Civil Aircraft and a Multilateral Steel Agreement (MSA). These negotiations have not been concluded.

<Subsidies Agreement>

The Subsidies Agreement provides a definition of subsidies and classification of three categories of subsidies according to purpose and nature. Furthermore, the Agreement defines the relation between countervailing measures and remedies for each type of subsidy, provides special and differential treatments for developing country members, and provides transitional arrangements for members in the process of transformation from a centrally-planned economy to a market economy.

Below is a more detailed outline of the more important aspects of the Subsidies Agreement.

(i) Definition of Subsidies (Article 1)

In the Subsidies Agreement, a subsidy shall be deemed to exist if: “there is a financial contribution (i.e., a fiscal burden) by a government or any public body within the territory of a Member” or “there is any form of income or price support in the sense of Article XVI of GATT 1994,” and “a benefit is thereby conferred.” Actions constituting “financial contributions” include:

(a) Direct transfers of funds (for example, grants, loans and equity infusions) and potential direct transfers of funds or liabilities (for example, government guarantees).
(b) Forgoing or non-collection of government revenue that is otherwise due (for example, fiscal incentives such as tax credits).
(c) Government provision of goods or services (other than infrastructure) or government purchases of goods.
(d) Government making payments to a funding mechanism or entrusting or directing a private body to carry out one or more of the type of functions above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments.
(ii) Categories of Subsidies

The Subsidies Agreement defines three categories of subsidies according to specificity, purpose and nature: 1) subsidies that are prohibited outright (hereinafter “red-light subsidies”), 2) subsidies that are not prohibited but which may be subject to countervailing measures (hereinafter “yellow-light subsidies”), and 3) subsidies that are neither prohibited nor subject to countervailing measures (hereinafter “green-light subsidies”) (see Figure 6-1). It also defines the relation between countervailing measures and remedies for each type of subsidy.

<table>
<thead>
<tr>
<th>Specific</th>
<th>Red-light Subsidies</th>
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<tbody>
<tr>
<td></td>
<td>- Export subsidies and Subsidies contingent upon the use of domestic over imported goods fall into the category of Red-light Subsidies.</td>
</tr>
<tr>
<td></td>
<td>- Red-light Subsidies may be subject to countervailing measures.</td>
</tr>
<tr>
<td></td>
<td>- Red-light Subsidies are deemed to be specific.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Yellow-light Subsidies</th>
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<tbody>
<tr>
<td>- Specific subsidies fall into the category of Yellow-light Subsidies</td>
</tr>
<tr>
<td>- Yellow-light Subsidies may be subject to countervailing measures</td>
</tr>
<tr>
<td>- Green-light Subsidies include R&amp;D subsidies, regional development subsidies and environmental conservation which are specific but which meet certain conditions.</td>
</tr>
<tr>
<td>- These subsidies are not subject to countervailing measures</td>
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</table>

<table>
<thead>
<tr>
<th>Non-Specific</th>
<th>Green-light Subsidies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Non-specific subsidies fall into the category of Green-light Subsidies.</td>
</tr>
<tr>
<td></td>
<td>- Green-light Subsidies are not subject to countervailing measures.</td>
</tr>
</tbody>
</table>

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1 The following principles are applied to decide specificity (Article 2). In addition, any subsidies falling into the category of “red-light subsidies” shall be deemed to be specific.

(a) There is specificity when legislation explicitly limits the availability of a subsidy to certain enterprises or industries.

(b) There is no specificity when there are objective criteria or conditions for determining eligibility for, and the amounts of, subsidies, and the subsidies are automatically granted to any and all who meet the eligibility requirements. However, the objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

(c) Notwithstanding any appearance of non-specificity resulting from the application of the principle laid down in a) and b) above, if there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. These factors are:

1. use of a subsidy program by a limited number of certain enterprises;
2. predominant use by certain enterprises;
3. the granting of disproportionately large amounts of subsidy to certain enterprises; and
4. the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy

2 Countervailing measures include the imposition of countervailing duties or the undertaking of price changes that would offset the subsidy.

- Remedies include referring the subsidy to the consultation and dispute settlement body, obtaining a panel report, adopting the report, and obtaining approval for retaliation. Different remedies apply to the different categories of subsidy: red-light, yellow-light, and green-light.
(a) Red-light Subsidies

Red-light subsidies mean prohibited subsidies. With certain exceptions, such as preferential treatment for developing countries and transitional economies, all red-light subsidies must be eliminated (Article 3). If a red-light subsidy is granted, it may be subject to the remedies for red-light subsidies (Article 4). Furthermore, the remedies for red-light subsidies may be invoked in parallel with countervailing measures; however, with regard to the effects of a particular subsidy in the domestic market of the importing member, only one form of relief (either a countervailing duty or the defined remedies) shall be available.

There are two categories of red subsidies: export subsidies and subsidies contingent upon the use of domestic over imported goods. The New Subsidies Agreement illustrates the following measures as export subsidies.

- Measures which provide direct subsidies contingent upon export performance
- Measures which involve a bonus on exports, such as currency retention schemes.
- Measures which treat internal transport and freight charges on export shipments on terms more favourable than for domestic shipments.
- Measures which provide products or services for use in the production of exported goods on terms or conditions more favourable than for domestic consumption.
- Measures which allow the full or partial exemption, remission or deferral specifically related to exports, of direct taxes or social welfare charges.
- Measures which allow the exemption or remission, in respect of exported products, of indirect taxes in excess of those levied in respect of like products when sold for domestic consumption.
- Measures which provided export credit guarantees or insurance programmes at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.
- With some exceptions, government export credits granted at rates below those which the government actually has to pay for the funds so employed, or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

(b) Yellow-light Subsidies

Yellow-light subsidies are not prohibited per se but may be subject to the remedies for yellow subsidies if they cause adverse effects, such as serious injury (“serious prejudice”)

Furthermore, the remedies for yellow-light subsidies may be invoked in parallel with countervailing measures; however, with regard to the effects of a particular subsidy in the

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3 Among those subsidies likely to have "serious prejudice" are subsidies to cover recurring losses, direct debt relief, and subsidies in excess of "quantitative discipline"(Articles 5 and 6).
- The "Quantitative discipline" means that subsidies exceeding 5 percent of a product's price create the rebuttable presumption that the subsidies cause serious prejudice to the industries concerned.
domestic market of the importing member, only one form of relief (either a countervailing duty or the defined remedies) shall be available.

(c) Green-light Subsidies

Green-light subsidies are neither prohibited nor subject to countervailing measures (Article 8). Green-light subsidy includes non-specific subsidies and those specific subsidies that meet certain conditions found below. Specific green-light subsidies include research and development subsidies, regional development subsidies, and environmental conservation subsidies that have been reported to the Committee before they take effect, reviewed by the WTO Secretariat, and approved by the Committee.

Furthermore, specific green-light subsidies may be subject to the remedies for green-light subsidies (Article 9) if they cause damage which would be difficult to repair to the domestic industry of a member.

- Research and Development Subsidies
  Among research and development subsidies, those for industrial research must cover no more than 75 percent of expenses; those for pre-competitive development activities, no more than 50 percent. There are also limits on the uses to which funds can be put within this context, for example, to cover wage costs.

- Regional Development Subsidies
  This includes assistance to disadvantaged areas within a member's borders when it is provided under a general regional development scheme. However, the subsidy should not have specificity within the region, and the region involved must have an unemployment rate that is at least 10 percent higher than the national average or income that is at least 15 percent lower.

- Environmental Conservation Subsidies
  Environmental conservation subsidies to promote the upgrade of existing equipment to new environmental criteria set forth in legislation are permitted when such upgrades would impose heavy constraints or financial burdens on companies and the subsidy meets the following conditions: One-time only, covers no more than 20 percent of expenses; Subsidy does not cover the cost of replacing or operating equipment; Subsidy is directly linked to and proportionate to a firm's planned reduction of nuisances and pollution; Subsidy does not cover any manufacturing cost savings which may be achieved; Subsidy is available to all firms which can adopt the new equipment and/or production processes.

(iii) Countervailing Measures (Articles 10 to 23)

Countervailing measures may be used for red-light and yellow-light subsidies when imports of subsidized goods harm a competing domestic industry. They are used to offset the effect of the subsidy by, for example, imposing a countervailing duty (limited to the amount of the subsidy) on the import of subsidized goods or securing quid pro quo commitments from the subsidizing country (that it will abolish or restrict the subsidy, or that exporters will raise
prices). Countervailing duties may only be applied after an investigation has been initiated and conducted according to procedures specified in the Agreement. Countervailing duties are also subject to a "sunset clause" \(^4\) and a "de minimis clause" \(^5\).

Furthermore, countries are obligated to explicitly articulate the method by which the amount of assistance will be calculated in either their national legislation or their implementing regulations. The New Subsidies Agreement provides guidelines for calculating the benefits of government equity infusions, loans, debt guarantees, and provisions or procurement of goods and services by governments.

(iv) Institutional Framework (Article 24)

The Subsidies Agreement calls for the establishment of a Committee on Subsidies and Countervailing Measures ("the Committee" hereinafter) and a Permanent Group of Experts. The Permanent Group of Experts is an institution that reviews the nature of subsidies in line with the disciplines in the Agreement. If requested by a panel, it may render a verdict on whether a subsidy is prohibited. It may also issue advisory opinions on the existence and nature of a subsidy if requested by a panel or by any member.

(v) Notification and Surveillance (Article 25 and 26)

To ensure the transparency of subsidies, the New Subsidies Agreement contains detailed rules on members' obligation to provide notification of specific subsidies, without prejudice to the provisions of paragraph 1 of Article XVI of GATT 1994, Committee reviews of notified subsidies, etc. For countervailing measures, the Agreement also contains disciplines on reporting measures, furnishing semi-annual reports, notifications of domestic procedures, etc.

(vi) Special and Differential Treatment of Developing Country Members (Article 27)

In light of the fact that subsidies may play an important role in the economic development of developing country members, the New Subsidies Agreement contains preferential measures for developing countries, concerning red subsidies, remedies, dispute settlement, countervailing measures and others (see Figure 6-2 concerning preferential

\(^4\) Sunset Clause
A clause that stipulates the termination of the countervailing duty no later than five years after its imposition unless the authorities determine, in a view initiated on their own initiative or upon a duly substantiated request made by the domestic industry, and the investigating authorities find that damage from the subsidy continues or has the potential to recur (Article 21.3).

\(^5\) De Minimis Clause
A clause that stipulates the termination of an investigation in such cases as where the total \textit{ad valorem} subsidization of a product is less than 1 per cent
measures of red subsidies).

(vii) Transitional Arrangements (Article 28 and 29)

Members must notify the Committee of any existing subsidies that are inconsistent with the New Subsidies Agreement within ninety days after the date on which the Agreement takes effect for those members. Members shall bring those subsidies into conformity within three years of the date of entry into force of the WTO Agreement for such member. However, no member shall extend the scope of any inconsistent subsidies, nor shall such subsidies be renewed upon their expiry.

The Agreement also provides for special handling of subsidies enacted by members that are in a transformation from a centrally-planned economy into a market economy when those subsidies are necessary for the transformation. If notified to the committee, such members have up to seven years from the date of entry into force of the WTO Agreement to eliminate red-light subsidies (see Figure 6-2).

Still, the most of parts, the Subsidies Agreement has been implemented very well, despite the failure of many contracting parties to fulfil their notification obligations (for subsidies with specificity and for countervailing measures). Members will need to make greater efforts in order for the Agreement to achieve adequate levels of fulfilment.

Also, the Agreement re-examine 1) serious prejudice (Article 6.1) 2) green subsidies (Article 8 and 9), and 3) export competitiveness of the developing countries (Article 27.6) which is a built-in-agenda. The Committee has acknowledged the continuance informal discussions of the consideration of the review proceeding excluding the developing countries export competitiveness and expects future discussions to commence.

<Figure 6-2> General Rules on Preferential Measures and Transitional Arrangements of Red-light Subsidies

| Least-Developed Country (LDC) Members | Export Subsidies: not applied | Subsidies Contingent upon the Use of Domestic over Imported Goods: not applied for a period of eight years from the date of entry into force of WTO Agreement |
| Developing Country Members described in the Annex (b) | Export Subsidies: not applied | Subsidies Contingent upon the Use of Domestic over Imported Goods: not applied for a period of five years from the date of entry into force of WTO Agreement |
| Other Developing Country Members | Export Subsidies: not applied for a period of eight years from the date of entry into force of WTO Agreement | Subsidies Contingent upon the Use of Domestic over Imported Goods: not applied for a period of five years from the date of entry into force of WTO Agreement |
Developed Country Members not applied for a period of three years from the date of entry into force of WTO Agreement for the Member

Members in the process of Transformation from a Centrally-planned into a Market not applied for a period of seven years from the date of entry into force of WTO Agreement

<Agreement on Agriculture>

In the area of agriculture, treatment of subsidies on agricultural products will follow the disciplines laid out in the Agreement on Agriculture even though they may appear to come under the provisions of the Subsidies Agreement.

(i) Domestic supports (Article 6 and 7)

(a) Domestic supports are divided into “yellow” (subject to elimination) and “green” (not subject to elimination) categories.

(b) The following policies are deemed “green” as long as certain conditions are met:
- Research, promotion, education, inspection, and other general services.
- Infrastructure services for agricultural areas and rural communities; creation of markets for agricultural products.
- Public stockholding for food security purposes.
- Domestic food aid.
- Decoupled income support (i.e. that directly linked to production)
- Income insurance and safety-net programmes.
- Relief from natural disasters.
- Structural adjustment assistance provided through producer retirement, resource retirement, and investment aid programmes.
- Payments under environmental programmes.
- Payments under regional assistance programmes.

(c) All programmes not considered to be “green” are included in an “Aggregate Measurement of Support (AMS),” which is to be reduced by 20 percent over a period of 6 years. The AMS represents the amount of market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment provided by a given country. They are concluded using the fixed external reference price, based on the years 1986 to 1988. The AMS expresses the extent of protection given agricultural products. Specific guidelines are set for individual basic items, with non-specific supports measured in aggregate monetary amounts. But it is not required to include product-specific domestic support, which does not exceed 5 percent of the total
value of its domestic production, in the calculation of total AMS.

(ii) Export Competition (Articles 8 to 11)

(a) Over a period of 6 years, direct export subsidies are to be reduced by 36 percent and the volume of subsidized exports by 21 percent.
(b) Measurements are based on the period 1986-1990.
(c) Each Member undertakes not to provide export subsidies other than in conformity with this Agreement and with the commitments as specified in that Member's Schedule.

The uniform dispute settlement procedures of the WTO apply to consultations and dispute settlements under this Agreement.

(3) Recent Trend

Subsidies and countervailing measures are not a subject with which people in Japan are very familiar. Japan has only conducted one subsidy investigation in its history and it has never been the subject of an investigation by another country. But elsewhere in the world, countervailing duties are almost as widely used as antidumping duties (see Figure 6-3). The United States, the most frequent imposer of countervailing duties, initiated 210 subsidy investigations between 1985 and June 1998, and had 53 countervailing duties in place at the end of June 1998.

<Figure 6-3> Number of Countervailing Duty Investigations and Outstanding Countervailing Measures in Selected Countries

<table>
<thead>
<tr>
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<th></th>
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</thead>
<tbody>
<tr>
<td>US</td>
<td>179(22)</td>
<td>12(0)</td>
<td>5(2)</td>
<td>4(2)</td>
<td>4(0)</td>
<td>6(0)</td>
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<td>0(0)</td>
<td>1(0)</td>
<td>0(0)</td>
</tr>
<tr>
<td>Chile</td>
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<td>1(0)</td>
<td>0(0)</td>
<td>0(0)</td>
<td>0(0)</td>
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<tr>
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<td>2(2)</td>
<td>1(1)</td>
<td>0(0)</td>
<td>0(0)</td>
</tr>
<tr>
<td>NZ</td>
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<td>0(0)</td>
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</tr>
<tr>
<td>Brazil</td>
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<td>2(1)</td>
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<td>0(0)</td>
<td>0(0)</td>
</tr>
<tr>
<td>EU</td>
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<td>0(0)</td>
<td>0(0)</td>
<td>0(0)</td>
<td>0(0)</td>
</tr>
</tbody>
</table>

*6 Japan did initiate an investigation into imports of cotton thread from Pakistan in April 1983 but did not impose a countervailing duty because Pakistan eliminated the subsidy in February 1984. An application was also filed for a countervailing duty against Brazilian ferro-silicon in March 1984 but was withdrawn in June of that year so no investigation was ever initiated.
2. Number of Outstanding Measures as of the end of June 1998

<table>
<thead>
<tr>
<th></th>
<th>US</th>
<th>Australia</th>
<th>Chile</th>
<th>Canada</th>
<th>NZ</th>
<th>Brazil</th>
<th>EC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>53</td>
<td>6</td>
<td>0</td>
<td>5</td>
<td>2</td>
<td>6</td>
<td>2</td>
</tr>
</tbody>
</table>

(Source: GATT/WTO Documents)

[Note] 1. Figures in parentheses indicate number of cases for agricultural products.

2. There has not been any investigation in Japan.

The disputes concerning subsidies and countervailing measures were one of the fields in which disputes occurred frequently. One reason for the frequency of subsidy complaints under the GATT was the ambiguity of the GATT’s rules on subsidies. Countries interpreted differently the procedural rules for invoking countervailing duties. Underlying this disagreement was a basic conflict between the various contracting parties as to how to view government assistance designed to protect and nurture domestic industry.

Exporting countries frequently initiated GATT disputes involving subsidies. The exporting countries generally claimed that countervailing duties had been imposed unfairly on the basis of arbitrary determinations of subsidies, injury or causation. Other disputes concerned domestic subsidies which nullify the benefits gained through tariff reductions by effectively excluding exports from the domestic market. While there has been a decline in the number of cases brought before a panel since the WTO Agreement went into force, it is notable that prohibited subsidy disputes that have reached a panel have recently increased. (See Figure 6-4 and 6-5)

<Figure 6-4> Number of Panel Cases Concerning Subsidies

<table>
<thead>
<tr>
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<tr>
<td>Other Measures</td>
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<td>0</td>
<td>0</td>
<td>1</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>Total</td>
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<td>3</td>
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<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>7</td>
<td></td>
</tr>
</tbody>
</table>

[Note] CVD indicates Countervailing Duties (Source: GATT/WTO Documents)

<Figure 6-5> Case of Panel in Connection with CVD Measures since 1991

<table>
<thead>
<tr>
<th>Date of Establishment</th>
<th>Claimant</th>
<th>Respondent</th>
<th>Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>7/91</td>
<td>United States</td>
<td>Canada</td>
<td>Canada-Imposition of Countervailing Duties on Grain Corn from the United States (Panel adopted in March 1992)</td>
</tr>
</tbody>
</table>
11/92 EC Australia Australia-Imposition of Countervailing Duties on Glace Cherries from France and Italy (Cancelled by Australia in October 1993)

1/93 EC Brazil Brazil-Imposition of Countervailing Duties on Milk Powder from EC (Panel adopted in April 1994)


3/96 Philippines Brazil Brazil-Imposition of Countervailing Duties on Desiccated Coconut from the Philippines (Appellate adopted in March 1997)

2/99 EC United States United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products from United-Kingdom

(Source: GATT/WTO Documents)

(4) Economic Implications

Government subsidization may have far-reaching implications. When a government subsidizes projects, such as research projects in advanced technology, the benefits may extend well beyond the industry directly concerned. This is true because the results of projects spill over into a wide range of fields. Government assistance for research activities can contribute not only to domestic economic development, but to the development of the world economy as a whole.

Subsidies may also be used to encourage less competitive industries to reduce excess capacity or to withdraw from unprofitable fields. They may, therefore, smooth the way for structural adjustment and shifts in employment. Such subsidies therefore promote the appropriate allocation of resources and encourage imports of competitive goods.

On the other hand, subsidies can also distort trade when they are used to protect a domestic industry regardless of its competitiveness. Governments have often used subsidies to needlessly prolong the natural adjustment process in certain industries. Over the short term, such subsidies may place a domestic product in a better competitive position. They may maintain or increase the profitability of the products and keep employment in that industry stable. Over the longer term, however, the disadvantages of the subsidies become clear. They impede the productivity gains that come from intensely competitive environments and undermine companies’ efforts to rationalize. Thus from a medium- and long-term perspective, subsidies may obstruct an industry’s development or impede the rational allocation of domestic resources.
For example, subsidies tend to impede the efforts of companies struggling to improve productivity and rationalize operations in an extremely competitive environment. Over time, therefore, subsidies actually obstruct the development of domestic industry and the appropriate allocation of domestic resources. On a global economic level, distortions in the allocation of resources and the international division of labour become serious problems as well. And even when subsidies are used to make up for short-term market failures, there is still potential for their purposes and terms to be subverted.

Subsidies that are used as part of a “beggar-thy-neighbour” policy ultimately may induce retaliatory subsidies, leading to “subsidy wars.” Subsidy policies will then be to blame not only for preventing a product from achieving its proper competitive position, but for needlessly draining the treasuries of the countries involved. The result is a larger burden for tax payers. In no way, therefore, do such policies improve the economic welfare of anyone concerned.

Countervailing duties should be used properly or not at all. When improperly imposed, countervailing duties seriously affect the trade of the product concerned and distort the flow of world trade.

2. Problems of Trade Policies and Measures in Individual Countries

<Industries Other than Agriculture>

At present, it is considered that the following measures below are called into question regarding the conformity with the Subsidies Agreement. For these measures, further information should be gathered and improvements should be monitored. When problems are found and no improvement seen, those issues should be raised at the WTO and appropriate resolution under the Agreement should be sought according to necessity.

(1) United States

(i) Imposition of Countervailing Duties on hot-rolled lead and bismuth carbon steel products

In January 1993, the United States imposed countervailing duties on certain hot-rolled lead and bismuth carbon steel products from France, Germany and United Kingdom.

The European Union maintained that in calculating the amount of the subsidies, the United States used arbitrary methods and argued that the US method was inconsistent with Article 4.2 of the Previous Subsidies Agreement, which states: “No countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product.”

In June 1993, a panel was established at the request of the EU to examine countervailing
duties on hot-rolled lead and bismuth carbon steel products. The panel reviewing the case published its report in November 1994, but the report was not adopted.

Japan participated in this case as an interested third party, and submitted an opinion paper in October 1993 in agreement with the EU position.

The US Department of Commerce (DOC) reviewed the countervailing duty (CVD) rate on imports entering the United States from 1995 to 1997. EU claims that the duty rate calculation of the review violates of Article 14 and 19.4 of the Subsidies Agreement. In February 1999, a panel was established at the request of the EU.

(ii) Tax Treatment for “Foreign Sales Corporations”

On November 1997, the EU revealed that it had requested bilateral consultations with the United States at the WTO because of damages to EU from a US system which exempt taxes for exports. The United States and the EU subsequently held three consultations, but were unable to arrive at a solution to the issue, resulting in the establishment of a panel in September 1998.

According to the EU, this programme is to exempt from United States of a portion of FSC income related to exports and of dividends distributed to United States parent companies for the foreign sales corporations (FSCs) most of which are subsidiaries of US companies.

The EU argues that this constitutes an export subsidy and a subsidy contingent upon the use of domestic goods over imported goods, both of which are prohibited by the Subsidies Agreement.

The programme was instituted in 1985 to take the place of the Domestic International Sales Corporation (DISC) scheme that had earlier been found to be a GATT violation (export subsidy) in a panel requested by the EU. Japan was participating in the panel as a third country, and will need to continue to watch the nature of the programme and its consistency with the Agreement.

(iii) Problems with the Uruguay Round Implementation Legislation

As in anti-dumping, there are any number of problems with US subsidy and countervailing duty measures, including the existence of anti-circumvention regulations, and the practice of “cross-cumulation” in calculation damages for dumping exports and subsidized exports. We provide a discussion of these issues in the anti-dumping chapter of this report.

(2) European Union

(i) Export-related measures

The United States requested bilateral consultations with several EU countries in May
1998 claiming that measures in their income tax systems constituted prohibited subsidies. Consultations were held with France, Greece, Ireland, Netherlands, and Belgium. Below are the US allegations for each.

France: 1) Income tax law provides for the start-up costs of overseas businesses conditional upon the inclusion of French products through a tax-deductible reserve accounts.
2) Allowance of 10 percent of the receivables accounts to be held in a special account for medium and long-term credit risks related to export sales.

Netherlands: Income tax law allows to establish special export reserves for small and medium-sized businesses

Greece: Income tax law allows domestic exporters to claim special tax exemptions depending on the percentage of their revenues coming from exports.

Ireland: Income tax law includes a “Special Trading House” (STH) system under which special tax rates are levied for revenues from export sales of Irish products.

Belgium: Income tax allows certain tax exemptions for recruiting personal with export-related functions.

The United States claims that these measures constitute export subsidies or subsidies contingent upon the use of domestic goods imported goods both of which are prohibited subsidies under the Subsidies Agreement. Japan will need to fully monitor the nature of these programmes and their consistency with the Agreement.

(ii) Problems with the Uruguay Round Implementation Legislation

The application of anti-circumvention measures needs to be monitored carefully.

(3) Malaysia

(i) Local Content Requirement Attached to Incentives

Malaysia has offered a preferential tax system subject to a local content requirement in manufacturing sectors since 1991. This local content requirement attached to incentives fits the definition of "subsidies contingent upon the use of domestic over imported goods" that are expressly prohibited in the Subsidies Agreement.

It is not, however, currently a violation of the Agreement because Malaysia, as a developing country, is allowed a five-year transition period from the time the WTO Agreement takes effect for the elimination of existing subsidies. Still, we must express our hope that Malaysia will terminate the requirement within a proper time schedule.
(iii) Export Promotion and Import Reduction Plan

During a budget speech on 17 October 1997, Malaysia announced an “Export Promotion and Import Reduction Plan.” This plan contains many measures that may be inconsistent with WTO rules.

Of concern is preferential tax treatment given to a percentage of export growth for companies exporting products that meet certain local content rates. Not only is the preferential tax treatment based on priority usage of domestic goods over imports, but it is also conditional on exporting, which makes it an export subsidy and a subsidy contingent upon the use of domestic over imported goods, both of which are prohibited by the Subsidies Agreement.

As a preferential measure, the Subsidies Agreement allows developing countries to maintain prohibited subsidies during a certain transitional period. However, it prohibits them from expanding the scope of subsidies inconsistent with the Agreement after the WTO takes effect.

Because Malaysia’s recent Export Promotion and Import Reduction Plan expands the scope of the prohibited preferential tax subsidy, it is considered that the plan is in contravention to the Agreement.

(4) Indonesia

Preferential Tax Treatment of Automobiles

Since February 1996, Indonesia has offered preferential tax treatment to automobiles that reach certain local content levels. (In February 1998, Indonesia reported the abolition of its national car programme to the Subsidies Committee.)

This measure provides preferential taxation predicated on priority use of domestic products over imports. It therefore would seem to be a subsidy contingent upon the domestic goods, which is prohibited under the Subsidies Agreement. At the same time, the Agreement allows developing countries, as a preferential measure, to maintain for a certain grace period (in Indonesia’s case five years after the entry into effect of the WTO Agreement) subsidies that were in place prior to the entry into effects of the WTO Agreement, conditional upon their not expanding the range of application of prohibited subsidies after the WTO Agreement take effect. In this sense as well the programme was in violation of the agreement, and the amount of the subsidy was extremely large, which made it conceivable that “serious prejudice” would be incurred. In its June 1998 report, the panel found “serious prejudice to the interests of another member” for the EU but not for the United States. It also rejected the US claims that developing countries were under a standstill obligation for subsidies for contingent upon the domestic goods over imported goods. Japan will need to monitor how the recommendations is put into effect (See the column in Chapter 2 on Indonesia’s National Car Project.).
On November 1997, the United States requested bilateral consultations with Australia at the WTO, alleging that Australia was providing a subsidy to producers and exporters of leather products for automobiles, which constituted an prohibited subsidy.

The US claims that the governments of Australia’s loans with preferential, non-commercial terms and of grants to producers and exports of automobile leather products constitutes an exports subsidy. Consultation on the case was held in December 1997, but were unable to reach a conclusion.

In January 1998, a panel was established at the request of the US. In May 1998, the US again requested consultations with the government of Australia on the case. The issues involved in the consultations were the same as in January 1998, but Australia pointed out that the evidence provided by the US at the time the panel was requested had been is not sufficient, so the “request for consultation” documents contained several items on evidence. The second round of consultations also failed to reach a conclusion, and in June 1998 a panel was established at the request of the US (the US withdrew its January panel request). Japan will need to carefully the outcome of the panel.

The Agriculture Agreement in principle provides for reductions in trade-distorting policies and measures in this area. Japan will need to monitor implementation of the Agreement closely.

In the 1980’s, the European Union, faced with a serious glut of agricultural products, increased its subsidized exports. During this period, the United States saw its share of export markets rapidly diminish, its competitiveness sapped by the strong dollar and domestic price supports. To counter the export slump and revive prices, the United States has developed the following export promotion programmes. The Agriculture Act of 1996 (enacted in April) maintains these export policies, though it brings them into conformance with the WTO Agreement.
(a) Export Enhancement Plan (EEP)

The EEP specifies markets and pays exporters bonuses equivalent to the discounts they provide customers. The major items eligible for EEP bonuses are wheat, wheat flour and barley.

(b) Dairy Export Incentive Programme (DEIP)

The DEIP is an export subsidy system similar to EEP, and its application is limited to such dairy products as dry whole milk, non-fat dry milk, butter, and cheese.

(c) Marketing Loans

Marketing loans provisions provide a repayment rate for short-term CCC loans repaid by farmers who have sold their crop during the term of the loan at prices below the loan rate. The system increases the government contribution, but it also holds down prices for US agricultural products, thereby increasing their export competitiveness. The marketing loans apply to products such as rice, upland cotton, soybean, wheat, and feed grain.

(d) Export Credit Guarantee Programme

The Export Credit Guarantee Programme seeks to promote exports of US agricultural products by having the CCC provide debt guarantees to banks issuing letters of credit for borrowing used to finance imports of US agricultural products imported on a commercial basis by developing countries. The Agriculture Act of 1996 provides for: a short term credit guarantee programme (GSM-102) for short-term export credits involving loans of 90 days to three years; a medium-term credit guarantee programme (GSM-103) for medium-term export credits involving loans of three to ten years; and a suppliers export credit guarantee programme (SCGP) that guarantees a part of accounts receivable by exporters of US agricultural products from importers. GSM-102 and GSM-103 apply both to 100 percent US agricultural products and value-added products with at least 90 percent US content (by weight). Emphasis in the SCGP is on high value-added products and promising future markets, and it defines specific products covered. The OECD is currently studying disciplines on public export credits for agricultural products.

(2) European Union

(i) Export subsidies for processed cheese

The EC has an internal processing regime (IPR) that enables producers to import raw materials for processing without tax within the community and export processed products to other areas. In February 1997, it modified this system: (a) to add to the list of IPR-eligible items cheese processed within the EC and exported; and (b) to provide export subsidies for processed cheese in proportion to the percentage of the contents of EC non-fat dry milk and
butter used as raw materials (conditional upon at least 5 percent imported content in the final product).

During the Uruguay Round, the EC committed to limit and reduce the quantity and budgetary outlay of export subsidies for four items: cheese, butter, non-fat dry milk, and miscellaneous dairy products. This system tries to use allowance for butter and non-fat dry milk to subsidize processed cheese, and many countries suspect that it is an attempt to circumvent the commitments made for export subsidies.

In October 1997, the United States requested consultations under GATT Article XXII, arguing that the EC measure violated Articles 8, 9, 10, and 11 of the Agriculture Agreement and Article 3 of the Subsidies Agreement. (Japan is participating as a third party since, as the largest export market for EU processed cheese, it has a substantial trade interest in the case.)

It will be necessary to monitor developments in Article XXII consultations.

<Reference> Common Agricultural Policy (CAP)

In the past, the EU imposed import levies on agricultural products as a cross-border measure and paid the difference between prices within the Union and international market prices as subsidies when exporting EU agricultural products to third countries. All of the import levies were changed into tariffs and the export subsidies will be reduced in accordance with the Uruguay Round Agreement.

The tightening of the world market in cereals has caused international prices for some products - for example, wheat - to exceed EU prices since the summer of 1995. In order to stabilize the international market for cereals, the EU suspended export subsidies on wheat in July 1995 and amended EC regulations so as to impose export taxes on common wheat in November 1995 and barley in December 1995. In September 1996, the imposition of export taxes was suspended and the grant of export subsidies was resumed because of the reduction of international prices for cereals. In response to a drought in May and June of 1997, which raised the potential of tight supplies and the depreciation of D-mark against dollar in August, the EC imposed export taxes again on ordinary wheat and other products.

Developments in this regard need to be monitored closely because of the EU’s position in world cereals trade. Accounting for about 20 percent of the world's wheat exports and about 40 percent of the world's barley exports in recent years, the imposition of export taxes by the EU could have significant influence on the world market in cereals.

(3) Canada

Measures similar to export subsidies for dairy products

An agreement between the Canadian federal and provincial governments resulted in the “National Marketing Plan,” under which the country regulates the supply of raw milk.
The purpose of the programme is to use market sharing quotas (MSQs) to balance the supply and demand for milk to be used in processing. The system allocates quotas to individual dairy farms and provincial producers groups in response to domestic demand.

However, Canada is facing excessive supply of milk products (in particular, non-fat dry milk) arising from demand and supply imbalance. Prior to the Uruguay Round negotiations, producers whose shipments exceeded their quotas were subject to stiff levies, and their collection was used to fund subsidies for exports of the surplus. These levies were defined as export subsidies by the WTO, and Canada has abolished the levy. In their place, it has established a new policy of "special milk class," after revising the price classification of milk for processing. “Special milk class” is set primarily with reference to US market prices and at levels lower than the domestic consumer price. They enable surplus domestic dairy products to be exported at prices below those of the domestic market by classifying them into that class.

In October 1997, the United States requested consultations with Canada under GATT Article XXII, claiming that the programme was an attempt to circumvent the disciplines on export subsidies and violated GATT Article II, the Agriculture Agreement Articles 8 and 10, the Subsidies Agreement Article 3, and the Import Licensing Agreement Articles 1 and 3. New Zealand also requested Article XXII consultations in December, claiming that the programme was inconsistent with Articles 3, 8, 9, and 10 of the Agriculture Agreement. (Japan is participating to both consultations as a third party.)

It will be necessary to monitor Article XXII consultations and the deliberation of a panel, if it is established.