

AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES (SCM)

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 potential the WTO Agreements prohibit with respect to industrial goods any 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 injure the domestic industry and certain procedural requirements are met. For agricultural products, the WTO Agreements requires obligations such as reducing export subsidies and domestic supports.

(2) Legal Framework

Concerning the legal framework for subsidies, the 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 the 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 Subsidies Code, the Subsidies Agreement provides more explicit definitions of subsidies and stronger, clearer disciplines on countervailing duty.

There have also been some sector-specific discussions of subsidies. The Uruguay Round 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 classifies of three categories of subsidies according to purpose and nature. Furthermore, the Agreement defines the relationship 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) Foregoing 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 which in practice does not differ from practices normally followed by governments.

(ii) Categories of Subsidies

The Subsidies Agreement defines three categories of subsidies according to specificity,¹ 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 relationship between countervailing measures and remedies for each type of subsidy².

Categories of Subsidies

Specific	<p>Red-light Subsidies</p> <ul style="list-style-type: none"> - Export subsidies and subsidies contingent upon the use of domestic over imported goods fall into the category of red-light Subsidies. - Red-light Subsidies may be subject to countervailing measures. - Red-light subsidies are deemed to be specific.
Non-Specific	<p>Yellow-light Subsidies</p> <ul style="list-style-type: none"> - Specific subsidies fall into the category of yellow-light subsidies. - Yellow-light subsidies may be subject to countervailing measures. <p>Green-light Subsidies</p> <ul style="list-style-type: none"> - Non-specific subsidies fall into the category of green-light subsidies. - Green-light subsidies are not subject to countervailing measures. <p>Note:- Green-light subsidies include R&D subsidies, regional development subsidies and environmental conservation subsidies which are specific but which meet certain conditions. These subsidies are not subject to countervailing measures.</p>

1) 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 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.

2) Yellow/Amber-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”)³ to other countries (Article 7). 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 domestic market of the importing member, only one form of relief (either a countervailing duty or the defined remedies) shall be available.

3) Green-light Subsidies

Green-light subsidies are neither prohibited nor subject to countervailing measures

(Article 8). Green-light subsidies 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, covering 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; and 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 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 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, a Committee reviews of notified subsidies. For countervailing measures, the Agreement also contains disciplines on reporting measures, furnishing semi-annual reports, and notifications of domestic procedures.

(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 Subsidies Agreement contains preferential measures for developing countries, concerning red subsidies, remedies, dispute settlement, countervailing measures, and others (see Figure 6-2 concerning preferential 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 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).

For the most part, 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 be more effective.

The Subsidies Agreement also calls for re-examination of 1) serious prejudice (Article 6.1): 2) green-light subsidies (Article 8 and 9), : and 3) export competitiveness of the developing countries (Article 27.6). These items are considered the built-in-agenda. The Committee was to reach a decision by the end of 1999 on extending application for the first two items (competitiveness questions were excluded from the discussion), but was unable to reach a consensus because of sharp divisions of opinion between the developing countries, which argue that extension should be allowed on the basis that development subsidies are covered by as green-light subsidies, and the developed countries.