DISCUSSION PAPER

SUBSIDIES OF INTERNATIONAL CONCERN

by

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Abstract

This paper discusses the reasons why countries may wish to subsidize industries or to take action against foreign subsidies, considers which subsidies might be of legitimate concern to countries other than those imposing them, and sketches the principal international rules that constrain governments in the use of subsidies. Attention is focused on subsidies given by developing countries and to the countervailing actions by major governments, in particular the United States. Some consideration is given to the question of dumping and anti-dumping actions. The paper concludes with a set of possible actions in relation to subsidies.
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I. Introduction

Subsidies that reduce imports or promote exports have attracted considerable attention in recent years. Such subsidies have been common in developed countries in agriculture and some ageing industries (e.g. shipbuilding, motor vehicles, iron and steel) as well as in some high technology areas; they have also been used by a number of developing countries to promote nontraditional exports. Negotiation of a code aimed at controlling subsidies and countervailing duties is regarded in some quarters as a major accomplishment of the Tokyo Round of Multilateral Trade Negotiations. But not all are pleased with the results of these negotiations. One point of criticism is that the Subsidies Code permits countervailing actions to be taken against subsidies that are aimed at improving the efficiency of resource allocation in developing countries.

The General Agreement on Tariffs and Trade (GATT) and the Subsidies Code take a stance against subsidies that promote exports of manufacturing products. (Subsidies in agriculture face less severe strictures, not because of considerations of efficient resource allocation, but for reasons of practical politics.) The general thrust of the GATT with respect to import barriers is that they should be in the form of nondiscriminatory tariffs, be...
negotiated downwards, and be "bound" by agreement against increases. (If they are increased above the bound levels, compensation can be required for countries adversely affected.) On the other hand, direct export subsidization (except by developing countries and on agriculture) is prohibited under the Subsidies Code. These subsidies (including those by developing countries) and any other subsidies that promote exports, may be "countervailed" if they bring injury to an industry in another country. There are no provisions in GATT (or in the Subsidies Code) 1/ for negotiated reductions in or bindings of subsidies, as there are for import tariffs, nor for compensating those who are injured by the subsidies.

Reasons for these asymmetrical provisions are considered later. From one perspective they can be regarded as somewhat inconsistent. Let us suppose that a country has a set of import tariffs - for simplicity assume that all imports bear tariffs at the same rate. If the government wished to move to the free trade set of price ratios it could (i) remove all the tariffs, or (ii) introduce a set of equal export subsidies at the same rate as the tariffs. The two actions are equivalent, as far as relative prices are concerned but, under the GATT and the Subsidies Code, the former is encouraged and the latter prohibited. Although the two actions would have similar effects on international trade, one is viewed as being an "unfair" trading practice and injurious to other countries - or more particularly to industries in these countries - while the other is not.

This paper discusses the reasons why countries may wish to subsidize industries or to take action against foreign subsidies, considers which

1/ Apart from a minor exception for developing countries.
subsidies might be of legitimate concern to countries other than those imposing them, and sketches the principal international rules that constrain governments in the use of subsidies. Attention is given to subsidies given by developing countries and to the countervailing actions by major governments, in particular the United States. Some consideration is given to the question of "dumping" and anti-dumping actions. The paper concludes with a set of possible actions in relation to subsidies.

The paper concentrates on government actions and leaves on one side private actions that may have similar effects. Thus government policy that facilitates the differential pricing of sales on domestic and export markets receives attention, while such dual pricing arising from purely private action does not. This focus reflects the generally accepted use of the term "subsidy".

II. Why Subsidize?

Like other measures that may affect international trade, subsidies are implemented for a variety of reasons. Particularly in manufacturing industries in developed countries, these subsidies have been used in attempts to support incomes and/or employment in industries that have been affected by recession, foreign competition, or secular decline. In some cases they have been introduced with the intention of lubricating the adjustment process. In agriculture subsidies have long been used for income support. While there are possible economic reasons for these subsidies, in general they have been introduced in the pursuit of aims other than economic efficiency.

Of more concern in the current content is the possible use of subsidies to promote growth in developing countries. Such subsidies may be
supported on external economy or infant industry grounds, or because they are used to counter other distortions in the economy. These apparent justifications are considered in turn.

(i) **External Economies and Infant Industries**

Subsidies of various types may be appropriate instruments to encourage production that yields external economies, or the use of factors of production with which externalities are associated. Particularly important in developing countries could be externalities that decline over time, being associated with the early stages of an industry or industrial sector. These transient externalities provide the major economic justification for infant industry protection for particular industries or whole sectors. Infant industry justifications for assistance rest on the inability of entrepreneurs to recoup enough of the social benefit from particular investments to justify undertaking the investments, even though they may be economically desirable from the national point of view. "Infancy" is associated with costs of establishment; production is expected to be viable without assistance once the initial period is overcome.

Balassa and Sharpston (1977) have emphasized the importance of externalities arising from manufacturing production in developing countries and advocate export subsidies and import tariffs (in lieu of general production subsidies) for manufacturing in these countries to promote this production. Johnson (1970) and Westphal (1981) have drawn attention to the economies of learning in infancy. Johnson (1970) and Corden (1974, Chapter 9) emphasize the important point that assistance will not be justified if the firms which are incurring the costs of learning also capture the benefits.
Evidence on these external, non-capturable benefits is sparse. Brash (1966, pp. 197-202) argued that such externalities emanated from the early motor vehicle industry in Australia, though it is by no means clear that protection against imports was needed to secure them, and the multiplication of small uneconomic plants behind trade barriers in that country is a warning against such protection. Krueger and Tuncer (1982) examined whether protected industries in Turkey experienced greater increases in productivity than other industries. This higher productivity growth which, on infant industry grounds, might have justified the protection, was not found. 1/

Certainly there is an abundance of evidence that those countries that have adopted so-called export-promoting policies have grown most rapidly, but it does not appear, to this author, that the evidence is yet in to support an hypothesis that these gains are arising from the promotion of particular industries or sectors, rather than the countering of a bias to import-substitution, nor that the gains from learning cannot be sufficiently "captured" by the firms incurring the costs of learning. In view of the problems regarding the provision of incentives for protected industries to grow-up rather than to remain in protected infancy (e.g. Baldwin, 1969), and the dangers that a climate in which the returns from seeking protection draw resources away from more productive uses, it appears wiser that when a "not-proven" verdict is returned, that infant industry assistance not be granted.

1/ See Krueger (1983, pp. 6-13) for a summary of the arguments relating to infant industry protection in developing countries; see also Corden (1974, Chapter 9). Feder (1982) estimates, with cross-country regressions, the effects of externalities arising from the export sector, but there is some doubt whether cross-country analysis is the appropriate technique for examination of this question.
This being said, however, there is a good case that if infant industry assistance is to be granted, it is better in the form of those subsidies that expose industries to some of the disciplines of the world markets, rather than in the form of trade barriers that insulate from the markets. Furthermore, subsidies tend to be self-limiting in the degree and perhaps duration of the protection they give, in contrast to barriers to imports. Subsidies (unless given by self-financing dual price schemes) are a charge on Treasury, and this tends to limit the extent and life of protection. Import barriers — and particularly if they are in non-tariff forms — do not have such constraints.

(ii) **Offsetting Other Policies**

Subsidies are often advocated to offset or neutralize the effects of other government policies which, for one reason or another, cannot be changed or can be changed only gradually. Foremost among these are export subsidies designed to offset the distortive effects which barriers to imports bring to the pattern of production and consumption — these barriers giving a higher weight to the "saving" of foreign exchange in the production of import substitutes and to reduced consumption of imports than to the "earning" of foreign exchange through the production of exports and the reduced consumption of exportables. Subsidizing exports tends to reduce the distortion towards import-replacement, in that it increases the return on exporting and, as it tends to increase the domestic prices of exportables, discourages domestic consumption of exportables.

If all imports are subject to an equal ad valorem restraint and all exports are subsidized at the same ad valorem rate, then the effect upon prices of these actions is the same as a devaluation of the currency. (This
assumes that the price of nontraded goods and services is the same in both scenarios.) But this symmetry applies only if all imports and exports, respectively, are subject to the same *ad valorem* restraints and subsidies. If, for example, services were not covered then discrimination would exist against the saving and earning of foreign exchange through services. It is argued by many (e.g. Haberler, 1967) that the required symmetry and complete coverage will never, in practice, be achieved.

This point is worth emphasizing because if, for example, there is a system of barriers to imports which have varying *ad valorem* impacts on the prices of imports, then an attempt to negate their impact through subsidization of exports cannot be presumed to increase efficiency. It is only when there is an equal *ad valorem* impact on all imports that an export subsidy not greater than the import restraint can in general be presumed to be efficiency-increasing. In many developing countries, however, there has been a very marked bias towards import-substitution across wide sectors of the economy. In such circumstances it may be quite clear that efficiency could be increased by subsidizing some exports and it may also be clear which classes of exports these are. In the absence of the externalities discussed above, the exports to be subsidized would not be those products whose domestic production has been stimulated by the restraints on imports. Rather, they would be products whose costs have been raised, or prices lowered, by the import restraints.

Evidence abounds regarding the importance of reducing the bias to import-replacement in developing countries, both in terms of accelerating growth (Krueger, 1978, Ch. 12; Bhagwati, 1978, Ch. 8) and, contrary to a common perception, stability (Balassa, 1982). Particularly important appears
to be an incentive structure for enterprises that bears some relation to conditions in the international market, rather than one that rewards successful insulation from it. Export subsidies that have offset the bias towards import-substitution have been a part of this incentive structure in some countries, though not the only part.

The question of "tariff compensation", as it has been called, by various means other than export subsidies has been extensively debated. This debate has emphasized the point that while across-the-board, equal, export subsidies may fairly clearly improve efficiency, the case for some other forms of "compensation" (for example subsidies on factors of production used in affected exportables) is far from clear. A great deal of information may be required before one can be confident that some of these subsidies will increase efficiency, and the risk of reducing efficiency can be considerable. This is quite apart from the risk of encouraging demands for compensation for the effects of the tariff compensation (Warr 1978, 1979; Lloyd, 1975).

Subsidies have on occasion been suggested as a means by which employment may be increased when wages in the urban or manufacturing sector are set, perhaps by law, at too high a level for full employment (e.g., Harris and Todaro, 1970, and comments by Bhagwati and Srinivasan, 1974; also Ahluwalia, 1973). If unemployment is substantial and if these subsidies were to be adopted on a general basis, their budgetary implications are likely to be considerable. Furthermore, they could provide incentives for labor unions to press for still higher wages.

The first question to address when subsidies are being contemplated to offset the effects of other policies, is why the other policies are
regarded as fixed. It may be that this offsetting or neutralization is a step on the path to adjusting the other policy, and export subsidies are often advocated as the commencement to a process of trade liberalization: subsidies may provide the path of least resistance towards trade liberalization. However, there is also the risk that these subsidies may contribute to a further obfuscation of the impact of the incentive structure, and encouragement of lobbying for industry-specific benefits. If countries are to use export subsidies to offset import barriers, perhaps the secret is to devise an incentive structure that would facilitate the move towards liberalization—one that would tend to ensure the reduction of both import barriers and export subsidies over time. Some attention is given to this in Section VIII below.

III. Why Worry About Others' Subsidies?

Few argue that a subsidy which had no impact on international trade should be a matter of international concern. However, some do take a view that subsidies are in general distorting, and therefore should be opposed and offset even in the absence of substantial impact on other countries.1/ The logic of this argument does not appear to be confined to subsidies—it would extend to all intervention that reduces efficiency, including all trade barriers. Others take the view that price discriminating practices that are prohibited within many countries should not be permitted between countries, particularly when facilitated by export subsidies. Policies designed to curb

1/ See Hufbauer and Shelton-Erb (forthcoming), Ch. II, for a summary of these views which are attributed by the authors to some parts of the US Government.
such subsidies (including anti-dumping legislation) are seen as extensions of domestic trade practices legislation. Leaving these views aside, we concentrate on a number of ways in which subsidies may have adverse effects on the real income of other countries, and then on other reasons that appear to motivate concern for subsidies by these countries.

(i) Terms of Trade

To the extent that direct or indirect subsidization by a country of its exports affects international prices it will worsen its own terms of trade, and thereby improve the terms of trade of its trading partners; subsidization of import-competing production will have the opposite effect. In the former case the action will tend to raise the potential real income of its trading partners and in the latter case lower it. Of course these effects may not be the same for all trading partners—those that are net exporters will face worsened terms of trade in both cases and those that are net importers will have their terms of trade improved. The difference overall arises only according to whether the rest of the world is a net importer from, or exporter to, the country in question. From a terms of trade point of view subsidies that promote exports should be welcomed by trading partners as a whole and those that promote import substitution discouraged; in fact the international agreements on subsidies take exactly the opposite attitude, in that export subsidies are subject to more stringent rules than other subsidies.

Many developing countries are unable to affect their terms of trade. Thus if their subsidies have an impact of concern on other countries,
it will tend to be through income changes or resource movements induced by competitive production, at unchanged prices.

(ii) Unemployment

Export-promoting subsidies may reduce employment in particular industries in other countries, but in considering whether injury is caused to the economy as a whole of these countries, the relevant question is whether total employment is reduced. There seems to be little reason to suppose that this should be so other than, perhaps, on a transitory basis. Except to the extent they are temporary, predatory or contagious (and consideration is given to these below), these subsidies will not have an impact on competition in other countries different from any other factor (e.g. changing comparative advantage) that causes exports to be more competitive. Resisting such changes, whatever their source, would require a less open trade regime. There does not appear to be any evidence that less open trading regimes have a better record as far as employment is concerned than those that are outward-oriented.

(iii) Temporary Adjustment Costs

Export-promoting subsidies may adversely affect the real income of other countries if they are temporary. Costs of adjustment may be incurred, and if the change is soon to be reversed, they may not be worthwhile. Unlike changes in underlying comparative advantage, many government subsidies may with good reason be regarded as easily removable, and therefore likely to induce unwarranted adjustment in other countries. In such circumstances it may be best that the adjustment does not occur. There are, then, two questions to be addressed. Who is the best judge of whether the subsidies are
temporary, and, secondly, who should bear the costs? Producers in the importing countries may be able to perceive whether the subsidies are likely to be temporary, resist adjustment, and bear the short-term losses caused by the subsidies. These producers may prefer the government to take action against the temporarily cheap imports to prevent the losses. There would then be costs imposed on the consumers in that prices would not be cheaper, albeit temporarily. Alternatively the government in the affected countries may be a better judge than producers of whether the subsidies are temporary and, accordingly, may choose to levy countervailing duties to prevent producers undertaking costly adjustments. But there does not appear to be a clear case for countervailing action in all cases where it is suspected that the subsidies may be temporary.

(iv) Predatory Subsidization

Temporary subsidies could result in predatory dumping - the intention being to drive out a foreign competitor and then to raise prices above their original (pre-dumping) level, the threat of renewed dumping acting as a deterrent to the re-establishment of the industry. This possibility has received a good deal of attention in the economic literature. But such predatory dumping, whether or not it is backed by government subsidization, appears to have been rare. The discussion often appears to have ignored the constraint that competition from other countries would impose on subsequent price-raising above the pre-dumping level.
(v) **Contagion**

Beggar-thy-neighbour policies appeared contagious in the 1930s, in the form of barriers to imports and promotion of exports, both directly and through currency practices. And whether or not they affected employment, these policies certainly led to uncertainty, inefficient import substitution and export promotion and, in the case of subsidized exports, a wasteful use of resources as each country was encouraged to buy the others' bargains. Again in recent years in some industries (e.g. steel and shipbuilding) there appears to have been some competitive subsidization. These experiences have suggested that trade-affecting subsidies and other trade measures are best discouraged. There is little evidence, however, that subsidies are more contagious than other trade policies.

(vi) **Summary**

There appears to be no strong reasons in terms of "injury" to the economies of trading partners, rather than to particular industries in them, why there should be greater concern regarding subsidies than there is for many other trade measures. Indeed, several writers /1/ have argued that subsidies should be of less international concern than trade barriers. This is due to the fact that, if anything, they will tend to improve the terms of trade of other countries (considered as a whole), in contrast to trade barriers, which have the opposite effect. Also they have drawn attention to the self-limiting tendency of subsidies, at least in the longer term, due to their cost to Treasuries. Richard Cooper (1978, p. 120) writes:

/1/ Some of these are summarized in Hufbauer and Shelton-Erb (forthcoming), Chapter II.
This perspective on the problem suggests that perhaps we should not worry so much about government subsidies to economic activity—or rather government intervention of all types—as far as their effects on foreign trade are concerned, provided the interventions are introduced sufficiently gradually so that they do not impose acute adjustment costs on economic activities outside the country in question.

Adjustment costs, he suggests, would be reduced by advance notification and gradual introduction. He argues further:

On this general view of the matter, if a country wants a particular industry so badly that it is willing to subsidize foreign and domestic consumption of the product, that would be all right so long as others have ample time to adjust to the new situation.

Barcelo (1980, p. 287) goes along a similar path, distinguishing between those subsidies that worsen other countries' terms of trade and those that improve them, and arguing that foreign subsidies that improve a country's terms of trade should be countervailed only on a general "safeguard against injury to industry" basis. Corden (in Cline (ed.), 1983, p.746) draws this efficiency approach to its logical conclusion by proposing the abolition by international agreement of all import barriers, and allowing every country to subsidize as much as it wishes.

(vii) Injury to Industries

While on the basis of injury to the economies as a whole of trading partners there would appear to be less reason for concern regarding export-promoting subsidies than for other trade policies, of more importance in determining attitudes is the distribution of injuries and gains in these countries, and the causes of change. The body politic has appeared to accept the legitimacy of government actions in excluding or governing foreign
competition in their domestic markets, and international agreements have aimed at limiting the extent and forms of this protection; it has appeared to regard as illegitimate attempts by governments to assist their residents to penetrate foreign markets. The former is regarded as defense; the latter as invasion. Thus import barriers are acceptable (or at least some forms of them are); export promotion is not and the competition resulting from this is often branded as unfair, perhaps because governments are not motivated by normal commercial considerations when they subsidize and because of the potential depth of the public purse. ("We can compete with Mexican companies, but we cannot compete with the Mexican government.") 1/ To an economist the distinction between fair and unfair trade tends to be as elusive as that other economic holy grail the "just price". There is no doubt that the whole concept of fairness is heavily producer-oriented and that it reflects mercantilist perceptions of the role of international trade which have long been regarded by the bulk of the economics profession as fallacious. However, it does appear to influence policy, and account of it must be taken in contemplating policy changes, at least in the short run.

IV. Which Subsidies Should be Controlled?

While there are many who take the view that subsidies should not be subject to international control, one needs to address the question that if international control is to be exercised, how is it to be exercised. For this purpose, subsidies must be defined and those of concern must be identified.

First, to define and measure a subsidy, a base must be specified from which to determine whether or not a subsidy is in existence. That is, what is the so-called "level playing field" - the situation that is regarded as fair and in which international trade is undistorted by subsidies? Secondly, which subsidies should be controlled? The distinctions between subsidies can be made in many ways--by the type and/or size of the actual impact; by the nature of the subsidy; by the intent of the subsidy; by the nature of the country granting the subsidy or being injured by it; or by the commodity to which the subsidy is applied. All these criteria in fact form part of national and international rules. A brief consideration of each of these points leads to the conclusion that all are fraught with problems, and that policies that depend upon them must involve arbitrary and, often, economically illogical distinctions.

(i) From What Base Should Subsidies be Measured?

There can be few government interventions that do not affect international trade in some way. Thus a tax on the production or consumption of nontraded products discourages production and consumption of these products. Internationally traded goods will thereby be made relatively cheaper to produce and consume. International trade may be stimulated--if so, is the tax on nontraded goods to be regarded as a subsidy on exports (and imports)? While it is unlikely to attract international attention, a tax on a particular nontraded product may have as large an impact on international trade as an export subsidy on some other product and therefore, from an economic perspective, it is equally an export subsidy. Thus a tax on milk production (a non-tradeable) could stimulate beef production and exports.
Should then the base from which one determines whether a subsidy is in existence be an efficient allocation of domestic resources? A base that represents a state with an efficient allocation of resources is appealing in principle. Any industry with an output greater than that which would occur under this efficient allocation could be regarded as being subsidized. In practice, it may be difficult to discover whether any particular measure improves or worsens the allocation of resources and a very complete and excellent econometric model of the economy may be required to measure the extent to which a particular action could be considered a subsidy in relation to an efficient allocation of resources. Furthermore, there is no unique efficient allocation of resources for an economy—output depends on demand which in turn depends on income distribution.

The simplest base from which to work is the state of the world without the particular subsidy in question. But many subsidies and allowances are introduced to offset, in some directions, the impact of other government policies. Those other policies can be regarded as being negative subsidies. Thus taxes paid on the usage of inputs into productive processes (taxes on material inputs or on labor, etc.) may be refunded on exports; exports may be subsidized to offset the trade restraining effect, and the bias towards production for the home market, brought by barriers to imports. It would not appear logical to regard such subsidies as being export-promoting subsidies. But in practice there will be arbitrary distinctions—the refund of import duties paid on inputs used in producing exports may clearly not be export subsidies, but what if imports had been restricted by quantitative restrictions rather than tariffs? Should tariff equivalents of the import quotas be imputed so they can be refunded? And what about import duties on
capital equipment used in producing the exports, or import duties on capital equipment to produce electricity used in exporting industries? The list of potential problems and paradoxes is endless.

Another aspect of the "base" question is whether tax systems should be source- or destination-based. The essence of this is whether indirect taxes, for example, should be levied on goods in the country in which they are produced, or in the country in which they are consumed. If the latter principle is adopted then the refund of indirect taxes when commodities are exported should not be regarded as an export subsidy. 1/ But the mixture of destination principle for indirect taxes and source principle for direct taxes can (and does) give rise to anomalous situations when deciding which remissions of taxes on exports are to be regarded as subsidies and which are not.

(ii) How Should Distinctions be Made between Subsidies?

Should the effect of subsidies on other countries be the criterion for evaluating acceptability? Effects of particular subsidies could be measured in terms of the impact on the size of the international trade flows, the impact on other countries' terms of trade or national incomes, or their impact on various groups within the other countries—for example consumers of the products or producers of competitive products. If the policy under

1/ Some favor the general adoption of this destination taxation for direct as well as indirect taxes (e.g., Hufbauer and Shelton-Erb (forthcoming)), though implementation of it with regard to direct taxes would seem to be rather impractical. It would imply the refund of direct taxes paid by the owners of the factors of production the services of which are incorporated in exports, and the levying of taxes on imports at rates appropriate to the factor content of these imports.
consideration is directly concerned with exports, the impacts on the terms of trade and on trade flows may not be too difficult to estimate; the impact of such a policy on the producers (labor and capital—but one could mention also the producers of inputs into the affected goods) would be more difficult; even more difficult is to estimate the impact on competitive producers of a policy that indirectly affects trade. Precision is of course impossible. And how big an impact should there be before it becomes of legitimate concern? And on what, or whom?

Rather than attempt to measure the effects of particular policies and design responses accordingly, a judgment may be made that some actions are likely to have a more adverse impact on trading partners than others. Thus, policies that have a direct impact on international trade may trigger a more severe response than those whose impact is indirect. A distinction could be made between general policies (e.g., a ten percent subsidy on all exports, or the remission at a standard rate of indirect taxes) and policies that are imposed differentially (e.g., an export subsidy at a rate in excess of the general rate, or excessive remission of indirect taxes). As far as subsidies are concerned, the most obvious distinction here is between a subsidy that discriminates in favor of selling on the export market rather than on the home market and one that does not, but even this distinction looks less clear if a production subsidy is given for a product which is almost entirely exported.

The intent of subsidies could appear as a promising criterion for differentiating between subsidies. The first general countervailing duty law of the United States dates from 1897 when Russia subsidized sugar exports in order to undercut a U.S. import tariff, 1/ and it is this type of export

1/ Feller (1969) p.21. In 1890 the first specific countervailing duty law was enacted by the U.S.
subsidy which is the target of a great deal of national legislation and international agreements. Subsidies that differentially affect sales for export and sales for the home market are deemed to be "unfairly" attempting to undercut the trade policy of other countries. And it would seem, at first blush, that explicit export subsidies (whether they be on export sales, or on credit for export sales, and so on) are clearly intended to penetrate foreign markets, in part by displacing other supplies. Indeed, if such additional sales could not be obtained, there would be no point to the export subsidies for the country giving them -- the subsidies would simply lower prices abroad. But even direct subsidies to exports may be given to "level the playing field" within the country giving them. In such circumstances the intent would not be foreign invasion but the counteraction of a bias of other policies towards producing for the home market. Improved domestic resource allocation is the real intent and increased exports a by-product.

Differential pricing of domestic and export sales is no real test of intent as exemplified by the Common Agricultural Policy of the European Economic Community -- export sales at prices lower than internal prices are the consequence of a domestic income support policy pursued by high frontier protection and consumption prices that are above world prices. Export sales at prices below internal prices is not a policy objective as such. Equally, it might be argued that the real intent of some production subsidies when the bulk of which production is exported could be to undercut foreign trade barriers. The nature of the subsidy may not reveal the main intent, and, in any case, different parties may see different intents in the same action. Thus intent does not appear to be a useful criterion for differentiation.
Attitudes towards subsidies may be conditioned by which country is employing them. Most obvious here is a distinction between developed and developing countries — burdens may be borne more easily when there is a presumption that the very poor are the beneficiaries. There does not appear to be any strong economic logic to differentiate between commodities. However, economic considerations aside, some sectional interests are so powerful that they appear able to secure preferred treatment even where the general structure of industry assistance is being considered.

V. The Rules

The multilaterally agreed rules on subsidies are found in GATT, as modified after the GATT Review of 1954-55, and in the "Interpretation and Application" of the relevant GATT Articles agreed in 1979 as part of the outcome of the Tokyo Round of Multilateral Trade Negotiations — particularly the Subsidies Code. National legislation by major importing countries is generally consistent with these internationally agreed rules. As the United States has for long been a leader in interpretation, as part of its legislation is thought by some not to conform to the provisions of GATT, and as there has been a surge of countervailing duty cases there, particular attention is given to that country, as well as to developing countries.

(i) The Articles of GATT

The original GATT Articles did not prohibit any production or export subsidies 1/, but the GATT Review in the mid 1950's, introduced a prohibition of subsidies which result in a lower price for manufactured goods on the

1/ Article III of the GATT does prohibit other forms of subsidies (e.g., consumption subsidies) that discriminate according to national source (Dam, 1970, pp. 141-2).
export market than the domestic market (Article XVI:4). A note to this paragraph explains that the intention was to abolish "all subsidies" (presumably all subsidies that promote exports of manufactured products), but the Article itself incorporates a dual pricing test (i.e., export prices lower than domestic prices) to define the prohibited subsidies. Not all subsidies that encourage exports will result in dual pricing. Direct export subsidies can be expected to do so in a competitive market structure, but may not when producers have discretion regarding the prices they charge. Indeed the threat of countervailing action in the presence of dual pricing would provide an incentive to producers not to price in that way -- instead the subsidies could bring lower prices in both domestic and foreign markets.

As far as primary products are concerned, the GATT provides that "contracting parties shall seek to avoid the use of subsidies on the export of primary products", but if they do use subsidies, they should not use them in a manner "which results in that contracting party having more than an equitable share of world trade in that product" (Article XVI:3), a very vague prescription. Domestic subsidies to agriculture and barriers to imports of agricultural products have been virtually outside GATT control since a waiver was granted to the United States in 1955 for the import restrictions which were part of its agricultural price support program (Dam, 1970, p.260). Nevertheless, subsidization of agricultural exports is still, in principle, under GATT jurisdiction when these subsidies result in "more than an equitable share of world trade". However, the inability of GATT procedures to constrain effectively the actions of the EEC with respect to sugar exports following
successful complaints under the GATT by Australia and Brazil, casts doubt on whether such subsidies are under GATT control in practice (Teese, 1982).

The GATT Articles permit the levying of countervailing duties, no greater than the amount of subsidy 1/, if the importer "determines that the effect of the ... subsidization ... is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry" (Article VI: 6(a)) and it is this provision which has been most important in practice in discouraging export-promoting subsidies. (Export stabilization schemes for primary products are not deemed to be subsidies that can trigger countervailing actions or to result in "more than an equitable share of world trade" as long as export prices on occasion rise higher than domestic prices -- Articles VI: 7 and XVI: 3, Ad.) GATT also allows countervailing duties by an importer (say country A) when subsidized exports by country B are displacing the exports of country C in A's market, and this loss of exports causes material injury to an industry in C (Article VI: 6(b)). In practice country A may have no incentive to countervail for the benefit of an industry in C.

Article XVI: 1 of GATT provides that member countries shall notify other members of any subsidy which "operates directly or indirectly to increase exports of any product form, or to reduce imports of any product into, its territory" and also of the extent and nature of the subsidy and the estimated effects on exports or imports, but it appears that this is a dead

1/ The relevant Article refers to "bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such project in the country of origin or exportation, including any special subsidy to the transportation of a particular product". (Article VI:3).
letter. The other Article of the GATT that relates to subsidies is Article XXIII concerning "nullification or impairment" of any benefits accruing under the Agreement. Thus if a country, in the course of trade negotiations, had agreed to bind a particular tariff (that is, in GATT language, has granted a "concession"), and another country then subsidized exports so as to get "under" that tariff, "nullification and impairment" could be deemed to occur. The matter could then be referred to members of GATT for multilateral resolution in accordance with the provisions of that Article. Negotiated benefits accruing to the offending party could be suspended.

(ii) The Subsidies Code

In 1979 the Subsidies Code emerged out of the Tokyo Round of multilateral trade negotiations. In August 1983 GATT had 90 "contracting parties" (i.e., members) and of these only 20 had accepted the Subsidies Code. 1/ Among developing countries, only Brazil, Chile, Egypt, India, the Republic of Korea, Pakistan, and Uruguay have accepted it. The Code is an "Agreement on Interpretation and Application" of the relevant Articles (VI, XVI, and XXIII) of the GATT. Thus, the Code does not replace any of the Articles of the GATT and where particular matters are not dealt with in the Code, the provisions of the GATT must be presumed, in some sense, to remain. For example, although the dual pricing test (Article XVI: 4) is not referred to in the Code, it remains on the books (Hufbauer and Shelton-Erb, forthcoming, Chapter III).

1/ The 20 includes the EEC as a whole, and one of its members (the United Kingdom). It appears that the Council of the EEC can accept for the member countries. (Jackson, 1983, p.170). Another country (Yugoslavia) had signed, with acceptance pending.
An important consideration concerning the Subsidies Code (and the other Codes and Framework Agreement negotiated at the Tokyo Round) is whether the provisions of the Code should be applied only to other signatories to the Code, or whether they should apply to all contracting parties to GATT. The matter is not unimportant, for under a grandfather clause of GATT, the United States is not required to apply an "injury test" in order to levy countervailing duties against subsidies granted by other countries, whether or not they are signatories to GATT. (That is, the "material injury" requirement of Article VI: 6(a) of GATT does not apply to the United States in that it was not consistent with the U.S. countervailing duty legislation that existed at the time the GATT was first signed.) 1/ Under the Code, however, the United States is required to establish that there is material injury to a domestic industry prior to impose countervailing duties. The United States maintains that this provision applies only with respect to other signatories to the Code. Some other countries argue that Article I of the GATT has primacy—"any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." What is at

1/ This exemption from the injury test applies only with regard to products which are dutiable on import to the United States. Thus inter alia it does not appear to apply to imports that come in duty-free under the Generalized System of Preferences for developing countries: for countervailing duties to be applied against subsidized exports coming in duty-free under GSP, it appears that injury has to be established.
issue is unconditional most-favored-nation (MFN) treatment, a fundamental principle of the GATT, expressed in its first Article. The attitude that the provisions of the Codes should be applied only to other signatories of the relevant Code is one of conditional not unconditional MFN (Hufbauer, Shelton-Erb and Starr, 1980, pp. 59-70) and is an important departure from the trading principles established in the post-World War II negotiations.

The Subsidies Code distinguishes between agricultural \(^1\) and other products, between developed and developing countries, and between export subsidies and other types of subsidies. Though not as clear as it might be - there is a good bit of vagueness which appears to be deliberate - it also distinguishes between various levels of injury. Thus, all the categories referred to in Section IV above to distinguish between types of subsidies are utilized, even "intent", which arises in relation to some subsidies imposed by developing countries. The "base" from which subsidies are calculated is the state without the particular subsidy.

The Code continues the trend started in the GATT review of 1954-5 in attempting to distinguish between export subsidies and other subsidies (some of which may, inter alia, encourage exports) and in prohibiting (Article 9) export subsidies (except on agricultural products and by developing countries). It provides an illustrative list of what it deems to be export subsidies. In short, the list covers direct subsidies on exports, bonuses for exporting through currency retention schemes, reduced freight charges for exports, cheap inputs supplied by governments for use in exports, reduction or

\(^1\) It refers to "certain primary products" and, unlike the GATT itself, excludes minerals from these. Neither the Articles of the GATT nor the Codes cover services.
remission of direct taxes with regard to exports, excessive remission of indirect taxes (and import charges) on the products exported or any exemption or remission of indirect taxes and import charges on inputs into exports unless the inputs are physically incorporated into the export product, guarantees on export credits or insurance at premium rates that are "manifestly inadequate" to cover the long-term costs of the program, subsidized export credits, and any other charge on the public account having similar effects. The Code list is not intended to be exhaustive: other practices may be deemed to be export subsidies. It will be noted that the destination principle for taxation is adopted for indirect taxes (but only partly for indirect taxes on inputs) but not for direct taxes.

As far as agriculture is concerned, export subsidies are not prohibited by the Code for either developed or developing countries. Instead, the Code attempts, rather weakly, to define what the "more than an equitable share of world export trade" is which signatories should not capture by means of export subsidies (Article 10).

Export subsidies on manufactured products are not banned for developing countries; instead: "Developing country signatories agree that export subsidies on their industrial products shall not be used in a manner which causes serious prejudice to the trade or production of another signatory" (Article 14:3), and they "should endeavour to enter into a commitment to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with ... competitive and development needs" (Article 14:5). Furthermore, when such a commitment has been entered into, countermeasures which might otherwise be authorized on a multilateral basis against the export subsidies, may not be undertaken by other signatories.
This "multilateral action" involves consultations, reconciliation and, ultimately, authorization of "such countermeasures as may be appropriate".

For subsidies other than export subsidies, the Code takes a somewhat more permissive approach, but recognizes that they "may cause or threaten to cause injury to a domestic industry of another signatory or may nullify or impair benefits accruing to the interests of another signatory under the General Agreement, in particular where such subsidies would adversely affect the conditions of normal competition. Signatories shall therefore seek to avoid causing such effects through the use of subsidies" (Article 11:2). It is even more permissive regarding such subsidies when they are granted by developing countries, in that the multilateral track for action may not be taken against them unless nullification or impairment of tariff concessions or other obligations under GATT is found to exist. While at the end of it all, there appears to be little differentiation between developed and developing in the action that an importing country can take through the imposition of countervailing duties against subsidies, there is a considerable "understanding" written into the Code regarding the use of subsidies in developing countries. For example:

Signatories recognize that subsidies are an integral part of economic development programmes of developing countries (Article 14:1);

Signatories recognize that in developing countries, governments may play a large role in promoting economic growth and development (Article 14:7).

But in view of the similarity of possible countervailing action, this understanding does not appear to amount to very much.
The bases for remedies provided for by the Code are complex and, as noted, provide for both national action on the initiative of an importing country, and multilaterally agreed action, and vary according to many factors including whether they are in response to export subsidies or other subsidies, whether the subsidies are on agricultural or other products, and whether the subsidies are given by developed or developing countries. Most important to date and in the foreseeable future, are the provisions for countervailing duties to be imposed by an importing country, although for action against subsidies that affect another country's exports to a third market the multilateral path is likely to be the only feasible one. To date, however, this track has proved to be slow and rather ineffective, as illustrated by the Brazilian and Australian experiences relating to subsidized EEC sugar exports. While the extent of injury to an industry that needs to be demonstrated for multilaterally-authorized action is generally less than for countervailing duties to be imposed by national authorities after their own investigation, the wheels of the multilateral gods grind slowly, and often ineffectively.

Thus, the main source of remedy is in unilaterally imposed countervailing duties. Part I of the Subsidies Code elaborates the GATT provisions, and specifies the procedures which countries should follow in conducting investigations into whether material injury has (or will) occur, and into the causal link between subsidized imports and the injury. The Code provides for visible and public investigation, for consultations, and also states that it is the size of the subsidy, and not the amount of injury, that will determine the limits to the countervailing duty. The Code provides for price undertakings by exporters (that would remove the source of the injury)
to be entered into, in lieu of countervailing duties. It also states that in determining injury there should be "an objective examination of both (a) the volume of subsidized imports and their effect on prices of the domestic market for like products and (b) the consequent impact of these imports on domestic producers of such products" (Article 6:1). It lists factors to be taken into account in determining the impact on prices and on domestic producers, but the attempt is far from satisfactory, as the Code itself implies. As far as the important countervailing actions are concerned, there is no differentiation between export and other subsidies. Granting an export subsidy would, however, normally be in breach of a signatory's obligations under the Code and therefore could attract more severe multilaterally-authorized action than other subsidies.

VI. Countervailing Actions

The United States is well out in front in terms of countervailing action. In part this is because the inquiry procedures of the International Trade Commission are generally in conformity with GATT and are clearly visible--some have suggested that other countries are using more subtle but less visible means to achieve similar ends. But the U.S. actions in this area have become increasingly common over the last decade. Prior to the Tariff Act of 1930 the United States imposed countervailing duties only 12 times, and between 1930 and 1964 an average of once per year (Hufbauer and Shelton-Erb, forthcoming, Chapter I; see also Balassa and Sharpston, 1977). There were only three countervailing duties operative in 1973; this had increased to 37 in 1979 (Ethier, 1982). The UNCTAD data base on trade measures indicates that 143 countervailing actions were initiated in the United States in the four
years 1979-1982, 111 of which were in 1982, while over the same period there were five in the EEC, four in Canada and three in Australia. Japan has not used the countervailing machinery. As Balassa and Sharpston (1977, p. 31) have noted "European countries and Japan take a pragmatic attitude in the sense of using quantitative measures in cases of serious injury to domestic injury ... without inquiring into the causes of the expansion of imports. Decision-makers appear to focus on the injury itself ..."

Since 1976 there have been affirmative findings regarding subsidies and countervailing duties levied (or pending) by the United States on products from the following developing countries. 1/

<table>
<thead>
<tr>
<th>Country</th>
<th>Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil:</td>
<td>castor oil products, scissors and shears, cotton yarn, pig iron, men's and boys' apparel, hot-rolled carbon steel plate, stainless steel bars and wire rods, frozen concentrated orange juice, certain tool steels.</td>
</tr>
<tr>
<td>Uruguay:</td>
<td>handbags, leather apparel (twice).</td>
</tr>
<tr>
<td>Argentina:</td>
<td>wool suits, non-rubber footwear, wool.</td>
</tr>
<tr>
<td>Korea:</td>
<td>bicycle tires and tubes, steel products.</td>
</tr>
<tr>
<td>Taiwan:</td>
<td>bicycle tires and tubes.</td>
</tr>
<tr>
<td>India:</td>
<td>footwear.</td>
</tr>
<tr>
<td>Pakistan:</td>
<td>men's and boys' apparel, cotton, wool, or man-made fibers textiles.</td>
</tr>
<tr>
<td>Israel:</td>
<td>fresh-cut roses.</td>
</tr>
<tr>
<td>Colombia:</td>
<td>leather apparel.</td>
</tr>
</tbody>
</table>

1/ The source is the Trade Action Monitoring System of the Office of the United States Trade Representative.
Mexico: leather apparel, ceramic tiles, toy balloons and playballs, red lead and lead stabilizers, certain iron metal construction castings, pectin, polypropylene film, polypropylene yarns, carbon black.

Peru: cotton sheeting and sateen, cotton yarn.

Numerous other petitions have been withdrawn, presumably because exporters have come to an agreement to remove or nullify the offending practice.

Many actions which alternatively could have been prosecuted as subsidies have been addressed as dumping actions, which have also increased markedly. UNCTAD data indicate that 152 anti-dumping actions were initiated in the US in the four years 1979-1982, 69 of them in the final year. Anti-dumping actions are more common than countervailing duty actions in several countries, the number of anti-dumping cases over the four years being 154 in the EEC, 214 in Australia and 144 in Canada.

VII. Dumping

As noted earlier, export subsidies may or may not result in pricing of products on foreign markets at prices lower than on domestic markets; it depends on the market structure and could also be affected by the nature of the subsidy. If they do (or if they result in other pricing practices deemed to be dumping), then countries may take counteraction under anti-dumping legislation. We noted above that in agreeing to amendments to the General Agreement itself in the 1950's, member countries agreed to cease granting any subsidy which resulted in the dual pricing of manufactured goods, though not all contracting parties fully accepted the Article XVI:4. While still on the
books, the provision has lost much of its force in that there is no mention of it in the Subsidies Code.

Of more importance is the Anti-Dumping Code. The Code amplifies the provisions of the General Agreement relating to the definition of dumping and the requirement that injury ("material injury") be experienced before anti-dumping duties are levied and elaborates procedures for investigation, etc. Like the Subsidies Code, it allows for price undertakings from exporters in lieu of the levying of duties. Again like countervailing duties, the extent of allowable anti-dumping duties is determined by the source of the problem, not by the extent of injury. Unlike the Subsidies Code, the Anti-Dumping Code does not provide a "multilateral" track for action against dumping. Apart from price undertaking, the only relief path is the imposition of anti-dumping duties by the country affected or by a third country on behalf of the country affected (i.e., when country A's exports into B's markets are affected by C's dumping in B, country B may take action against C if material injury has been caused to the industry in A by the dumping). Of course the nullification and impairment provisions of Article XXIII still provide a multilateral path where the dumping is, for example, undermining a bound tariff.

The Anti-Dumping Code makes only token concession to developing countries: "special regard" and "possibilities of constructive remedies provided for by this Code shall be explored before applying anti-dumping duties where they would affect the essential interests of developing countries." (Article 13) Presumably these constructive remedies are price undertakings. Together with the provision for price undertakings in the Subsidies Code, it appears that government-sponsored restraints on competition are regarded as less offensive than subsidies and discriminatory pricing.
VIII. **Policy Questions and Options**

Policy questions and options are considered under four headings: (i) the pros and cons of developing countries signing the Subsidies Code; (ii) whether export-promoting subsidies should be recommended when they appear to improve the efficiency of resource allocation; (iii) what fairly minor adjustments could be made in the existing international rules governing subsidies so as to accommodate the types of subsidies that might improve resource allocation; and (iv) looking more widely, what major changes might be made in the international rules governing subsidies in the interests of a more efficient international system.

(i) **Developing Countries and the Subsidies Code**

Membership of GATT is not required in order to sign the Tokyo Round Codes, so it is quite reasonable to consider signing the Subsidies Code without considering the larger question of GATT membership. Apart from questions relating to internationalism *per se*, there appear to be four reasons why a developing country may wish to sign the existing Code:

(a) As an encouragement to other countries to sign and to adhere to the provisions regarding investigation, determination of injury, etc., prior to imposing countervailing duties on subsidies that promote exports. While this reason may not appear to have a great deal of substance as the countries imposing countervailing duties are already signatories, there is always the possibility that they may withdraw, unless more countries sign.

(b) So as to utilize the multilateral path for remedies against countries that subsidize exports into third markets and thereby
cause injury to the developing country's exporters. But as the multilateral path for relief appears to be rather ineffective (as Brazil has found with respect to sugar from the EEC), this reason also does not appear to be so substantial in practice.

(c) As a discipline on its own trading policies. This reason could be of importance (particularly in relation to a program of trade liberalization initiated by the introduction of export subsidies aimed at offsetting import barriers) but it is unlikely, on its own, to provide sufficient reason for signing.

(d) So as to require the United States to determine that "injury" has occurred to an industry prior to the imposition of countervailing duties (Balassa, 1980, p. 105). In practice this is the most substantial reason, but it has another side to it as is now noted.

In requiring a country's signature to the Subsidies Code as a condition for applying the injury test to subsidized exports from that country, the US is departing from the unconditional most-favored-nation principle and is reverting to conditional most-favored-nation, a feature of its trading policy prior to 1922. But developing countries (and small countries generally) have a strong interest in the preservation of unconditional MFN, not only because it means they can receive benefits from the trade negotiations among the major powers, but also because it underlies a truly multilateral trading system--conditional MFN can easily be a step towards bilateralism. It is true that the unconditional MFN has also been eroded by preferential arrangements for developing countries, but nevertheless developing countries could well be wary of the US initiative in this regard. Prior to signing the Subsidies Code, India challenged this US policy, arguing
that it was inconsistent with Article I of GATT, but the issue has not been resolved. Developing countries members of GATT could well consider settling the US injury test matter by probing its conformity with Article I of the GATT under the GATT's dispute-settlement procedures, rather than signing the Subsidies Code so as to receive the benefits of the injury test.

Another reason why developing countries may hesitate to sign the Subsidies Code is that they may be required to discontinue policies which they regard as being in their own interest (though such is the price of most international agreements and, in any case, the constraints on some recent developing-country signatories have been mild.). 1/ Finally, developing countries may hesitate to sign in the hope that a better Subsidies Code may emerge—or perhaps that subsidies may come to be regarded as not warranting special treatment. These points are returned to in considering modifications to the international rules.

(ii) Should Developing Countries Grant Export-Promoting Subsidies?

In Section II above, some possible reasons for granting subsidies were examined. It was noted that those developing countries pursuing outward-oriented trading policies have generally fared better than others. Subsidies that promote exports have been an ingredient of this outward-orientation in some countries. While external economy and infant industry arguments have been advanced for the support of the manufacturing sector in developing countries, it appears that the export-promoting subsidies have been more important in offsetting biases towards import-substitution, and as an

1/ Hufbauer and Shelton-Erb (forthcoming), Chapter V.
ingredient in trade-liberalization, than in increasing the return to exporting industries above free-trade levels.

With the extension of its lending policy beyond project loans, the World Bank has found it necessary to examine and comment upon the trading policies of particular countries. The question has arisen in some cases as to whether it should recommend the subsidization of exports, in particular to offset the effects of import barriers and thereby attempt to improve the allocation of resources. An alternative policy could be to reduce these import barriers and to devalue the currency. But some countries belong to regional currency blocs, the rules of which do not permit currency adjustment by a single member. The countries are not, therefore, able to alter their nominal exchange rates without major changes in the structure of their economic arrangements. But in making judgments as to whether to recommend export subsidies, the Bank has had to consider whether the removal of the import barriers would or would not be politically feasible, at least in the short run, and whether the real exchange rate can be "devalued" by export subsidies; that is, whether the domestic price rises that are likely to be associated with the export subsidies are likely to be contained.

Such recommendations, if implemented, might improve resource allocation in the countries concerned. But they risk the export subsidies being countervailed—in which case the countervailing countries would not import any more of the products concerned, but the exporting countries would receive less for them. There would be a transfer of income from the exporting countries to importing countries. In considering whether to recommend subsidies, this risk of countervail has to be taken into account by the Bank. A further consideration is whether the Bank should recommend policies
that run counter to the Subsidies Code, even if the countries in question are not actually signatories to that Code.

One view of the dynamics of protection is that no quarter should be given to protectionist pressures; that whatever constraints there are should be retained, or tightened. In this view, facilitating the granting of export subsidies to offset the effects of barriers to imports would in the longer term simply add another distorting weapon to the protectionist armory (see, for example, Haberler, 1967). Even if export subsidies were introduced at rates that improved efficiency, they would be unlikely to remain at these levels. Those arguing this position suggest that the energy given to designing offsetting subsidies would be better directed to removing the import barriers, and that the real exchange rate should be changed by altering the nominal exchange rate and/or restraining domestic inflation relative to that in trading partners and competitors. Subsidies that appear to improve resource allocation should not be granted, it is argued, for any short-term gains in economic efficiency will be offset by longer-term losses. Unless the subsidies are introduced in the context of a very explicit program of trade liberalization, the author has considerable sympathy for this view.

There remains the question of whether export-promoting subsidies should be recommended given the existing rules of GATT and of the Subsidies Code.

Many argue that the openness of the world trading system is being diminished in many ways and that further closing of it is being held at bay by the internationally agreed rules. It has been suggested that in the present world economic climate it is unwise to undermine these rules any further and any attempt at renegotiation of the rules is likely to lead to a less
satisfactory, more discriminatory outcome. Rocking the boat should be discouraged. It can be argued that the wide adoption of subsidies that promote exports—even for the best of reasons—may trigger countervailing duties and other action under the Subsidies Code to such an extent that chaos will result, and therefore such subsidies should not be advocated.

As a considerable variation on the last point, others argue that adherence to the present set of rules, many of which are based on a mercantilist argument that injury by imports to a domestic industry is sufficient reason to restrict those imports, or that there is content to the concept of fair trade, are so reinforcing attitudes to trade that are destructive to the concept of efficient allocation of resources, that the rules (and in particular the Subsidies Code) which are based on these misconceptions should not be accepted. On this argument policies that improve resource allocation should be adopted even if they run counter to existing rules.

Leaving such a radical view on one side, export-promoting subsidies that are aimed at improving efficiency could be recommended with more confidence if the international rules were adjusted to accommodate this type of subsidy. Attention is now given to ways in which this could be done.

(iii) Minor Changes in the Rules to Accommodate Some Developing Country Subsidies

An approach which is designed to accommodate what are perceived to be efficiency-increasing export subsidies for developing countries, requires a small drafting change to Article 14 of the Subsidies Code. It involves the...
addition of "I," to Article 14:6. 1/ The effect of this would be to render safe from any counteraction (other than through Articles XIX (serious injury) and XXIII (nullification or impairment)), export subsidies by developing countries when a developing country had entered into a commitment to reduce or eliminate export subsidies when such subsidies are no longer required for its "competitive and development needs." Thus, a developing country could grant export subsidies at levels designed to offset the distorting effects of import barriers as the first step in a program of trade liberalization, and then sign the Subsidies Code and enter into a commitment in terms of Article 14:5. Currently such a country would be guaranteed immunity from counter-measures against subsidies along the less important multilateral track of remedies; the suggested amendment would also give immunity from unilaterally imposed countervailing duties by signatories to the Code. The required "commitment" could be negotiated with the Committee established under the Subsidies Code: if the program of liberalization was not forthcoming, then countries would be

1/ The relevant paragraphs read:

5. A developing country signatory should endeavour to enter into a commitment* to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with its competitive and development needs.

6. When a developing country has entered into a commitment to reduce or eliminate export subsidies, as provided in paragraph 5 above, counter-measures pursuant to the provisions of Parts II and VI of this Agreement against any export subsidies of such developing country shall not be authorized for other signatories of this Agreement, provided that the export subsidies in question are in accordance with the terms of the commitment referred to in paragraph 5 above.

* It is understood that after this agreement has entered into force, any such proposed commitment shall be notified to the Committee in good time.
free to countervail provided, of course, that injury occurred. This
requirement could be a very valuable discipline for the developing country
itself on its use of export subsidies, and could provide it with an incentive
to continue of a program of general trade liberalization.

Another advantage of this approach is that it should appeal to those
who desire, for whatever reason, to take a tough attitude against subsidies.
Retaliation in this case would be suspended because of the existence of a
program of liberalization, and the suspension would be revoked if the
liberalization program did not proceed.

There is an even gentler approach that goes quite a distance along
the same path. 1/ Currently in the U.S. (at least) countervailing duties can
be levied against each of a number of subsidizing countries if the imports
from all (in total) bring injury. In return for the Article 14:5 "commitment"
just described, the package of subsidized imports could be unpacked. Thus,
country X's exports would not be subject to countervailing action, provided
that it had undertaken a commitment of liberalization approved by the
Committee established under the Subsidies Code, unless country X's subsidized
exports--on their own--caused material injury to an industry in an importing
country. It is possible that this path of action may prove acceptable even in
the short run and particularly to the United States: indeed it could be taken
by the U.S. even without a commitment under Article 14:5. It is a path that
could accommodate most small countries, although the larger developing

1/ This refinement has been suggested by Gary Hufbauer in the course of conversation.
countries--Brazil, Argentina and India, for example--could still expect to run into countervailing duties for some products.

(iii) Major Changes to International Rules

Consideration is now given to some major changes in the international rules governing subsidies. Some of these possible changes involve a change of attitudes to subsidies, particularly those that promote exports.

(a) One major change in the Subsidies Code is to permit export subsidies by developing countries when they are applied at a uniform rate across the board and only allow countervailing action when export subsidies are above this uniform rate. If used to offset import barriers that average about the same rate (and which are not at markedly dispersed rates) this could be viewed as roughly equivalent, as far as the allocation of resources is concerned, to a currency devaluation with free trade. But the interpretation of GATT has been such as not to permit practices just because their economic impact can be deemed to be equivalent to some other action that is permitted. The approach of "economic equivalence", if applied to import barriers plus export subsidies, is thought by some to open Pandora's box:

In short, the "functional equivalent" argument would open the door to a considerable range of subsidies that might be justified by an appeal to general equilibrium analysis--finding a "second best" solution in a "third best" world. If such justifications could be offered for particular subsidy practices, then the fabric of international discipline would quickly dissolve in the face of arguments advanced by imaginative economists (Hufbauer and Shelton-Erb, forthcoming, Chapter III).
And, one might add, lawyers.

The author has considerable sympathy with this view in the context of the existing structure of GATT and the Codes. But it leaves open the question of whether the current structure of rules should be retained.

(b) Another possible change would be to treat subsidies similarly to tariffs. It was pointed out earlier that import barriers and export subsidies are not viewed symmetrically by the GATT and the Subsidies Code. From the perspective of economic theory they are similar in that they both encourage domestic production, but different in that import barriers contract international trade while export subsidies expand it. GATT and the Subsidies Code reflect a view, popular in some quarters, that barriers to imports do not constitute unfair trade—harmful perhaps, but not unfair. Subsidies that promote exports, on the other hand, are viewed as unfair. Despite this difference in perception, a possible line of action would be to negotiate restraints on export and other subsidies in a manner similar to that which has been adopted for tariffs—to negotiate the binding of them at particular levels and the reduction of them over time. This could apply to agricultural produce as well as to manufactures. But such an approach would require a complete renegotiation of the GATT, and would involve, once again, the problem of defining a subsidy. The author is not particularly attracted to it.

(c) There can be few, other than those with an interest in complexity, who do not react to a study of the Subsidies Code and the
associated literature by thinking there must be a simpler way. Complexity has no virtue in itself, and the uncertainty it creates can act as a deterrent to efficient transactions. Much of the complexity that entangles those in the subsidies pond surrounds the concept of injury, in particular the different degrees of injury that must be established, according to the nature of the cause, before remedial action may be taken. Many feel that the field of debate needs to be shifted, and it is in this spirit that the following possibilities are outlined.

In large part, the various fine graduations of injury - material injury, serious injury, adverse effects and so on - arise because the concept of injury is industry-based. The interests of producers within the relevant industry are emphasized. This leads then to distinctions between acceptable and unacceptable forms of competition - that is between fair and unfair trade.

It is unlikely that countries will foresake all provisions for safeguarding industries against foreign competition. But if such safeguarding could be viewed more in an efficiency than in a "fairness" context, the distinctions between various causes of injury could be dropped. Ideally, the criteria of injury for "safeguarding" would then be amended to focus on economy-wide rather than industry-specific effects, but even without this amendment, much could be gained in simplicity by repealing the special provisions covering subsidies and dumping and relying on the general safeguard provisions of Article XIX of GATT, together with the nullification and impairment provision of Article XXIII.

Simplification and consistency—and less protection by "harassment" of exporters—would be achieved by getting all injury cases on the one track
with the exception of "damage" in third markets where, as now, action can be taken under nullification and impairment (Article XXIII).

While this path has much appeal, the following points should be noted if reliance is to be placed on the existing safeguard Article XIX (Barcelo, 1977, pp. 842 ff.)

Unlike the Subsidies and Anti-Dumping Codes, the Article provides that the country taking action should grant offsetting "concessions", or face the possibility of retaliation.

Action taken under Article XIX must be non-discriminatory: if applied to any, it must be applied to imports from all sources. This may appear to discriminate against those who do not subsidize (or dump), but such would be a consequence of abandoning the distinction between fair and unfair changes in the prices of imports. (It should be noted, however, that the question of selectivity of the existing safeguard rule is on the negotiating table.)

Actions under Article XIX are viewed as temporary, giving time for adjustment. Action against subsidies and dumping, on the other hand, has no such adjustment presumption. The difference in practice does not appear significant, however.

Barriers under Article XIX can be raised to any extent to prevent injury. Unlike countervailing or anti-dumping duties they are not limited by the cause of the trouble.

Article XIX requires "serious" not "material" (or less) injury, and this is regarded as being a higher injury test.

The United States legislation for Article XIX action requires the imports to be a "substantial cause" of injury--not less than some other cause. Countervailing or Anti-Dumping duties can be imposed when the subsidy or dumping makes a much lesser contribution to injury of the relevant
industry. Within the U.S. one effect of this change would be to reduce the automaticity of relief action, leaving more discretion with the President, and making action and procedures less subject to appeal through the courts.

If it were resolved internationally to simplify procedures, a Safeguards Code (the "unfinished business" of the Tokyo Round) could be negotiated, if necessary, to replace the existing Article XIX and the Subsidies and Anti-Dumping Codes.
References


