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# *Export Promoting Policies Under Countervailing Threats: GATT Rules and Practice*

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# EXPORT PROMOTING POLICIES UNDER COUNTERVAILING THREATS: GATT RULES AND PRACTICE

by

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## Abstract

This paper reviews the GATT (including the Subsidies Code) rules on subsidies in trade and examines the quantitative importance and pattern of countervailing actions undertaken by major advanced industrial countries, particularly against imports from developing countries. The major purpose of the paper is to derive some policy implications for those developing countries contemplating turning to an outward-oriented development strategy or entering a new round of Multilateral Trade Negotiations on subsidy issues. The paper focuses on the conceptual as well as technical problems associated with the current GATT rules and on the countervailing actions undertaken by the US. The paper then makes a brief assessment of a prospective agenda for developing countries in the forthcoming Multilateral Trade Negotiations on subsidies. The paper also suggests a direction for policy reforms for domestic as well as trade incentives in developing countries facing the countervailing risks.

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# Export Promoting Policies Under Countervailing Threats: GATT Rules and Practice

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## I. Introduction

By the early 1970s, the relative superiority of an outward-oriented over an inward-oriented development strategy was well established both in theory and by empirical evidence. 1/ The successful experience of some developing countries, now better known as the newly industrializing countries (NICs), has in recent years encouraged a number of other developing countries to emulate their outward-oriented development policies. Moreover, the recent balance of payments crises in some debt-ridden countries have also led to increased attention to export promotion efforts.

Ideally, shifting to an outward-oriented from an inward-oriented development strategy can best be accomplished by removing existing trade barriers with appropriate exchange rate adjustments. In practice, many developing countries have instead attempted to achieve a similar goal by introducing a set of export incentives--including susbidies--without dismantling import barriers. The preference for the second approach over the first rests in general on the following reasons: first, import liberalization can take place only slowly because of influential vested interest groups; second, exchange rate adjustment is often incorrectly feared to cause domestic inflationary pressures; third, import taxes often constitute a major source of government revenue; and finally, many policymakers are often guided by the

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1/ See, for example, Keesing (1967), Bhagwati and Krueger (1973), Krueger (1981), and Balassa (1982).

erroneous belief that both exports and import substitution can be better promoted through export incentives without dismantling import barriers.

Outward-oriented policies involving subsidies, however, have in recent years increasingly come under the threat of countervailing actions by some advanced industrial countries (AICs). 2/ Furthermore, domestic subsidies not directly linked to export activities have also become a greater source of international dispute in trade lately, with certain types of domestic subsidies subject to retaliation.

Subsidies and countervailing actions are in principle constrained by the international rules provided by the General Agreement on Tariffs and Trade (GATT) provisions. But the rules appear to be less than definitive in describing what does or does not constitute countervailable subsidies. 3/ Nor does the GATT provide any meaningful mechanisms for settling disputes between governments. In dealing with trade subsidy problems, therefore, individual countries tend to rely on their national laws and procedures, seeking bilateral rather than multilateral solutions. The application of countervailing measures can differ substantially across countries and over time for a particular set of export subsidies in developing countries, depending upon national policies at the time countervailing actions are being considered.

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2/ Following the classification used by the World Bank in the World Development Report 1986, AICs represent all OECD countries, except for Greece, Portugal, and Turkey, which are included as developing countries.

3/ The GATT rules, for instance, allow developing countries to adopt any measures, including export subsidies, to assist their industries while industrial countries are permitted to countervail against such subsidies whenever they are deemed to cause "serious prejudice" to their trade or production. The meaning of serious prejudice is, however, nowhere clearly stated in the GATT rules, leaving considerable flexibility in its interpretation. Details will follow in Section II.

Hence, any effort to understand the extent and nature of countervailing actions by AICs against NICs or other developing countries, must rely on factual evidence in addition to the guidelines provided by the GATT rules.

The purpose of this paper is first, to review the characteristic features of the GATT rules (including the Subsidies Code) on subsidies in trade, particularly from the perspective of developing countries. Second, to analyze the recent pattern of countervailing actions undertaken by the AICs in order to draw policy implications for developing countries contemplating turning to outward-oriented development strategy or entering a new round of Multilateral Trade Negotiations (MTNs) on subsidies. In analyzing the pattern of countervailing actions, the paper considers three major aspects: (i) the recent trend of country and industry-incidence of countervailing actions undertaken by major AICs; (ii) the extent of export or domestic subsidies in the developing countries and the major channels through which they are provided; and (iii) the quantitative importance of the duty structure and the trade coverage of countervailing duty cases. The paper concludes with a brief assessment of a prospective agenda that may be put forth by the developing countries in the forthcoming MTN on subsidies in trade.

## II. Subsidies in the GATT Rules

The General Agreement on Tariffs and Trade contains a number of provisions relating to the use of subsidies, mostly in Articles VI, XVI, and XXIII as modified in 1955. These provisions were further elaborated by the Tokyo Round of Multilateral Trade Negotiations held during 1973-79. The results were summarized in the "Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the GATT (1979)", now better known as the

Subsidies Code. The GATT Articles and the Subsidies Code establish a consensual framework of rights and obligations of contracting parties in relation to subsidies and countervailing duties, and also provide guidance on the procedure of international dispute settlement. The major elements and some qualifications of the GATT Articles and the Subsidies Code are briefly sketched below.

A. Major GATT Articles on Subsidies

The GATT provisions that deal with subsidy matters in trade make important distinctions between export and domestic subsidies, and between primary and nonprimary products. There is limited obligation for signatories with respect to domestic subsidies. According to Article XVI, signatories should notify other contracting parties if subsidies affect imports and exports, and the party granting a subsidy should discuss, upon request, with other parties the possibility of limiting the subsidization if it causes serious prejudice to the latter. 4/ The GATT recognizes that a subsidy granted on the export of any product by a contracting party may have harmful effects on other contracting parties. It therefore prohibits any form of subsidy on the export of nonprimary 5/ products, direct or indirect, that results in the sale of a product in the export market at a price lower than that charged in the domestic market. 6/ With regard to the export of primary

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4/ See GATT Article XVI:1.

5/ A nonprimary product is understood to be any product except the product of farm, forest or fishery, or any mineral.

6/ See GATT Article XVI:4. This prohibition is, however, applicable only to those contracting parties which have signed the 1960 Declaration Giving Effect to the Provisions of Article XVI:4. Those countries that have accepted the Declaration include 17 industrial countries; thus developing countries are implicitly excluded from this obligation.

products, however, the GATT permits, but limits the use of subsidies such that "they shall not be applied in a manner which results in a contracting party having more than an equitable share of world export trade" (GATT Article XVI:3).

Under Article VI, importing countries are allowed to offset export subsidies by levying countervailing duties, but they are required to use discipline in applying them. Duties may be imposed in an amount not greater than the estimated subsidies, 7/ and countervailing actions are limited to cases where the subsidies "cause or threaten material injury to an established domestic industry, or retard materially the establishment of a domestic industry" (Article VI:6(a)).

Article XXIII entitled "Nullification or Impairment" also has some bearing on subsidies. This articles provides for resolving disputes arising when one country's expected benefits under the Agreement are nullified or impaired by another country's failure to meet obligations under the Agreement. 8/

B. The Subsidies Code

The major purpose of the Subsidies Code, which emerged as a result of the Tokyo Round in 1979, is to clarify and expand the existing GATT provisions on subsidies and countervailing duties. The Subsidies Code, consisting of seven Parts and nineteen Articles, became effective January 1980. Part I

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7/ See Article VI:3.

8/ For example, if country A loses its market share of a certain product in country C due to subsidized exports by country B into country C's market, and if there is no domestic producer for the like-product in country C, country C may have no incentive to countervail country B's export for the benefit of country A. Country A can then take the case to the GATT's contracting parties for multilaterial solution.

attempts to set forth procedures for applying countervailing duties in greater detail than in the Article VI of the GATT, and Part II clarifies GATT Article XVI by providing definitions on terminologies and illustrative examples of export and domestic subsidies. Part III addresses the rights and obligations of developing countries with regard to the use of subsidy measures. The remaining four Parts of the Code deal mainly with Article XXIII of the GATT: procedures to establish committees or panels on subsidies and countervailing measures under the GATT; dispute settlement procedures through GATT channels; and procedures for entry and withdrawal from the Agreement.

Several aspects of the Code deserve attention. First, the Code prohibits the use of any export subsidies on manufacturing and mineral products. The inclusion of minerals under the nonprimary product category is a new development. Moreover, the Code establishes the prohibition rule more strictly than suggested by the GATT Articles. 9/

Second, the Code prohibits any export subsidies on nonprimary products irrespective of their price effects, authorizing use of countervailing duties whenever such subsidies prove to cause or threaten "material injury" to a domestic industry. This contrasts with the requirement of the existence of dual pricing in the GATT Article XVI:4. 10/

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9/ For example, Code Article 9:1 states that "signatories shall not grant export subsidies...," whereas, Article XVI:4 of the GATT states that "contracting parties shall cease to grant... subsidies on the export...."

10/ Article XVI:4 prohibits the grant of export subsidies when it results in the sale of a nonprimary product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.

Third, a major question still remains unresolved: neither the GATT nor the code has an agreed-upon definition of "export or domestic subsidy". The Code, however, provides a list of illustrative examples of prohibited export subsidies and a list of objectives for which domestic subsidies could be used.

Finally, the Code recognizes that subsidies are an integral part of the economic development programs of developing countries, and explicitly deals with rights and obligations of developing countries concerning subsidies in Article 14 of the Code.

In view of the countervailing threats to subsidy measures by developing countries, the last two points made above are of particular interest, and they will be discussed further below.

(i) The Meaning of Subsidies in the Code

The Code contains an illustrative list of export subsidies which can be considered to violate the Agreement. While clearly a step forward in clarifying the meaning of export subsidies, the provisions are vague in parts, overlapping in others, and generally, not definitive. In brief, the list includes:

(a) direct subsidies linked to export performance;

(b) subsidies in the form of a currency retention scheme or bonus on exports;

(c) transport subsidies for export shipment in excess of those provided for domestic shipment;

(d) delivery of intermediate goods by government for export production at lower than international prices;

(e) full or partial exemption of direct taxes related to export activities;

(f) allowance of special deductions related to exports in the calculation of the direct tax base;

(g) rebate of indirect taxes on exported products that exceed taxes levied on like products sold for domestic consumption;

(h) rebate of cumulative indirect taxes on goods or services used in the production of exported products that exceed taxes levied on goods or services used in the production of like products sold for domestic consumption;

(i) drawback of import charges on imported intermediate inputs in excess of actual charges;

(j) government controlled premium rates on export credit guarantees or insurance programs lower than their long-term operating costs;

(k) grants by governments of export credits at rates below their actual financing costs; and

(l) any other charge on the public account constituting an export subsidy in the sense of Article XVI of the GATT.

The list enumerated above has several important features. First, and most important, export sectors are allowed to purchase intermediate inputs and sell outputs at world market prices for a given exchange rate, thus subjecting them to free trade conditions. This is implied by illustrative examples (d), (g), (h), and (i).

Second, direct subsidies of any form, if related to export activities, are forbidden as indicated by illustrative examples (a) and (b).

But, interestingly enough, implicit subsidies that can be generated through changes in the exchange rate or through protection of domestic markets for export industries are not mentioned in the list.

Third, unlike the case for indirect taxes, any direct-tax preferences in favor of export sales over domestic sales are prohibited as suggested by illustrative examples (e) and (f). The Code, therefore, is implicitly applying the destination principle for indirect taxes while applying the source principle for direct taxes.

Fourth, subsidies on nontraded intermediate goods are allowed as long as they are neutral between export and domestic sales, and subsidies on other intermediate goods are allowed insofar as they do not bring the prices lower than international prices, as implied by illustrative examples (c) and (d).

Fifth, financial subsidies of any form linked to export by providing loans and other services at below-market rates or below-financing costs are forbidden as indicated by illustrative examples (j) and (h).

Finally, the illustrative list is by no means exhaustive but remains open-ended by the inclusion of item (l). Thus, it is still difficult to make an accurate assessment of whether any particular set of incentives would be permissible or not under the terms prescribed by the Code.

The Subsidies Code also recognizes that subsidies other than for export are widely used for social and economic policy objectives and admits "the right of signatories to use such subsidies to achieve these and other important policy objectives" (Code Article 11:1). However, this right is constrained in two respects. First, the Code provides a positive list of objectives for which such domestic subsidies could be used. These are: (a) to eliminate economic and social disadvantage of specific regions; (b) to

facilitate restructuring which has become necessary due to certain changes in trade and economic policies; (c) to sustain employment or to encourage retraining; (d) to encourage R&D programs; (e) to promote economic and social development of developing countries; and (f) to avoid environmental problems. 11/ Second, the Code explicitly requires that signatories not "cause or threaten to cause injury to a domestic industry of another signatory..." (Code Article 11:1) through the use of such subsidies, meaning that they could still be countervailed under the same criteria as for export subsidies. Thus, whether, and the extent to which, domestic subsidies could be countervailed in practice is an empirical question that will be considered in Section III of this paper.

(ii) The Treatment of Developing Countries in the Code

As mentioned explicitly in the Code Article 14:2, developing countries are allowed preferential treatment to adopt any measure or policy to assist their industries, including those aimed at export promotion. This is not, however, entirely unconditional. Developing countries are obliged "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 need" (Code Article 14:5), where the meaning of competitive and development need remains unexplained. When such a commitment is made, the Code guarantees that "countermeasures...against any export subsidies of such developing country shall not be authorized for other signatories" (Code Article 14:6), provided 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" (Code Article 14:3). Thus, while developing countries

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11/ See Code Article 11:1.

seemingly remain free to use export subsidies, they are not entirely free from risks of being countervailed if, in fact, their use of subsidies causes material injury in another country's markets.

A few comments are in order. First, apart from the rhetoric of the Code, the preferential treatment toward developing countries' subsidy measures may not amount to much in practice, since they are technically subject to countervailing for the same condition (i.e., material injury) as AICs. The significance of the preferential treatment is, therefore, an empirical question.

Second, the constraints on export subsidies of developing countries imposed by the Code contrast sharply with the relatively permissive stance of the GATT on the side of import restrictions. For example, the GATT explicitly allows for developing countries "to maintain sufficient flexibility in their tariff structure...for an establishment of a particular industry" and "to apply quantitative restrictions for the balance of payment purposes" (GATT Article XVIII:2). On balance, the GATT rules seem to be biased toward encouraging developing countries to take an inward-oriented rather than an outward-oriented development strategy, thereby impeding trade expansion with all-too-familiar ramifications.

Finally, the Subsidies Code seems to be more clear about the obligations of developing country signatories than about their rights, as seen above. Thus, signing the Code may be viewed by developing countries as a reduction of freedom to implement trade and industrial policies in exchange for some unsecured benefits of less retaliation against their subsidy

measures. This is perhaps one important reason for the Subsidies Code's failure to attract many developing country signatories. 12/

C. Some Conceptual and Technical Problems with the GATT Rules

One of the main objectives of the GATT is to foster free trade by eliminating distortionary elements that could undermine world trade and prosperity. The Subsidies Code establishes rules in an attempt to protect the trading interests of contracting parties against the use of subsidies by other countries and to provide mechanisms for settling disputes between governments. The Code is also aimed at preventing abuse of countervailing measures that could impede international trade unjustifiably. However, it suffers from numerous conceptual as well as technical problems. A few notable features will be briefly discussed below, particularly from the viewpoints of developing countries, including definitional problems, discriminatory aspects, and some procedural problems with the Code.

(i) Definitional Problem

One of the most serious problems of the Code is its failure to provide an economically meaningful definition of a subsidy in conformity with the spirit of the GATT. Ideally, one may wish to define subsidies based on their potential effects on production costs or demand conditions for a product or an industry--on whether or not they distort the pattern of trade. Those that tend to alter a situation from that which could be obtained under free trade would, therefore, be rejected and regulated. This approach may not be

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12/ As of June 1, 1986, the developing countries which had signed the Code included Brazil, Chile, Egypt, Hong Kong, India, Indonesia, Israel, Korea, Pakistan, the Philippines, Portugal, Turkey, and Uruguay. In addition, Yugoslavia has signed, but with acceptance pending. See USTR (1986, p. 89).

feasible, however, because it requires a consistent evaluation of the potential effects of subsidies. The Code circumvents this difficulty by establishing a negative list of export subsidies and a positive list of domestic subsidies, condemning the former more harshly than the latter. Moreover, the Code virtually bans any subsidy measures that promote exports, regardless of their potential effects on the efficiency of resource allocation and world economic welfare. One could, therefore, characterize the Code as "policy-oriented" rather than "consequence-oriented": export expansion is implicitly viewed as a gain, and import increase as a loss for a nation (i.e., a mercantilistic view).

In fact, in terms of efficiency, taxes on imports and taxes on exports have similar distortionary effects by causing the rate of domestic transformation between exports and imports to deviate from that of the rest of the world, as shown by Lerner (1936) long ago. Thus, in the presence of import restrictions, subsidizing exports could, under certain circumstances, functionally be equivalent to merely removing some undesired effects of import restrictions, though it certainly constitutes an inefficient second best policy to eliminating the import controls themselves. This is because only a uniform, across-the-board subsidy to exports combined with an equal, across-the-board tax on imports is equivalent to a devaluation of the currency by the same rate, but in practice, import controls tend to be applied discriminatorily with respect to different industries. Since developing countries are often plagued by complicated incentive systems with import as well as exchange rate controls, the lack of economically meaningful and comprehensive definitions of subsidies in the Code is particularly significant. That is, it tends to limit the freedom of developing countries

to use subsidies as temporary second best measures aimed at improving the efficiency of resource allocation even for a transitional period.

In defining subsidies through illustrative examples as given in the Code, two problems arise. The first is the need to clarify what constitutes subsidies in the spectrum of government expenditures from direct grants to firms to publicly-supported training programs of labor. The other problem is where to draw the line between export and domestic subsidies, even if one is successful in identifying subsidies among the various types of government expenditures. In fact, there are no domestic subsidies that do not affect the pattern of trade through their indirect effects on relative prices, production costs, and their effects on the distribution of income. Although the Code attempts to clarify these questions, there remains much lee-way that could lead to various interpretations.

(ii) Discriminatory Aspects

As seen, the Code makes important distinctions between export and domestic subsidies, between developed and developing countries, and between primary and nonprimary products, insofar as the rights and obligations of contracting parties are concerned. But while distinctions made between types of subsidies and between developed and developing countries can be spurious, the distinction made between types of products can be real. This is because domestic subsidies and subsidies in general applied by developing countries, despite the preferential treatment granted them in the Code, can still be countervailed if they cause material injury to the interest of other contracting parties. By contrast, subsidies on primary products--even for export promotion by AICs--are immune from countervailing actions so long as they do not result in a contracting party "having more than an equitable share

of world trade in that product" compared to such trade "during a previous representative period" (GATT Article XVI:3). 13/

This permissive attitude of GATT rules toward primary products, however, reflects political expediency rather than economic reasoning, reflecting political influence of some AICs, notably the US, prevailing at the time the GATT was chartered. 14/ Since then, many AICs--such as the nations of the European Communities (EC) and Japan--quickly followed the US pattern and it is now a common practice for them to channel excess agricultural production to the world market with export subsidies. Such a practice has significantly distorted the pattern of agricultural trade flows, particularly in recent years, contributing to price instability and resulting in a world welfare loss. 15/ For instance, the EC, which used to be a net importer of grain, sugar, dairy products, and beef as recently as 1974, became a net exporter of these products by the early 1980s under the stimulus of the price support system. 16/

It is a paradox that such welfare-reducing subsidies to agricultural exports by AICs are to a large extent permitted, while potentially welfare-

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13/ The meaning of "a previous representative period" was further elaborated in Code Article 10:2 to imply "the three most recent calender years in which normal market conditions existed."

14/ It is said that the US Department of Agriculture insisted on an exception to the rule, allowing it to continue to support domestic agricultural prices at higher than world market levels, thus necessitating export subsidies for the surplus product to be exported. See Dam (1970, p. 14) for details.

15/ See Zietz and Valdes (1986) and Nogues (1984) for the costs of agricultural protection to developing countries.

16/ See Patterson (1983, p. 229).

improving subsidy measures to manufacturing exports by some developing countries, particularly those in transition from an inward to an outward-oriented strategy, are forbidden under the current GATT rules.

(iii) Material Injury and Some Procedural Problems

In principle, countervailing duty cases can be settled by either bilateral or multilateral tracks. But signatories of the Code are implicitly required to follow the procedures suggested by the Code even if a bilateral track is chosen, since their national laws concerning countervailing duties had to be in conformity with the Code when they were accepted as a signatory to the Code. In any case, the Code requires petitioning parties to first try to reach a mutually agreeable solution with exporting signatories before resorting to countervailing duty proceedings. 17/

One of the most significant features of the Code is the requirement of an injury test as a prerequisite for imposing any countervailing duties on subsidized imports. The meaning of injury, however, is nowhere clearly defined in the Code. Instead, the Code simply lists a number of factors that should be taken into account when determining an injury to the interest of domestic industries. These include such factors as: actual and potential decline in output sales, market share, profits, productivity, utilization of capacity, prices, employment and wages and, in the case of agriculture,

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17/ See Code Articles 3 and 17. The EC seems to have heavily relied on this approach in dealing with subsidized imports by accepting pledges to renounce subsidy elements or remove injury by imposing voluntary export limits, and price assurances sufficient to relieve the injury. In contrast, the US seems to have relied more on the countervailing actions than such a pre-settlement approach. See UNCTAD (1984, p. 23).

whether there has been an increased burden on government support programs. 18/ The Code further requires importing countries to demonstrate that the subsidized imports are, through the effects of the subsidy, causing injury to their domestic industries. 19/

Two crucially important questions need to be answered when the GATT rules are to be applied in a practical situation. The first has to do with how much "causality" between subsidies and injury would establish countervailable injury. The other is concerned with how much "injury" would be required for triggering countervailing actions. The Subsidies Code provides little guidance to answering these questions. Nor is there any case law accumulated under the multilateral track to shed light on such questions. Although the Code provides a multilateral track to resolve disputes on the subsidy matter, this channel has rarely been used in practice. There are probably two reasons for this: first, petitioning parties may be reluctant to bring a case under multilateral scrutiny since they must show a causal link between subsidies and injury; and second, if experience is indicative of anything, the process is notoriously slow and ineffective in arriving at any conclusions. 20/

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18/ See Code Article 6:3.

19/ This appears to be a somewhat loose requirement in the sense that subsidized imports need not be a "principal" or "substantial" cause of injury. Rather they only need to be a cause of injury to domestic industries. See Code Article 6:4.

20/ See, for example, the GATT (1983, 1984) for the US complaints of 1982 against the EC subsidies on the export of wheat flour, and complaints of 1983 against the subsidies on poultry by Brazil and the EC. The deliberations for both were still going on as of November 1984.

It is therefore abundantly clear that the amount of injury or causality between subsidies and injury that would warrant countervailing actions can only be inferred from the experiences of individual countries, which differ across countries, from industry to industry, or over time for a country or an industry. Though ascertaining such questions may be a challenging empirical task, it is beyond the scope of this paper. But it is worth making a brief note on the meaning of, and practice of determining, injury in the US--by far the most active nation in applying countervailing duties.

The US Trade Agreement Act of 1979, which was enacted to implement the results of the Tokyo Round of the GATT Agreement, defines material injury as "harm which is not inconsequential, immaterial or unimportant" (Section 771 (7)(A)). In the US, the International Trade Commission (ITC) is given authority to establish the existence of injury on a case-by-case basis. The Department of Commerce is in charge of determining the existence of, as well as the amount of subsidies conferred by exporting nations, and the ITC evaluates the existence of material injury by investigating underlying factors which are very similar to those suggested in the Subsidies Code. The US practice of countervailing actions differs in one major respect from that of GATT rules or that of other AICs: it provides an injury test only to products of the countries which have either signed the Subsidies Code or entered into a bilateral agreement with the US to reduce or eliminate their export subsidies to acceptable levels. This seems to be in conflict with the principle of Most-Favored-Nation (MFN) treatment to member countries accorded by GATT Article I. But the US adheres to this discriminatory practice by following

the US countervailing laws 21/ under the protocol of the GATT which allows signatories to stick to their prelegislated laws if their requests were accepted when they acceded to the GATT.

By contrast national laws on countervailing duties in other AICs like the EC, Canada, Australia, and Japan closely resemble the framework of the Subsidies Code. 22/

From the foregoing review on the issue of injury test and related matters, a few points seem to warrant further comments from the perspective of developing countries. First, the lack of a comprehensive definition of material injury could be more hazardous to developing countries than to AICs because the likelihood of apparent material injury is much greater in those industries which are declining in the AICs but are growing rapidly in the developing countries. Thus, a loosely defined causal link between subsidies and injury, combined with the greater possibility that material injury would stem from shifting comparative advantage of AICs to developing countries for certain products rather than from subsidies by the developing countries, may provide an ample chance for AICs to abuse the injury test as an instrument for protectionist purposes. 23/

Second, once a satisfactory petition for countervailing duties is accepted in a country, the burden of proof as to whether factors other than subsidies may have been a major cause of injury, or whether initial findings

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21/ See Section 2(b)(2) of the US 1979 Trade Agreement Act.

22/ See Bellis (1983) and Sorsa (1985).

23/ Finger, Hall, and Nelson (1982) provide empirical evidence that the US "less than fair value" cases served, in fact, protectionist purpose.

on the amounts of subsidies were appropriately estimated, normally falls on the exporters. Such a proof requires not only a large amount of information, but also expensive legal costs which may be too burdensome for many developing countries to bear. 24/

Third and finally, the US's discriminatory application of the injury test seems to have produced an important side effect. A number of developing countries have either signed the Code or a bilateral agreement with the US to assume obligations which are substantially equivalent to obligations under the Code. Apparently, this is not so much because developing countries wanted to abide by the GATT rules, but because their export dependence on the US market might have been too high to risk countervailing duties without an injury test. Entering bilateral agreements with the US instead of signing the Code has been motivated by the desire of some developing countries to enjoy the benefits of unconditional MFN treatment without making a commitment to comply with the GATT rules. 25/

## III. The Pattern of Countervailing Actions by Major Advanced Industrial Countries

### A. Recent Trends

Table 1 presents data on the frequency of countervailing duty (CVD) cases initated by major AICs in recent years. Of the AICs, the US has been by

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24/ It is reported that the cost of a fairly routine antidumping or countervailing duty proceeding in the US easily exceeds $100,000 in US dollars. See UNCTAD (1984, p.16).

25/ As of 1983, the US entered into bilateral trade agreements with the following countries: El Salvador, Honduras, Liberia, Nepal, North Yemen, Paraguay, Venezuela, and Taiwan. See Roggensack (1984). The US also made a trade agreement with Mexico in 1985.

Table 1: Trend of Countervailing Actions By Major Advanced Industrial Countries (AICs)

(July 1980 - June 1985) (Unit : Number of Initiations)

| Major AICs | July 1980-June 1981 | July 1981-June 1982 | July 1982-June 1983 | July 1983-June 1984 | July 1984-June 1985 | July 1980-June 1985 |
|---|---|---|---|---|---|---|
| United States | 7 | 75 | 35 | 22 | 60 | 199 |
| European Communities | -- | 1 | 3 | 1 | -- | 5 |
| Australia | -- | -- | 9 | 3 | 5 | 17 |
| Canada | 3 | -- | 2 | 3 | 2 | 10 |
| Japan | -- | -- | 1 | -- | -- | 1 |
| Total | 10 | 76 | 50 | 29 | 67 | 232 |

Source: The GATT, Report of the Committee on Subsidies and Countervailing Measures, 1982, 1983, 1984, and 1985 issues.

far the undisputed leading nation in the initiation of CVD cases. The US has undertaken CVD action 199 times between July 1980 and June 1985, compared with only 33 cases in the EC, Australia, Canada, and Japan combined. This is a rather dramatic development compared with the trend in the 1960s and 1970s. For instance, there were no positive CVD cases in the US between 1959 and 1967, and only 17 positive CVD cases between 1967 and 1974. 26/ There was not a single case in which CVD was imposed by the EC or Japan until the late 1970s.

Table 2 presents the incidence of CVD action initiated by major AICs against country groups classified as AICs, developing countries, and East

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26/ See Balassa and Sharpston (1976, p. 8).

Table 2: Country-Incidence of Countervailing Actions by Major AICs

(July 1980-June 1985) (Unit: Number of Initiations)

| Exporters | Importers | | | | | |
|---|---|---|---|---|---|---|
| | US | EC | Australia | Canada | Japan | Total |
| I. Advanced Industrial Countries (AICs) a/ | 79 | 2 | 17 | 9 | -- | 107 |
| II. Developing Countries (LDCs) | 117 | 3 | -- | 1 | 1 | 122 |
| III. East European nonmarket Economies (NMEs) b/ | 3 | -- | -- | -- | -- | 3 |
| Total | 199 | 5 | 17 | 10 | 1 | 232 |

a/ Following the classification made in the World Development Report (1986) of the World Bank, AICs include all the members of OECD, except for Greece, Portugal, and Turkey which are included in LDCs.

b/ The NMEs include Czechoslovakia, East Germany, and Poland.

Source: The GATT, Report of the Committee on Subsidies and Countervailing Measures, various issues.

European Nonmarket Economies (NMEs). Of the 199 CVD actions undertaken by the US for the 1980-85 period, 117 cases were directed against developing countries, whereas only 5 cases out of the 33 cases undertaken by the EC, Australia, Canada, and Japan for the same period were directed against developing countries. The EC initiated only three CVD cases against Brazil, while Canada and Japan applied only once against Brazil and Pakistan, respectively. Australia has not yet applied a CVD against a developing country. It is clear that of the AICs, the US is the only country which has

heavily relied on countervailing measures in resolving trade disputes caused by subsidies, particularly against exports from developing countries.

Table 3 presents the trend of CVD actions undertaken by the US for the 1970-85 period. As can be seen, the US initiated a total of 11 CVD cases in the first half of the 1970s, but the number increased to 104 cases in the second half. This rose further to 171 cases during the first half of 1980s. 27/ A more important trend, is that over time, developing countries have tended to be more frequently countervailed than AICs, with a higher probability of ending up with an affirmative outcome for each CVD action. During the first half of the 1970s, only 2 out of a total of 11 CVD cases were initiated against imports from developing countries, but for the first half of the 1980s, 108 out of a total of 171 cases were initiated against developing countries. Further, 64 percent of CVD cases initiated against developing countries resulted in an affirmative outcome, whereas only 48 percent did so for the CVD cases against AICs.

The foregoing statistical review raises at least two interesting questions. The first question concerns the reasons why the US has been far more active than other AICs in applying CVDs. The second question is why CVD actions of the US have been growing much faster against imports from

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27/ The number of CVD cases in Table 3 was counted on the basis of case classification made by the US Department of Commerce. Further, there were 26 cases which were initiated before 1980, but a final determination was not made until after 1980, mostly because involved countries became signatories to the Subsidies Code and requested an injury test. The second decision based on the reopenings of these cases was not counted as a separate case in order to avoid double counting of an existing old case. Thus, the criterion of counting CVD cases in Table 3 is not necessarily the same as the one used by the GATT, and this may be the reason why the number of CVD cases in Tables 1 or 2 exceed that in Table 3 by a substantial margin.

Table 3: Trend of Countervailing Actions by the US (1970-85)

(Unit: Number of Cases)

| Year | Exporter | Number of Initiations a/ | Final Outcome | | | Average Countervailing duty rates d/ |
|---|---|---|---|---|---|---|
| | | | Affirmative b/ | Negative c/ | Pending | |
| 1970-74 | AIC | 9 | 8 | 1 | -- | na |
| | LDC | 2 | 2 | -- | -- | na |
| 1975-79 | AIC | 59 | 20 | 39 | -- | na |
| | LDC | 45 | 18 | 27 | -- | na |
| 1980 | AIC | 2 | -- | 2 | -- | -- |
| | LDC | 6 | 6 (1) | -- | -- | 8.10 |
| 1981 | AIC | 6 | 1 (1) | 5 | -- | -- |
| | LDC | 4 | 2 (1) | 2 | -- | 15.84 |
| 1982 | AIC | 30 | 19 (16) | 11 | -- | 11.46 |
| | LDC | 31 | 26 (13) | 5 | -- | 10.18 |
| 1983 | AIC | 3 | 2 | 1 | -- | 10.69 |
| | LDC | 13 | 8 (1) | 5 | -- | 10.89 |
| 1984 | AIC | 9 | 4 (1) | 5 | -- | 14.89 |
| | LDC | 30 | 18 (7) | 12 | -- | 13.29 |
| 1985 | AIC | 13 | 4 (1) | 1 | 8 | 5.72 |
| | LDC | 24 | 9 (4) | 6 | 9 | 6.10 |
| 1980-85 | AIC | 63 | 30 (19) | 25 | 8 | 10.65 |
| | LDC | 108 | 69 (27) | 30 | 9 | 10.26 |

a/ There were 26 cases initiated before 1980 (1970-79) for which new final determinations were made (mostly because involved countries become signatories of the Subsidies Code and therefore requested an injury test). The decisions used here are the original determinations prior to 1980.

b/ Cases withdrawn under an alternative arrangement are classified as affirmative and shown inside parenthesis; moreover, cases are considered affirmative even if there were negative determinations for some of the product lines.

c/ Cases withdrawn voluntarily by petitioners without any arrangements are classified as negative cases.

d/ Simple average of subsidy rates for affirmative cases.

AIC: Advanced Industrialized Countries

LDC: Developing Countries

na : not available

Sources: Trade Actions Monitoring System, the Office of US Trade Representative, September 30, 1985; Federal Register, various issues.

developing countries than from AICs. While there is no ready answer to these questions, a few plausible conjectures may be put forth, some of which are supported by casual observations of the facts, whereas others remain to be verified in future research.

As to the first question, one may first note that the US has a longer history in the legislation as well as in the practice of CVD laws than any other AIC. Ever since the first countervailing duty law of the US was implemented as part of the Tariff Act of 1890, the law has been continuously refined and in active service, although invoked only sporadically until the 1970s. 28/ In contrast, the EC established internal regulations to deal with CVD cases only in the 1960s, such that they conform to the GATT rules. 29/ Other AICs, such as Australia and Canada, have only recently begun to separate the CVD cases from the antidumping cases. Traditionally, the distinction between CVD and antidumping cases in these countries has not been made clear. This is because any government subsidies resulting in lower export than domestic prices were also subject to prosecuting under antidumping legislation.

Second, it appears that the social value attached to the free market enterprise system with less government intervention is far greater in the US than in any other AIC. In fact, perhaps with the exception of the US, AICs in general are themselves fraught with subsidy problems developed over many years

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28/ Prior to the Tariff Act of the 1930s, the US imposed CVDs only 12 times, and between 1930 and 1964 on average only once per year. See Snape (1984, pp. 30).

29/ See EC Regulation 459/68.

to assist ailing industries or to meet other social objectives. 30/ It is conceivable, therefore, that countries vulnerable to countervailing actions would be reluctant to apply those measures against others. On the other hand, a country with relatively less subsidies may be inclined to require others to exert similar discipline over their use.

Finally, the CVD cases may be viewed as a means of administered protection, although the extent to which countervailing measures have been used to provide relief from import competition is largely unknown. In general, the administered protection is implemented through a variety of channels such as the escape clause mechanism, antidumping duties, or other subtle means of import regulation. The extent to which a country relies on a specific measure may, therefore, vary from country to country. 31/ It is argued that the US is more "legal-process-oriented" in applying administered protection, inquiring, for example, into the causes of unfair trade practices, whereas other more "goal-oriented" AICs achieve similar objectives by easier and more practical means.

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30/ The degree of subsidization measured by the ratio of subsidies to GNP for some AICs is revealing in this regard. During the 1964-80 period, the ratio did not change too much from the 1964 level of 0.44 percent in the US; over the same time period, however, it rose from 0.85 to 2.34 percent in Canada, from 2.03 to 2.51 percent in France, from 1.56 to 2.32 percent in the United Kingdom, from 0.98 to 1.59 percent in West Germany, and from 0.65 to 1.32 percent in Japan. See Hufbauer and Shelton-Erb (1984, p. 3).

31/ For example, in contrast to the disproportionately frequent application of CVD measures by the US, antidumping measures have been applied by major AICs with more equal frequency: according to UNCTAD measures, between January 1980 and June 1984, 164 antidumping cases were initiated by the EC, 161 cases by Canada, 287 cases by Australia, and 196 cases by the US. This suggests a certain degree of substitutability between CVD and antidumping actions in AICs other than the US. See Sorsa (1985, p. 4).

Turning to the second question of why developing countries have been more frequently countervailed by the US than have the AICs, it should first be pointed out that since the late 1960s import competition has become more intense in AIC markets. This is partly a result of their successful implementation of multilateral tariff reductions, but largely due to increased efforts by the developing countries to promote exports using subsidies in pursuit of an outward-oriented development strategy. In particular, developing countries have been more successful in penetrating the US market than the market of any other AIC 32/, perhaps because the US is more open than other AICs.

Second, the likelihood of rapid developing country export expansion in AIC markets is much greater for industries in which comparative advantage is shifting from AICs to developing countries. Thus, apparent material injury can be much more visible in these industries. The situation became particularly acute during the 1970s due to a delay in structural adjustment in the AICs, coupled with rising unemployment caused by changes in the relative price of oil, and the concommitant worldwide recession.

Finally, as mentioned earlier, CVD petitions can be more successful against products from developing countries than from AICs, since the injury test is not required for imports from nonsignatories to the Subsidies Code, and since many developing countries have yet to sign the Code. Out of the 108 CVD cases initiated by the US against developing countries for the 1980-85

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32/ Despite increasing barriers to trade, the share of imports from the developing countries in the consumption of manufactured goods to the US rose from 1.1 to 3.0 percent during the 1973-83 period, whereas it rose from 0.3 to 2.1 percent in the EC, and from 0.7 to 1.0 percent in Japan, for the same period. See Balassa and Michalopoulos (1985, p. 16).

period, only 43 required the injury test, whereas all CVD cases against AICs were subject to it. This is reflected in the relatively higher ratio of affirmative outcomes to CVD cases initiated for developing countries than for AICs.

In the following section, the pattern of country and industry-incidence of the recent US CVD actions will be examined more closely, and the quantitative importance of the duty structure and import coverage will be investigated.

B. Country and Industry-Incidence of US Countervailing Duties

There are a few reasons why the pattern of the US CVDs deserves further analysis: (i) the US provides the largest market for developing country exports; (ii) the US is the most active nation among AICs in applying CVDs against subsidized imports; and (iii) the process of CVD action is fairly transparent following the guidelines provided by US domestic laws.

Table 4 provides basic statistics--prepared from actual CVD cases--for the country-incidence of CVD actions undertaken by the US for the 1980-85 period. A few interesting features may be noted from the Table. First, all trade data on US CVD actions also confirm the previous finding that the incidence falls more heavily on developing countries than on AICs. As seen in the last column of Table 4, 2.5 percent of the developing countries' total exports to the US were subject to CVD actions in force as of 1985, versus only 1.4 percent for AIC exports. Second, surprisingly enough, almost all major OECD countries have frequently been countervailed, most notably France, Italy, Spain, and Canada, suggesting that subsidies are not confined only to developing countries. Furthermore, the extent of subsidy rates differs little, at least on average, between developing countries and AICs: the

Table 4: Country-Incidence of US Countervailing Actions (January 1980-December 1985)

| Exporter | Number of initiations a/ | Final Outcome | | | Average countervailing duty rates d/ | Total US imports e/ | Imports e/ under CVD action f/ | Imports under CVD actions in force as a percentage of total US imports |
|---|---|---|---|---|---|---|---|---|
| | | Affirmative b/ | Negative c/ | Pending | | | | |
| I. AICs: | | | | | | | | |
| Australia | 2 | -- | 2 | -- | -- | 2,578 | -- | -- |
| Austria | 2 | 1 | -- | 1 | 2.27 | 713 | 80 | 11.3 |
| Belgium | 3 | 2 (2) | 1 | -- | -- | 3,122 | 140 | 4.5 |
| Canada | 7 | 2 (1) | 3 | 2 | na | 66,342 | 592 | 0.9 |
| Denmark | -- | -- | -- | -- | -- | 1,417 | -- | -- |
| EC | 2 | 1 (1) | 1 | -- | -- | na | na | -- |
| Finland | -- | -- | -- | -- | -- | 786 | -- | -- |
| France | 12 | 5 (4) | 6 | 1 | 3.6 | 7,945 | 506 | 6.4 |
| Germany,FRG | 4 | 3 (3) | -- | 1 | -- | 16,950 | 535 | 3.2 |
| Iceland | -- | -- | -- | -- | -- | 207 | -- | -- |
| Ireland | -- | -- | -- | -- | -- | 832 | -- | -- |
| Italy | 6 | 3 (2) | 3 | 2 | 1.37 | 7,884 | 529 | 6.7 |
| Japan | 1 | -- | 1 | -- | -- | 56,596 | -- | -- |
| Luxembourg | 2 | 2 (2) | -- | -- | -- | na | -- | -- |
| Netherlands | 2 | 1 (1) | 1 | -- | -- | 4,053 | 75 | 1.8 |
| New Zealand | 6 | 2 | 3 | 1 | 9.17 | 788 | 12 | 1.5 |
| Norway | -- | -- | -- | -- | -- | 1,907 | -- | -- |
| Spain | 8 | 4 (1) | 4 | -- | 17.12 | 2,369 | 53 | 2.2 |
| Sweden | 1 | 1 | -- | -- | 8.77 | 3,238 | 27 | 0.8 |
| Switzerland | -- | -- | -- | -- | -- | 3,089 | -- | -- |
| United Kingdom | 3 | 3 (2) | -- | -- | 19.31 | 14,324 | 92 | 0.6 |
| SUBTOTAL I | 61 | 30 (19) | 25 | 8 | 10.65 | 195,140 | 2,641 | 1.4 |

Table 4: (continued)

| Exporter | Number of initiations a/ | Final Outcome | | | Average countervailing duty rates d/ | Total US imports e/ | Imports e/ under CVD action f/ | Imports under CVD actions in force as a percentage of total US imports |
|---|---|---|---|---|---|---|---|---|
| | | Affirmative b/ | Negative c/ | Pending | | | | |
| II. LDCs: | | | | | | | | |
| Argentina | 5 | 5 (1) | -- | -- | 15.83 | 929 | 110 | 11.9 |
| Brazil | 16 | 11 (6) | 4 | 1 | 14.09 | 7,208 | 390 | 5.4 |
| China | 1 | -- | 1 | -- | -- | 3,040 | -- | -- |
| Colombia | 3 | 3 (3) | -- | -- | -- | 1,135 | 84 | 7.4 |
| Costa Rica | 1 | 1 (1) | -- | -- | -- | 469 | 1 | 0.2 |
| India | 4 | 2 | 1 | 1 | 15.55 | 2,546 | 30 | 1.2 |
| Indonesia | 1 | -- | 1 | -- | -- | 5,381 | -- | -- |
| Iran | 1 | -- | -- | 1 | -- | 698 | 40 | 5.8 |
| Israel | 2 | 1 | 1 | -- | 2.02 | 1,749 | 1 | -- |
| Korea | 8 | 4 (1) | 3 | 1 | 2.43 | 9,295 | 694 | 7.5 |
| Malaysia | 1 | -- | 1 | -- | -- | 2,682 | -- | -- |
| Mexico | 26 | 18 (4) | 7 | 1 | 10.83 | 17,762 | 307 | 1.7 |
| Pakistan | 1 | 1 | -- | -- | 12.67 | 242 | 5 | 1.9 |
| Panama | 1 | -- | 1 | -- | -- | 312 | -- | -- |
| Peru | 6 | 5 (1) | 1 | -- | 22.71 | 1,265 | 45 | 3.5 |
| Philippines | 1 | -- | 1 | -- | -- | 2,418 | -- | -- |
| Portugal | 2 | 1 (1) | 1 | -- | -- | 476 | 4 | 0.8 |
| Singapore | 3 | 1 (1) | 2 | -- | -- | 3,939 | 26 | 0.7 |
| South Africa | 9 | 7 (4) | 2 | -- | 9.41 | 2,482 | 107 | 4.3 |
| Sri Lanka | 1 | 1 | -- | -- | 4.03 | 270 | 141 | 52.2 |
| Taiwan | 3 | -- | 1 | 2 | -- | 14,706 | 10 | 0.1 |
| Thailand | 3 | 2 | -- | 1 | 1.51 | 1,317 | 162 | 12.3 |
| Trinidad and Tobago | 1 | 1 (1) | -- | -- | 6.74 | 1,360 | 15 | 1.1 |
| Turkey | 2 | 1 | 1 | -- | 18.81 | 402 | 1 | 0.2 |
| Uruguay | 1 | 1 | -- | -- | 2.37 | 562 | 3 | 0.6 |
| Venezuela | 5 | 3 (3) | 1 | 1 | -- | 6,475 | 54 | 0.8 |
| SUBTOTAL II | 108 | 69 (27) | 30 | 9 | 10.26 | 89,120 | 2,230 | 2.5 |

Table 4: (continued)

| Exporter | Number of initiations a/ | Final Outcome | | | Average countervailing duty rates d/ | Total US imports e/ | Imports e/ under CVD action f/ | Imports under CVD actions in force as a percentage of total US imports |
|---|---|---|---|---|---|---|---|---|
| | | Affirmative b/ | Negative c/ | Pending | | | | |
| III. NMEs: | | | | | | | | |
| Czechoslovakia | 1 | -- | 1 | -- | -- | 84 | -- | -- |
| Germany, GDR | 1 | -- | 1 | -- | -- | 149 | -- | -- |
| Poland | 1 | -- | 1 | -- | -- | 216 | -- | -- |
| USSR | 1 | -- | 1 | -- | -- | 556 | -- | -- |
| Yugoslavia | 1 | -- | -- | 1 | -- | 476 | 3 | 0.6 |
| SUBTOTAL III | 5 | -- | 4 | 1 | -- | 1,481 | 3 | 0.2 |
| TOTAL | 174 | 99 (46) | 59 | 18 | 10.54 | 285,741 | 4,874 | 1.7 |

a/ There were 26 cases initiated before 1980 (1970-79) for which new final determinations were made (mostly because involved countries became signatories and therefore requested an injury test). The decisions used here are the original determinations prior to 1980 to the Subsidies Code.

b/ Cases withdrawn under an alternative arrangement are classified affirmatives and shown inside parenthesis; moreover, cases are considered as affirmative even if there were negative determinations for some of the product lines.

c/ Cases withdrawn voluntarily by petitioners without any arrangements are classified as negative cases.

d/ Simple average of subsidy rates for all CVD. The subtotals for this column are weighted averages.

e/ All import values are for 1984 and in millions of US dollars.

f/ Imports under CVD actions include imports under affirmative decisions in force and pending cases as of the end of 1985.

AICs: Advanced Industrialized Countries
LDCs: Developing Countries
NMEs: Nonmarket Economies
na : not available

Sources: Trade Actions Monitoring System, The Office of the US Trade Representative, September 30, 1985; Federal Register, various issues.

average CVD rates are estimated at 10.6 percent for AIC exports and at 10.3 percent for the developing country exports. There is, however, wide variation in CVD rates from country to country in each group. Third, NICs are the most notable of the frequently countervailed developing countries in terms of CVD cases initiated by the US; Mexico and Brazil are far out in front, followed by South Africa and Korea. For the NICs the average CVD rate varies from 2.4 percent for Korea to 14.1 percent for Brazil. For all countries except Peru, the average CVD rate has not been greater than 20 percent.

Table 5 presents statistics for industry incidence of US CVD actions taken in the 1980-85 period. As seen from the table, CVD actions have been concentrated in only a few industries. Seventy percent of the US CVD actions were directed against steel and agricultural products from AICs and against textile, steel, and metal products from developing countries. The iron and steel industry is unique in that nearly half of the CVD actions against developing countries and AIC imports combined, were concentrated in this industry. Consequently, as of 1985, about 23 percent of the iron and steel products imported into the US were subject to CVD actions in force, followed by 5 percent for agricultural product imports.

Another interesting aspect that can be seen from Table 5 is that the subsidy rate, as reflected in the CVD rate, varies significantly across industries. While the subsidy rate conferred upon agricultural and chemical products is found to be between 2 to 4 percent of sales value, it ranges from 11 to 16 percent for textile, steel, and metal products. Despite substantial differences in interindustry subsidy rates, the difference in subsidy rates between AICs and developing countries for similar industries is remarkably

small, suggesting that subsidy schemes of individual countries tend to be industry specific rather than country specific.

A major conclusion that can be drawn from Table 5 is that US CVD actions are heavily concentrated on those industries in which comparative advantage has already been established in favor of developing countries, or is rapidly shifting from AICs to developing countries, as evidenced in the agricultural, textile, iron and steel 33/, and metal products industries. It should be noted that some of these industries, particularly agriculture and iron and steel, have long been fraught with subsidy problems in AICs as well as in developing countries. National security considerations in food supply or income distribution arguments have been advanced for the subsidization of agriculture in many AICs, and noneconomic significance attached to the steel industry has been considerable both in AICs and developing countries, mainly because it is a major input to a wide range of industries.

Despite frequent CVD petitions made against agricultural products, the ratio of affirmative outcome is much lower than the average of all industries--only 27 percent as compared to 58 percent for all industries. This indirectly reflects the preferential treatment provided to agricultural products in the GATT rules and the difficulty of countervailing subsidized agricultural imports. On the other hand, the ratio of affirmative outcomes to cases initiated for the iron and steel industry is 73 percent, which is much higher than the average for all industries. This largely reflects the industrial policies that have centered around the iron and steel industry both

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33/ See Nam (1985) for details of shifting comparative advantage in the steel industry.

Table 5: Industry-Incidence of US Countervailing Actions (January 1980-December 1985)

| | Number of Initiations a/ | | | Affirmative b/ | | | Pending | | | Average CVD Rates c/ | | | Percentage of affirmatives to number of initiations | | | Imports under CVD actions in force as a percentage of total US imports d/ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | AICs | LDCs | All | AICs | LDCs | All | AICs | LDCs | All | AICs | LDCs | All | AICs | LDCs | All | (In 1984 trade values) |
| I. Agricultural Products | 14 | 8 | 22 | 3 (1) | 3 (1) | 6 (2) | 4 | 2 | 6 | na | 2.40 | 2.40 | 21 | 38 | 27 | 5.0 |
| II. Manufactured Products | 49 | 95 | 144 | 27 (18) | 62 (24) | 89 (41) | 4 | 7 | 11 | 10.65 | 10.27 | 10.57 | 55 | 65 | 62 | 1.6 |
| Ta z/xtiles | -- | 20 | 20 | -- | 12 (4) | 12 (4) | -- | -- | -- | -- | 13.94 | 13.94 | -- | 60 | 60 | 2.8 |
| 2. Footwear | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| 3. Iron & Steel | 31 | 42 | 73 | 23 (17) | 30 (12) | 53 (28) | 3 | 3 | 6 | 13.62 | 11.29 | 11.90 | 74 | 71 | 73 | 23.0 |
| 4. Ceramic Prod. | -- | 4 | 4 | -- | 4 | 4 | -- | -- | -- | -- | 6.64 | 6.64 | -- | 100 | 100 | 3.1 |
| 5. Metal Prod. | 3 | 13 | 16 | -- | 6 (4) | 6 (4) | 1 | 4 | 5 | -- | 15.55 | 15.55 | -- | 46 | 38 | 0.9 |
| 6. Machinery & Mechanical | 2 | 2 | 4 | 1 | 2 (1) | 3 (1) | -- | -- | -- | 1.37 | 8.06 | 4.71 | 50 | 100 | 75 | 0.8 |
| 7. Electrical Machinery | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| 8. Transport Equipment | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| 9. Chemicals | 4 | 7 | 11 | 2 (1) | 4 (1) | 6 (2) | -- | -- | -- | 3.60 | 2.79 | 3.00 | 50 | 57 | 55 | 1.0 |
| 10. Miscellaneous | 9 | 7 | 16 | 1 | 4 (2) | 5 (2) | -- | -- | -- | 9.17 | 6.68 | 7.30 | 11 | 57 | 31 | 0.1 |
| III. Others | -- | 5 | 5 | -- | 4 (2) | 4 (2) | -- | -- | -- | -- | 17.95 | -- | -- | 80 | 80 | 0.1 |
| TOTAL | 63 | 108 | 171 | 30 (19) | 69 (27) | 99 (45) | 8 | 9 | 17 | 10.65 | 10.26 | 10.54 | 48 | 64 | 58 | 1.7 |

a/ There were 26 cases initiated before 1980 (1970-79) for which new final determinations were made (mostly because involved countries became signatories to the Subsidies Code and therefore requested an injury test). The decisions used here are the original determinations prior to 1980.

b/ Cases withdrawn under an alternative arrangement are classified as affirmatives and shown inside parenthesis; moreover, cases are considered affirmative even if there were negative determinations for some of the product lines.

c/ Simple average of subsidy rates for all CVD imposed affirmative cases.

d/ CVD actions in force include imports under affirmative decisions and pending cases as of the end of 1985.

The following are the annotated tariff schedules of the United States used in the above classification:

| | |
|---|---|
| I. Agricultural Products | 10001-19325 |
| II. Manufactured Products | 20003-47462, 48005-49520, 53101-54805, 60502-79900 |
| 1. Textiles | 30010-39060 |
| 2. Footwear | 70005-70095 |
| 3. Iron & Steel | 60600-61093 |
| 4. Ceramic Prod. | 53101-54805 |
| 5. Metal Prod. | 64005-65810 |
| 6. Machinery & Mechanical | 66010-681442 |
| 7. Electrical Machinery | 68205-68847 |
| 8. Transport Equipment | 69202-69260 |
| 9. Chemicals | 40102-47672, 48005-49520 |
| 10. Miscellaneous | The remaining that is not included in 1 through 9. |
| III. Others | (10001-87045) minus (I+II) |

Sources: Trade Actions Monitoring System, The Office of the US Trade Representative, September 30, 1985; Federal Register, various issues.

in the developing countries as well as in the AICs, a few of which are worth mentioning. First, the strategic importance attached to the steel industry, coupled with growing evidence of shifting comparative advantage to NICs in steel-intensive industries such as shipbuilding, metal fabrication and even automobile, has prompted many developing countries to establish national steel industries through various industrial incentives or as state-owned firms even before their factor endowments would have warranted a competitive advantage in its production. 34/

Second, despite deteriorating international competitiveness, many AICs attempted to protect their steel industries, partly to avoid massive bankruptcies and labor dislocation, and partly in the expectation that the world steel market would turn around in the near future. The favored means of government intervention in the EC combined direct subsidies, nationalization, and trade policies 35/, while the US relied heavily on trade policies to protect the domestic steel industry. As is well known, a "reference price" system such as the trigger price mechanism (TPM) or the basic price system (BPS) was adopted by the US and the EC, respectively, in the late 1970s to monitor imports and to determine if there was any evidence of dumping or subsidies.

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34/ An estimate shows that in 16 major developing countries about 90 percent of steel producing capacities were publicly controlled as of 1975. See UNIDO (1978, p. 124).

35/ In 1967, the United Kingdom nationalized its steel industry for the last time, and during the 1970s a large segment of the steel industry became publically owned or controlled in Italy, France, and Belgium. See Nam (1985, p. 23). An estimate by Mutti (1984, p. 874) indicates further that government subsidies amounted to 25 percent of steel production cost in the UK, 13 percent in Italy, 8 percent in Belgium, and 22 percent in France, as of 1980.

Third, as import penetration continued in the US despite the TPM safety jacket, steel industry operations fell to below 50 percent of capacity in 1982, precipitating an explosion of antidumping and CVD suits against imports from the EC and some NICs. In 1982 alone, there were 33 CVD petitions against steel products. This was not enough, however, to stem the tide of imports. As the ratio of imports to domestic consumption surpassed 25 percent in 1984, the US Government sought bilateral voluntary export restraint (VER) agreements from many exporters.

All factors considered, it appears that escalated CVD actions against steel products is the result of heavy developing country government intervention to promote national steel industries through subsidy measures, and excessive efforts by some AICs to protect declining domestic industries through subsidy measures and import restrictions.

C. Types of Subsidy Measures and Countervailing Duties

As mentioned earlier, the Subsidies Code fails to provide a general definition of export or domestic subsidies that should be banned or subject to retaliation. It does, however, take a fairly tolerant view of domestic subsidies while tending to be very strict about export subsidies, providing a negative list of illustrative examples of export subsidies and a positive list of objectives for which domestic subsidies may be used. However, the US countervailing duty law appears to be equally restrictive on domestic types of subsidies, forbidding any domestic subsidies "if provided or required by government action to a specific enterprise or industry, or groups of enterprises or industries...." 36/ irrespective of their objectives.

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36/ See Section 771(5)(B) of the US Trade Agreement Act of 1979.

Countervailing action is the result of interaction between the willingness of exporting countries to provide subsidies to their industries and the demand in importing countries for protection of domestic industries against subsidized imports. The major means of providing export or domestic subsidies and the extent of the subsidies by investigating CVD cases with positive outcomes for selected NICs most frequently countervailed by the US in the 1980-85 period are examined below.

Table 6 presents information regarding the types of subsidies, average subsidy rates, and channels used. The raw data were obtained from actual cases of US CVDs imposed on Mexican, Brazilian, South African, and Korean imports from 1980 to 1985. Subsidies were first classified into export or domestic types, and further by fiscal, monetary, or other channels, and then average subsidy rates were computed for each of the cases. A few interesting features are noteworthy. It appears that industry-specific domestic subsidies have been widely applied in all countries, except perhaps for South Africa. In the case of Mexico and Korea in particular, domestic subsidies have been more than, or almost as important as, export subsidies in provoking CVD actions. Export subsidies are provided mostly through preferential loans at below-market rates or direct tax exemption or reduction, whereas domestic subsidies are provided through much more diverse channels. These include direct tax exemption or reduction, accelerated depreciation allowance, duty exemption on imported capital goods, preferential loans or credit guarantees, preferential pricing of public utilities, and government equity participation on terms inconsistent with commercial considerations. The average export subsidy rate per CVD case varies from 1.32 percent of value added in Korea to 9.82 percent in Brazil, while the average domestic subsidy

Table 6: Types of Subsidy Measures Countervailed by the US in Selected Countries with Countervailing Duties Imposed

(Unit: Frequency of Types of Subsidies a/ and Average Subsidy Rates in Parenthesis) b/

| Types of Subsidies | Mexico (14 Cases) | | Brazil (5 Cases) | | South Africa (3 Cases) | | Korea (3 Cases) | |
|---|---|---|---|---|---|---|---|---|
| | Export | Domestic | Export | Domestic | Export | Domestic | Export | Domestic |
| I. Fiscal Measures | | | | | | | | |
| 1. Direct tax exemption or reduction | 3 (5%) | 10 (1.30%) | 8 (2.89%) | -- | 1 (0.16%) | -- | 3 (0.50%) | 1 (0.33%) |
| 2. Accelerated depreciation of capital stocks | -- | 1 (0.22%) | -- | -- | -- | -- | -- | 1 (2.41%) |
| 3. Duty exemption on imported capital goods | -- | 1 (0.07%) | -- | 1 (.35%) | -- | -- | -- | 3 (0.04%) |
| 4. Direct grant | -- | -- | -- | -- | -- | 3 (0.35%) | -- | -- |
| Subtotal I | 3 (5%) | 12 (1.11%) | 8 (2.89%) | 1 (.35%) | 1 (0.16%) | 3 (0.35%) | 3 (0.05%) | 5 (0.57%) |
| II. Financial Measures | | | | | | | | |
| 1. Short & long-term preferential loans | 13 (3.02%) | 13 (0.82%) | 8 (3.24%) | 6 (0.34%) | -- | -- | 3 (0.81%) | -- |
| 2. Credit guarantee | -- | 1 (0.20%) | -- | 1 (0.31%) | 3 (1.40%) | -- | -- | -- |
| Subtotal II | 13 (3.02%) | 14 (0.77%) | 8 (3.24%) | 7 (0.34%) | 3 (1.40%) | -- | 3 (0.81%) | -- |
| III. Other Measures | | | | | | | | |
| 1. Preferential pricing of public utilities or upstream-industry production | -- | 2 (0.78%) | -- | -- | 6 (3.88%) | -- | -- | 2 (0.05%) |
| 2. Equity Participation | -- | 1 (40.49%) | -- | 1 (16.20%) | -- | -- | -- | 1 (0.71%) |
| 3. Unclassifiable | 2 (0.24%) | -- | -- | -- | -- | -- | -- | -- |
| Subtotal III | 2 (0.24%) | 3 (14.01%) | -- | 1 (16.20%) | 6 (3.88%) | -- | -- | 3 (0.27%) |
| Total | 18 (3.04%) | 29 (2.28%) | 16 (3.07) | 9 (2.10%) | 10 (2.76%) | 3 (0.35%) | 6 (0.66%) | 8 (0.46%) |
| Average per CVD case | 1.3 (3.91%) | 2.1 (4.72%) | 3.2 (9.82%) | 1.8 (3.78%) | 3.3 (9.20%) | 1 (0.35%) | 2 (1.32%) | 2.7 (1.23%) |

a/ The counting of frequency was based on cases for which countervailing duties were imposed for cases initiated during the 1980-85 period. There were 14 cases for Mexico, 5 cases for Brazil, 3 cases for South Africa, and 3 cases for Korea.

b/ When a single countervailing duty case involves multiproducts or multifirms, for each subsidy measure an average subsidy rate was obtained by averaging the subsidy rates over the products or firms.

Sources: Trade Action Monitoring System, The Office of the US Trade Representative, September 30, 1985; Federal Register, various issues.

rate ranges from 0.35 percent in South Africa to 4.72 percent in Mexico. The average total subsidy rate per CVD case as reflected in the CVD rates ranges from 2.55 percent in Korea to 13.60 percent in Brazil.

The implications of these findings are quite informative to many developing countries. First, export promotion policies through subsidy measures should no longer be viewed as a viable option in implementing an outward-oriented development strategy unless the current GATT rules change. Any export subsidies, regardless of whether they are industry-specific or industry-neutral, have been countervailed. Of course, there was a time when export subsidies were successfully implemented without provoking retaliation, as we have seen in the case of Korea during the 1960s and early 1970s. But the situation changed significantly as trade friction began to intensify, partly as a result of multilateral tariff reductions, but more significantly due to increased efforts to promote exports using subsidies by developing countries, increasing overvaluation of the dollar, delay in structural adjustment in the AICs, and the worldwide recession in general. Partly in response to this change, but primarily to rationalize domestic incentive systems, export subsidy measures had all but been removed in Korea by the early 1980s, as the export-subsidy cum import-barrier scheme was successfully replaced by the import-liberalization cum currency-devaluation scheme. 37/ Nonetheless, some countries, such as Mexico and Brazil, are still hanging on to the export-subsidy cum import-barrier scheme, putting their most efficient export industries under the increasing threat of retaliation, not to mention bearing the social costs associated with maintaining this second best policy itself.

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37/ See Nam (1986).

Second, the extent to which domestic subsidies have been unveiled and countervailed by the US is indeed alarming to developing countries in two specific contexts. One is that the concept of domestic subsidies remains one of the most loosely defined areas in the GATT rules or in national laws. Yet, domestic subsidies are becoming a major source of countervailing actions, raising the important question of what sorts of government expenditures are to be viewed as domestic subsidies and what types of domestic subsidies are to be banned. Certainly, this is an issue to be brought into focus in a new round of MTN. The other is that serious consideration needs to be given to reforming the domestic industrial incentive system in many developing countries where industrial incentives are more frequently industry-specific rather than directed to compensating for externalities. Traditionally, subsidies can be justified when used to correct economic distortions that arise from externalities and market imperfections. Market failures of this sort are often claimed to occur in areas such as technology development, manpower training, and information gathering or dissemination. Thus, unless a certain industry proves to produce more externalities than others, industrial incentives should be provided through intervention in such functional areas as mentioned above rather than through industry-specific measures. Fortunately, subsidies in functional areas as such have not been subject to retaliation unless directed at specific industries.

Third and finally, it appears that the extent of export subsidies in the four countries reviewed in Table 6 falls well within the margin of fluctuation in real exchange rates in these countries. While the average export subsidy rates are estimated at below 4 percent of export value for Mexico and Korea, and at below 10 percent for South Africa and Brazil, the

coefficient of variation in real exchange rates is estimated at 14.3 percent for Mexico, 9.9 percent for Korea, 10.3 percent for South Africa, and 18.1 percent for Brazil for the 1965-84 period. 38/ This demonstrates clearly how the management of exchange rates has been much more important than export subsidies in these countries in terms of potential effects on export performance.

## IV. Conclusions and Policy Implications for Developing Countries

In recent years, countervailing action by some AICs, most notably the US, has significantly increased, especially against manufactured exports from developing countries. This paper has reviewed the GATT rules on subsidies in trade and has examined the quantitative importance and pattern of countervailing actions undertaken by major AICs. The purpose of the study is to derive some policy implications for those developing countries contemplating turning to an outward-oriented development strategy or entering a new round of MTN. The major conclusions and policy implications which emerged from the study are summarized below.

The first, and perhaps most important conclusion is that an export-subsidies cum import-barriers scheme--a policy option so successfully implemented in developing countries such as Korea during its early period of transition from inward to outward-oriented development policies--no longer appears to be replicable in other developing countries. Such a policy was once widely adopted by developing countries as a second best alternative to an import-liberalization cum currency-devaluation scheme, mainly to circumvent

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38/ See Edwards (1985, p. 33).

domestic difficulties associated with the latter. But such a scheme has increasingly provoked retaliation by major AICs, particularly the US, which provides the largest market for developing country manufactured goods exports. Thus, unless the GATT rules change to admit the second best policy option, developing countries in general are forced to adopt the first best approach from the start in implementing an outward-oriented development strategy--that is an import-liberalization cum currency-devaluation scheme. This of course does not rule out the second best approach as an option to countries willing to risk retaliation or not likely to provoke it due to their small market share or diversity of their exports.

While adopting the first best approach is clearly to the greater benefit of developing countries, it may not be a politically feasible option for many developing countries for obvious reasons. Further, the current GATT rules permitting developing countries to adopt any import barrier while strictly banning any export subsidy, risk helping to perpetuate an inward-oriented strategy in many developing countries. Modifications of the GATT rules permitting the use of export subsidies, even in limited scope, are therefore desirable. For instance, export subsidies could be exempt from retaliation when a developing country enters into a commitment to eliminate export subsidies within a prescribed import liberalization schedule. 39/ Or, export subsidies could be exempt from retaliation when applied at a uniform rate to all exports and to the extent that they do not result in a significant

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39/ This recommendation was discussed by Hufbauer and Shelton-Erb (1984) and Snape (1984), but they had doubts about its practicability.

balance of payments surplus. Or, the permissible export subsidy rate could be related to the import duty rate. These modifications could be the subject of negotiation in the upcoming MTN.

The second conclusion is that the issue of domestic subsidies deserves special attention in two respects. Most important is the lack of internationally agreed-upon rules on domestic subsidies, even as these have become an increasing source of countervailing action. Thus, while the Subsidies Code takes a tolerant view of domestic subsidies by suggesting a positive list of objectives under which domestic subsidies may be used, the US has countervailed any domestic subsidy proven to be industry-specific, irrespective of its objectives. Unless internationally accepted definitions of permissible and nonpermissible domestic subsidies are clearly established within the GATT rules, national economic policymakers face an uncertain environment and may resort to an escalation of retaliation. Developing countries should also seriously consider reforming domestic industrial incentives systems from industry-specific to functional-intervention types, such as assistance to research and development or human capital accumulation. Industry-neutral functional intervention as such has not been countervailed.

The third conclusion is that countervailing measures may have been abused for protectionist purposes by providing troubled industries with temporary import relief, particularly against imports from developing countries. This view is supported by the finding that recent US countervailing actions have been heavily concentrated on a few industries in which comparative advantage has already been established in favor of developing countries, or is rapidly shifting to them from AICs. Technically,

two factors seem to have been instrumental in facilitating the abuse of countervailing measures. The first is that the concept of material injury and the requirement of a causal link between subsidies and injury are nowhere clearly defined in the GATT rules or in national laws. This blurs the distinction between subsidies and shifts in comparative advantage as a major cause of the material injury. The other factor is that, contrary to the Most Favored Nation principle of the GATT, the US applies an injury test only to subsidized imports from signatories to the Subsidies Code or from countries which have entered into a bilateral agreement with the US and assumed obligations similar to those of the Code. Consequently, the bulk of developing countries which have not signed the Code or entered into a bilateral agreement with the US have been put in a greatly disadvantageous position. 40/ Developing countries likely to provoke retaliation by the United States are well-advised to subscribe to the Subsidies Code.

The fourth conclusion is that one of the most discriminatory elements in the Subsidies Code is the preferential treatment extended to agricultural subsidies against the interests of developing countries and with negative effects on world trade and welfare. Agricultural trade remains the least disciplined area of subsidization. From the developing countries' point of view, it is ironic that welfare-reducing subsidies to agricultural exports by AICs are permitted while welfare-improving subsidies to manufacturing exports by developing countries, even for a transition period from inward to outward-oriented development policies, are strictly forbidden under the current GATT rules.

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40/ See Roggensack (1984) for the case of Mexico.

Finally, all things considered, active participation in a new round of MTN on subsidy matters appears to be much in the developing countries' interest. The current GATT rules are fraught with conceptual as well as technical problems which are clearly against the developing countries' interests, and developing countries stand to gain through a multilateral approach based on the principle of reciprocity, since much liberalization is needed for their own benefit. Indeed, in the past, developing countries have tended to liberalize their trade more or less unilaterally while AICs have done so through MTN rounds on a reciprocal basis. Certainly, developing countries as well as AICs would find it easier to dissuade internal protectionist sectors when greater access to each other's markets is ensured through multilateral negotiation.

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