

## **SPECIAL AND DIFFERENTIAL TREATMENT AND THE SUBSIDIES AGREEMENT**

### Communication from the United States

The following communication, dated 25 November 2002, has been received from the Permanent Mission of the United States.

#### Introduction

At the Fourth Ministerial in Doha, Ministers agreed to negotiations aimed at clarifying and improving disciplines under the Anti-Dumping and Subsidies Agreements, while preserving the agreements' basic concepts, principles and effectiveness, and taking into account the needs of developing and least-developed countries. As to the needs of developing countries, the United States appreciates and fully supports the integral role that special and differential treatment plays in the WTO system. The practical problems of developing and lesser developed countries addressed in Doha and in the Subsidies Committee demonstrates the United States' and other Members' commitment to addressing the legitimate economic development needs of the developing world. In light of the comments and proposals regarding special and differential treatment raised in the Rules Negotiating Group and other WTO fora, the United States believes it is important to engage in a discussion on the needs of developing and least-developed countries. The purpose of this paper is to review the current framework of the special and differential provisions of the Agreement on Subsidies and Countervailing Measures (the "Subsidies Agreement"); to outline the perspective of the United States on special and differential treatment issues; and, to propose that a substantial portion of the agenda for at least one meeting of the Rules Negotiating Group early next year be devoted to a discussion of the special and differential provisions in the Subsidies Agreement.

#### Overview of the Special and Differential Provisions of the Subsidies Agreement

The Subsidies Agreement envisions that over time, all countries will be subject to a single set of disciplines; the special and differential treatment provisions were not intended to be in effect for perpetuity. The current special and differential treatment provisions of the Subsidies Agreement are found in Article 27. Under the provisions of this article, developing and lesser-developed countries are granted exemptions from the general prohibition of subsidies that are contingent upon export performance ("export subsidies") or upon the use of domestic over imported goods ("import substitution subsidies"). Developing countries are obligated to phase out their export subsidies by the end of 2002, while lesser-developed countries may continue to provide export subsidies until they reach a designated per capita GNP and thereby graduate from Annex VII(b) of the Subsidies Agreement. Upon reaching "export competitiveness" in a particular product however, developing and lesser-developed countries must also phase out their export subsidies with respect to that particular

product. Developing countries were required to eliminate their import substitution subsidies by the end of 1999, while lesser-developed countries have until the end of 2002.

Members bringing countervailing duty actions against developing and lesser-developed countries must, under the provisions of Article 27, terminate such actions if imports are less than four per cent for any one country, unless collectively the imports of all developing and lesser-developed countries account for more than nine per cent of total imports. Special *de minimis* rules also apply to developing and lesser-developed countries facing countervailing duty investigations. Finally, Article 27 severely limits Members' abilities to bring a "serious prejudice" proceeding against developing and lesser-developed countries.

In addition to the special and differential provisions of the Subsidies Agreement, further accommodations were made for the benefit of developing and lesser-developed countries at the Fourth Ministerial in Doha in the decision on implementation. Several clarifications were made to the provisions of Annex VII(b), largely in response to practical problems raised by individual Members. First, Members who had graduated from Annex VII(b), but who subsequently fell below the graduation threshold, are now considered as re-included in Annex VII(b). Secondly, in response to concerns that inflation may inappropriately contribute to a Member graduating from Annex VII(b), the per capita GDP graduation threshold was set in terms of constant 1990 dollars (unless the threshold in current dollars is not reached). Finally, it was agreed that the per capita income level had to be exceeded for three consecutive years for graduation from Annex VII(b) to occur.

Beyond the clarifications to Annex VII(b), a special set of procedures were adopted in Doha for the extension of the transition period for export subsidy programmes. These procedures were agreed upon for certain developing country Members who were not included in Annex VII, but whose economies were small, who had very small export shares of world trade and who were in need of an extended transition period based on their individual financial, economic and development needs. The special procedures agreed to at Doha were designed – at the request of certain developing countries – to provide a stable economic environment beyond the single year extensions contemplated in the Subsidies Agreement under Article 27.4.

It is interesting to note that the Article 27 provisions of the Subsidy Agreement have been commended as a rational approach to the issue of special and differential treatment for developing and lesser-developed countries in the rules-based trading system of the WTO. In particular, the criteria for inclusion in Annex VII of the Subsidies Agreement, specifically the per capita income threshold, have been referred to as a sensible and objective basis for identification of those poorer developing countries in need of particular assistance and as an appropriate mechanism to provide a temporary respite from fulfilling the normal rules.<sup>1</sup> Further, the Subsidies Agreement recognizes that once a developing or lesser-developed country becomes export competitive in a product area, it is no longer in need of special and differential treatment. In addition to the special and differential framework originally established in the Subsidies Agreement, other pressing practical problems identified with respect to Article 27 and Annex VII(b), as discussed above, have been addressed in the decision on implementation agreed to at the Fourth Ministerial in Doha.

Despite the numerous and substantial clarifications made to Annex VII(b) of the Subsidies Agreement and the special extension procedures for export subsidies, additional special and differential provisions have now been proposed in the Rules Negotiating Group and other WTO fora. These include, *inter alia*, allowing permanent exemption from the prohibited subsidy provisions of the Subsidies Agreement and increased protection from multilateral and national actions brought against subsidy programmes causing adverse effects. Thus, a very important and significant issue has been

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<sup>1</sup> *Trade, Development and the WTO: A Handbook*; World Bank, 2002; p. 507.

raised as to whether the existing special and differential provisions of the Subsidies Agreement, as clarified in Doha, need further refinement.

### United States' Perspective

The United States has noted in a previous submission<sup>2</sup> that there is longstanding and widespread agreement that subsidies can undermine the efficient allocation and utilization of resources, the best foundation of economic growth and development. Government attempts to create artificial advantages through subsidization distort market signals indicating where the most profitable business opportunities can be found. Such distortions can lead to chronic oversupply by inefficient producers on the one hand and the closure of otherwise efficient and competitive facilities on the other, resulting in inefficient use of resources and costly budgetary outlays. Export and import-substitution subsidies are particularly troublesome in that, not only do they impede growth and development of a domestic economy, they also have an especially direct and adverse impact on international trade. In short, subsidization distorts the efficient and fair flow of trade, thereby reducing domestic and worldwide economic growth.

In an effort to address these negative effects on both economic growth and fair trade, Members have committed over time to increasingly stringent, mutually beneficial subsidies disciplines. The Uruguay Round represented a watershed in the evolution of GATT negotiations in that Members came to fully recognize that the long-run viability of the global trading system is dependent on the direct involvement of the developing and lesser-developed countries in the trade liberalizing process. Members have accepted that full implementation of the WTO disciplines, including a single set of subsidies disciplines, by all Members is vital to the integration of economies into the international trading system. This is crucial to the establishment of a lasting framework for utilizing trade as an engine for economic development, particularly for developing and lesser-developed countries.

With these principles in mind, during the Uruguay Round, Members agreed to the goal of bringing all Members under the Subsidies Agreement's full range of disciplines within a reasonable period of time. Recognizing, however, that many adjustment measures – though sound economically – could not practically be implemented over night, Members included in the Subsidies Agreement carefully structured provisions for the progressive phasing out of prohibited subsidies according to specific timetables, as well as mechanisms for monitoring Members' success in this regard. In specific, exceptional circumstances, certain Members who struggle at the most fundamental level with the institutional changes necessary to fully implement these disciplines were allowed to deviate from the implementation timetables generally applicable to all.

Against this historical backdrop, the United States makes the following observations about special and differential treatment. Generally, we are concerned by some of the comments and proposals regarding special and differential treatment raised in the Rules Negotiating Group and in other WTO fora, such as the Committee on Trade and Development.

We do not believe that the Subsidies Agreement endorses and actively promotes indiscriminate subsidization policies as an effective, permanent economic development tool. Nor do we believe that it is necessary to expand the special and differential treatment provisions of the Subsidies Agreement to allow greater undisciplined subsidization on the part of developing and lesser-developed countries in order to stimulate these Members' industries, to promote economic growth and development, or to increase their share of world trade. Rather, we view the special and differential provisions of the Subsidies Agreement as temporary deviations from the normal

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<sup>2</sup> Basic Concepts and Principles of the Trade Remedy Rules, Communication from the United States, 17 October 2002.

disciplines necessary to promote trade liberalization and growth that should only be invoked to the extent necessary and consistent with an individual country's particular economic, financial and development needs.

The special and differential provisions are not meant to be permanent, or lead to a permanent group of second-class Members. The goal rather is to completely integrate all Members under the full disciplines of the Subsidies Agreement as soon as practical in order that all Members enjoy the same rights and responsibilities, and are able to reap all the benefits that trade liberalization under the WTO affords.

In this regard, we note that development of the special export subsidy extension procedures for small exporters, as well as the current Subsidies Committee review of requests for extensions of the export subsidy transition period, have highlighted important issues which may be equally applicable to the special and differential discussion in the subsidies area more generally. As noted above, in our view, the special and differential provisions of Article 27 were primarily designed to allow for an orderly phase-out of the most trade-distortive subsidies. In light of the elimination of these subsidies by numerous developing country Members, it is apparent that other Members also view the essence of the provisions of Article 27 as a transition mechanism. For those developing country Members that have eliminated their export and import substitution subsidies, a very persuasive argument can be made that the widespread continuance of such subsidies by other developing country Members is less than fair. Therefore, as we continue the discussion of special and differential treatment, we must all consider the ramifications of changing the rules in the middle of the game, especially for those who relied upon, and acted in accordance with, the rules as originally written.

We recognize that a theoretical case can be made for the temporary provision of subsidies to aid and promote economic development. In our view, however, the case in favor of government intervention in the form of subsidies often overstates the benefits and, more importantly, understates the unintended and detrimental consequences of export subsidies and import substitution subsidies as policy instruments for promoting economic development. Export and import substitution subsidies often do not address the underlying causes of productivity and performance problems. Instead, such subsidies simply mask or compensate for the problems and, as a result, tend to perpetuate the underlying causes.

Many economists agree that government support of human capital development, technological change, institution building and the rule of law are critical components of any economic development policy, and that such policies are generally more effective than export subsidies and import substitution subsidies at boosting productivity and performance. Accordingly, Members should focus on market-strengthening and competition-strengthening initiatives, and should rely on subsidies only where absolutely necessary and in the least trade distortive way possible.

Fundamentally, from our perspective, the substance of the WTO prohibition on export subsidies and import substitution subsidies, and the general obligation of all Members to eliminate such subsidies – an obligation at the heart of the Subsidies Agreement – must be preserved. We recognize however, that this important topic deserves further consideration and discussion. To assist our efforts in this regard, we suggest that the Secretariat survey the literature on these topics and make available to all Members the important academic work that has been done in this area. Moreover, we believe that it would be helpful for the Chairman to designate a time early next year for a focused and sustained discussion of this critically important issue.

## Conclusion

The United States appreciates and fully supports the integral role that special and differential treatment plays in the WTO system generally, as well as in the Subsidies Agreement. The special Article 27.4 extension exercise in the Subsidies Committee illustrates the United States' and other Members' commitment to utilizing the special and differential provision of the Subsidies Agreement to the fullest extent possible, as well as the flexibility of the Subsidies Agreement itself to address the practical problems and legitimate economic development needs of developing and lesser-developed countries. However, it is imperative to maintain a very clear understanding of the purpose of these provisions in the Subsidies Agreement. The United States is confident that the certainty and predictability of adhering to a rules-based system, combined with a thoughtful recourse to special and differential treatment provisions only where appropriate, are the best way to promote long-term trade liberalization and economic growth.

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