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Subsidies and Countervailing Duties in the GATT: Present Law and Future Prospects

John W. Evans*

Subsidies that affect international trade, and the countervailing duties applied to subsidized products upon importation, are receiving increasing attention in the GATT and the current Multilateral Trade Negotiations. This heightened emphasis is in part a by-product of earlier progress in the reduction of tariffs and other trade barriers in multilateral negotiations. The relative importance of existing subsidies has increased, and in some cases governments have probably been led to adopt subsidies as a means of restoring the competitive advantage they had sacrificed in dismantling other trade-distorting measures. As a result, the negotiating governments are reflecting a growing apprehension that competitive subsidization will generate new and acrimonious trade disputes, threatening the progress that has been made in other areas of trade relations.

The GATT rules that purport to regulate governmental behavior in the area of subsidies and countervailing duties are both incomplete and equivocal. They will not be able to defend adequately against an acceleration of trade-distorting subsidies or against the arbitrary and excessive use of countervailing duties. The present paper analyzes those rules and attempts to clarify them, where possible, and to suggest ways in which the rules can be made more consistent and more effective — if the negotiating governments are willing to sacrifice short-term advantages in favor of long-term benefits.

It is uncertain whether the governments participating in the current Multilateral Trade Negotiations in Geneva will be able to reach agreements in the reforms that are needed. The industrialized contracting parties are deeply divided in their apparent aims. Some are concerned with reducing as far as possible the categories of trade-distorting subsidies that may be employed. Others have devoted most of their efforts to the imposition of new limitations on the right of a contracting party to

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* An earlier version of this study was prepared by the author in his capacity as consultant to the Department of State. He wishes to acknowledge the support provided by the Bureau of Intelligence and Research of that Department in the preparation of that version.

(211)
take countervailing action against the subsidized exports of others. The developing countries, apparently acting in unison, have concentrated their efforts on ensuring that no restraints on the use either of subsidies or of countervailing duties will be applicable to them.

In the following discussion of possible reform of the GATT rules, some of the proposals that have been made in the current negotiations will be referred to by way of illustration. However, in light of the inevitable interval between the preparation of this manuscript and its publication, no effort will be made to present a detailed or balanced account of the negotiations nor to predict their results. What will be attempted is to provide an analysis of the issues that may help the reader in his own appraisal of whatever new code of conduct may emerge from Geneva.

I. GATT PROVISIONS ON SUBSIDIES AND COUNTERVAILING DUTIES

One reason the GATT rules concerning subsidies are confused, and confusing, is that, instead of being parts of a single

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1. Articles of GATT are designated by their roman numeral, followed, where appropriate, by a paragraph number in Arabic. Thus XVI:4 indicates Article XVI, paragraph 4. "GATT, 7th Supp. BISD 52" indicates "GATT, Basic Instruments and Selected Documents, 7th Supplement, page 52."

The basic GATT subsidy provisions are in Article XVI, § A:

1. If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization.

The countervailing duty provisions are in Article VI, "Antidumping and Countervailing Duties." VI:3 limits the permissible amount of countervailing duties to the amount required to be offset:

3. No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of
scheme, drafted at one time, a number of them have emerged over time from:

1. The reports of GATT working parties devoted to giving greater substance to the too superficial provisions of the original GATT;\(^2\)

2. A body of case law arising out of complaints and disputes;\(^3\)

3. Additional provisions concerning export subsidies, drafted at the review session in 1955,\(^4\) together with a Declaration\(^5\) in which some, but not all, contracting parties accepted the most far-reaching of these new provisions; and

4. Other working party reports and reports of “experts” devoted to interpreting the expanded provisions.

A. The Rationale Behind the Provisions

The rationale behind the original GATT provisions governing the use of subsidies was a compound of economic doctrine and expediency. The drafters were persuaded that any subsidy that affects the pattern of international trade will tend to interfere with the optimum allocation of resources. On the other hand, they knew that most countries maintained a variety of domestic subsidies, often for desirable social purposes, the international effects of which were negligible or virtually impossible to measure. The result was the incorporation of a single paragraph on subsidies in the original GATT. This paragraph embodied a notification provision: a country granting a subsidy that acted to increase its exports or decrease its imports — in other words, that created or helped to create a competitive advantage for its products —

\[ \text{VI.6} \]

sets the standard that must be met before a countervailing duty can be levied:

6.(a) No contracting party shall levy any anti-dumping or countervailing duty on the importation of any product of the territory of another contracting party unless it determines that the effect of the dumping or subsidization, as the case may be, is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry.

Other provisions will be quoted as appropriate.

2. See notes 12 and 23 infra, and accompanying text.

3. See note 12 infra.

4. Article XVI, § B. See notes 22–25 infra, and accompanying text, Section II.C.

was obliged to notify the Contracting Parties\(^6\) of the extent and nature of the subsidization.

Political expediency was even more influential in the drafting of the countervailing duty provisions (Article VI). Most countries already had laws or regulations that permitted or required the government to take countervailing action against foreign subsidies on goods imported into their territories. In an agreement that acknowledged the right of a country to protect its domestic industries by tariffs and that provided for the reduction of such tariffs by negotiation, it was logical to reaffirm the right to counter actions by others that would nullify that protection. Nevertheless, economic doctrine again played a role, when the right to countervail was limited to cases in which the subsidized imports cause or threaten material injury to a domestic industry.\(^7\) This rule was incorporated in the same article as, and is identical to, the rule governing the use of antidumping duties. The drafters were influenced by Viner's well-known dictum in the analogous case of dumping, i.e., that imports of dumped products can reduce the aggregate real income of the importing country only if the effect is to destroy a domestic competitive industry and thus expose consumers to a subsequent increase in price.\(^8\)

### B. Summary of GATT Provisions on Subsidies and Countervailing Duties

The present section consists of a brief summary of the relevant obligations and rights under the GATT with respect to subsidies, countervailing duties and related matters.

1. Subsidies in General

   **Obligation to notify.** Each contracting party is obliged to notify the Contracting Parties of the nature and effect of any subsidy it maintains that operates to increase its exports or decrease its imports and, upon request, to consult with any other contracting party, with a view to limiting the subsidy. (XVI:1)

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6. "Contracting Parties" indicates the member states acting collectively. "Contracting parties" indicates member states acting in their individual capacities.
7. Article VI:6(a), quoted supra note 1.
2. Export Subsidies on Primary Products

In general. The contracting parties are obliged to "seek to avoid the use of subsidies on the export of primary products." (XVI:3)

Obligation to refrain from inequitable use. Where a contracting party directly or indirectly subsidizes the export of a primary product, thereby increasing its exports of that product, the export subsidy may not be applied so as to give the subsidizing party a "more than equitable share of world export trade in that product, . . . ." (XVI:3)

3. Export Subsidies on Non-Primary Products

Application. The provisions governing export subsidies on non-primary products apply only to those contracting parties that have accepted the Declaration Giving Effect to the Provisions of Article XVI:4. Seventeen nations have accepted the Declaration, including most of the major industrialized contracting parties. Notable exceptions include Australia, South Africa and Ireland.

Obligation to avoid export subsidies that result in dual pricing. The parties bound by the provision on export subsidies on non-primary products are obliged to refrain from direct or indirect subsidization that results in "the sale of such products for export at a price lower than the comparable price charged for the like product" in the domestic market. (XVI:4)

4. Countervailing Duties

Right to countervail. An importing country may impose a countervailing duty to offset a subsidy granted in an exporting country on the manufacture, production or export of the imported product, but only after a finding by the importing country that the effect is "to cause or threaten material injury to an established domestic industry or . . . to retard materially the establishment of such an industry." (VI:6(a))9 The amount of the countervailing duty may not exceed the "estimated bounty

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or subsidy” from which the imported product has benefited. (VI: 2) 10

Third country injury. The CONTRACTING PARTIES may (but are not required to) authorize an importing country to counter-\v{v}ai against a subsidy which causes or threatens injury to an industry of another contracting party whose exports compete with the subsidized exports. (VI: 6 (b)) If the CONTRACTING PARTIES determine that third country injury has occurred, they are required to allow the importing country to countervail against the subsidizing contracting party. (VI: 6 (b)) 11

Right to compensation for impairment of negotiated conces-\v{sions}. A contracting party may obtain redress if the value of a tariff concession it has negotiated is impaired by the later introduction of a domestic subsidy by the country which granted the concession. 12

5. Relationship Between Subsidies and Dumping in GATT

It is helpful to an understanding of the GATT provisions concerning subsidies to look at the relationship between them and the sometimes parallel and sometimes divergent provisions concerning dumping.

The right of an importing country to offset a subsidy by countervailing is reinforced in principle by exhortations and pro-\v{scriptions designed to affect the freedom of exporting countries to subsidize. Although injurious dumping is frowned upon (VI: 1), no restraints are imposed on the right to dump, although the right of the importing country to counter with an antidumping duty is in every respect parallel with the right to countervail.

This lack of symmetry, of course, arises from the fact that dumping, in a free enterprise system, is normally performed by

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10. The right to impose countervailing duties may be qualified by other provi-\v{sions of the GATT. See note 59 infra, and accompanying text.

11. For example, A, X and Y are all contracting parties. A imports widgets from X, which subsidizes its widget industry, and from Y, which does not. If the CONTRACTING PARTIES determine that X’s subsidization causes or threatens material injury in Y, they must allow A to countervail X’s subsidy.


The only complaint involving a subsidy which has been pursued to a decision by the CONTRACTING PARTIES turned on a somewhat different point. Chile claimed that Australia had impaired the value of a tariff the latter had granted on sodium nitrate by discontinuing a previous consumption subsidy while retaining it on competing domestic fertilizers. GATT, II BISD 192 (1952).
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private entities, whereas subsidies are granted by governments—a point that has a direct bearing on the definition of a subsidy for the purposes of the GATT.

In spite of this difference, subsidization and dumping can overlap: if a government grants a subsidy only on exports of a product, the difference in price between domestic and foreign sales that is likely to result fits the definition of dumping.

The drafters of the GATT recognized this potential overlap and avoided double jeopardy for the exporting country by providing that a contracting party may not impose both an antidumping duty and a countervailing duty to compensate for the "same situation" (VI: 5).

II. DEFINITIONS AND PROBLEMS OF INTERPRETATION

Definitional and interpretative problems abound in the GATT provisions on subsidies and countervailing duties. Nevertheless, the accepted meaning of many essential terms can be derived from GATT case law and Working Party reports. This section summarizes some of the more important established interpretations, together with problems of construction that have not yet been resolved.

A. "Subsidy"

"Subsidy" and "bounty," which is used interchangeably with "subsidy" in Article VI, are not defined in the original GATT text. This deficiency, however, is met partly by internal evidence and partly by subsequent decisions of the CONTRACTING PARTIES.

1. Cost to Government, and Private "Subsidies"

To be considered a subsidy for the purposes of the obligations of the exporting country, a measure must entail a cost to the government. This principle has been recognized in all the relevant GATT decisions. The question was considered, for example, by a panel appointed to consider the operation of the GATT notification procedures. In a report adopted by the CONTRACTING PARTIES, the panel said, with reference to a price-support system maintained by means of either import restrictions or a flexible tariff, "[i]n such a case there would be no loss to the

government, and the measure would be governed not by Article XVI but other relevant Articles of the General Agreement.\textsuperscript{14} The same panel considered the situation that would arise if a group of producers voluntarily taxed themselves in order to subsidize exports of a product; they concluded that the government would have no duty to explain that action under Article XVI unless the government itself took part in the subsidization, for example, by contributing to the subsidy.\textsuperscript{15} The Panel's conclusion has not been challenged in GATT case law, nor has any contracting party complained of the failure of another contracting party to comply with the provisions of Article XVI when a governmental subsidy was not involved. It is clear that for purposes of Article XVI a measure is not a subsidy unless it involves a cost to government.\textsuperscript{16}

2. Countervailable Subsidies

If the outer limits of the definition of "subsidy" for the purposes of Article XVI are relatively easy to define, it is less easy to establish that the same limits apply to the subsidies that are countervailable under Article VI. The problem does not arise because of the addition in that article of the word "bounty." Internal evidence in the article itself suggests that the drafters considered "subsidy" and "bounty" to be identical in meaning.

\textsuperscript{14} GATT, 12th Supp. BISD 191 (1961).
\textsuperscript{15} GATT, 12th Supp. BISD 192, ¶12 (1961). By extension, this interpretation must apply to all of the obligations in Article XVI, thus including the prohibition of certain export subsidies.
\textsuperscript{16} On the other hand, it is not clear whether a subsidizing measure involving a cost to government is necessarily a subsidy for Article XVI purposes, \textit{i.e.}, for notification procedures and so on. For example, it is unclear whether a subsidy granted by a subsidiary governmental unit triggers the Article XVI responsibilities of the government of the contracting party. If, say, the State of Maryland granted a subsidy to its crab industry, and if that subsidy would require notification had it been granted by the Federal government, then is the Federal government required to notify the \textbf{Contracting Parties}? This question has not yet arisen in the GATT case law, but its solution would lie in Article XXIV:12:

\begin{quote}
Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory. Probably the answer would depend in part on the extent to which, under its constitution, the central government had the power to prevent the regional or local government unit from granting subsidies. On the other hand, it is possible that the central government would have a duty to notify simply if it could impose a duty on its subsidiary governmental units to report local subsidies to a central agency.
\end{quote}
For, after the introduction of the twin terms, all references are to "subsidies" alone. The difficulty arises instead out of an unfortunately ambiguous statement in the report of the GATT panel cited above, which opens the way for a possible argument that in Article VI "subsidy" was intended to have a broader meaning than in Article XVI:

The GATT does not concern itself with (subsidies) by private persons acting independently of their governments except insofar as it allows importing countries to take action under other provisions of the Agreement.17

It is possible to interpret the qualifying clause as a reference to the right to countervail. In that case "subsidy" in the two articles would have different limits in the view of the expert panel. A more reasonable explanation, however, is that the panel had reference to the right of the importing country to impose an antidumping duty in those cases in which a "private subsidy" resulted in a differential price for export. It would appear that, to most of the contracting parties, this must have been the intended meaning. The report of a GATT Expert Group on Antidumping and Countervailing Duties, adopted only three days later than the panel report quoted above, recorded, in its discussion of countervailing duties, that "[a] large majority of the experts considered that it [the term subsidies] covered only subsidies granted by governments and semi-governmental bodies."18 Even on this issue, however, the experts were divided: three experts thought subsidies should include grants by private bodies.19

3. Remission of Direct Taxes

The GATT states explicitly that the exemption of an exported product from duties or taxes borne by the like product if sold domestically is not a subsidy.20 The clear inference is that the exemption of exports from a tax other than one on the product itself (such as a corporate income tax) is a subsidy.

19. Id.
20. Article VI:4 and Interpretive Note to Art. XVI, GATT, Annex I, Ad. Art. XVI.
The distinction between the exemption of exports from a product tax (a so-called indirect tax) and their exemption from a direct tax represents the export side of the controversy over "border tax adjustments," which is discussed in Section III D.

4. Differential Exchange Rates

A differential exchange rate that favors exports can be a subsidy. If approved by the IMF it can escape the substantive commitments concerning export subsidies but would still be subject to the commitment to notify.\textsuperscript{21}

B. Primary Product

The distinction between primary and non-primary products is important in regard to the substantive provisions of Section B of Article XVI. "Primary product" for the purpose of that section is "any product of farm, forest or fishery, or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade."\textsuperscript{22} At the processing end of the spectrum from raw material to prepared product, the definition is, itself, ambiguous.

C. Export Subsidy

The Contracting Parties have given considerably more attention to the definition of the term "export subsidy" than to the broader term "subsidy." It should be obvious, however, that any measure to which the narrower label applies also falls within the broader category and hence is subject to the notification obligation of Article XVI and to countervailing in accordance with Article VI if the criteria of that article are met.

The categories of subsidies affected by the Article XVI, Section B export subsidy provisions differ drastically, depending upon the nature of the products subsidized. The relatively mild and ambiguous commitment (XVI:3) with respect to primary products applies to some subsidies that hardly fit the common meaning of "export subsidy," i.e., a subsidy granted to exports \textit{per se} as opposed to domestic production. Taken literally it would apply to

\textsuperscript{22} Interpretive Note 2 to Art. XVI, Section B, GATT, Annex I, Ad. Art. XVI.
any domestic subsidy that so improved the competitive position of producers as to lead to an increase in their exports.

On the other hand, for non-primary products, the proscription in XVI:4 of export subsidies that result in an export price for the product lower than its domestic price does not even apply to all practices that are clearly export subsidies. An exporter who is the beneficiary of a direct subsidy could pass on the benefit to his foreign purchasers in the form of some other concession than a reduced price. The economic effect could be identical with that of an export subsidy that results in differential pricing, but the measure would not be subject to the prohibition in XVI:4. In effect, the drafters left an inexplicable lacuna in the restrictions on export subsidies. Although it would appear to have been their intention to treat such subsidies on manufactured goods more strictly than those on primary commodities, one category of export subsidies on the former — those that do not result in differential pricing — escapes both the prohibition in XVI:4 and the milder restraints of XVI:3.

To complicate the problem further, the size of this lacuna has been cast in doubt by the report of a GATT Working Party. In 1960 the Contracting Parties created a Working Party to consider the possibility of giving effect to the provisions of Article XVI:4, which had been drafted in 1955 but not adopted as an amendment to the GATT. This Working Party drafted a Declaration, the acceptance of which by a group of key Contracting Parties would bind each of them to apply the ban on export subsidies for non-primary products. The Declaration also included an illustrative list of governmental measures which, in the view of the governments prepared to sign the Declaration, would be considered “subsidies, in the sense of XVI:4.” The Working Party emphasized that this list was not exhaustive. The complete text of the list is not reproduced here; briefly paraphrased, it includes:

- direct subsidies to exports,
- currency retention schemes,
- remission of direct taxes “calculated in relation to exports,”
- exempting exports from indirect taxes in excess of those actually levied on the exported goods or their components,

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concessional governmental sales of raw materials to producers for export, and

- export credit and export credit guarantees at a rate that represents a loss to the government, etc.

The Working Party’s report fails to provide a clear answer to one key question: whether the Contracting Parties accepting it intended that any measure in its illustrative list is to be considered a prohibited export subsidy in all cases or only if it can also be shown to have resulted in “the sale of the product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market,” to use the language of XVI:4. In the preparations for the current Multilateral Trade Negotiation (MTN) in Geneva, some delegations seem to have adopted the latter interpretation. However, this cannot have been what the Working Party intended. If the only purpose of the illustrative list had been to give greater precision to the word “subsidy,” the list would have been many times longer; in fact, there would have been no purpose in constructing a list if it had not represented examples of measures that would be prima facie violations of XVI:4.

Whatever the Working Party’s intention, the measures in its illustrative list, in the absence of proof to the contrary, can be presumed to be such as would result in differential pricing and as such, would violate the intention of the XVI:4 prohibition.

The Contracting Parties that have agreed to accept the XVI:4 and the Working Party’s illustrative list of prohibited measures have not put an end to the practices the prohibition was designed to abolish. Many countries provide credit facilities for the production of goods for export that are not available for the same goods when sold domestically. Some mix commercial and concessional credit to exporters so that the concessional rate is concealed. Deferral of direct taxes (the United States DISC program is an example), and even forgiveness of taxes, on income earned through export operations are common practices, as are special income tax credits, tax-free reserves for potential losses,

24. I.R.C. § 992(1)(A). Since the preparation of this study, several parallel GATT panels of experts have examined the legality under Art. XVI:4 of the U.S. DISC system, and the income tax systems of France, Belgium, and the Netherlands, in each case concluding that each system was inconsistent with the obligations of Art. XVI:4. See GATT Doc. L/4422, 4423, 4424, 4425 (Nov. 2, 1976).
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and accelerated depreciation of capital goods used to produce for export.25 The common element in all these devices is that the benefits they provide are tied either to actual exportation or to the development of facilities that are of use primarily in promoting exports.

D. Price Supports

The first sentence of Article XVI is intended to specify the limits of the kinds of subsidy that must be notified to the Contracting Parties: "If any contracting party grants or maintains any subsidy, including any form of income or price support, . . . it shall notify the Contracting Parties. . . ." (XVI: 1, emphasis added) The inclusion of price supports in the general category of subsidies appears to extend the meaning of subsidy far beyond its usual limits, and in a way that could hardly have been intended by the GATT framers. On one occasion this language has been cited to support a claim that the variable levy system of the European Community constitutes a subsidy subject to all the relevant provisions of Article XVI and Article VI, because it is a system of price supports.

Although this interpretation is justified by the superficial meaning of the words cited above, it cannot stand up in the context of the rest of Article XVI, nor can it be reconciled with the logic of the GATT as a whole. Price supports may be implemented by a variety of measures, including government purchases and quota restrictions. Subsidization is often one of the implementing measures, as when a government sells at a loss stocks accumulated in order to support the domestic price. However, the measures other than subsidies that are used to support prices are dealt with elsewhere than in Article XVI.26 To subject price supports per se to the subsidy provisions would result in unnecessary duplication or outright conflict. The language "including any form of price support" can only be laid to bad drafting. This view was implicitly endorsed by the 1960 Expert Panel in the language quoted above in the discussion of the meaning of "subsidy."

25. For a detailed discussion of these practices, see Mullen, Export Promotion, 7 LAW & POL. INT'L BUS. 67 (1975); Domestic International Sales Corporations as Subsidies Under GATT: Possible Remedies, 5 CASE W. RES. J. INT'L L. 87 (1972).

26. E.g., Articles XI and XIII cover quantitative restrictions; Article XVII deals with government purchases.
E. Injury

The principal problems of interpretation presented by the material-injury clause are the meaning of the word "material" and that of "domestic industry." Does the former mean any injury that is appreciable or recognizable, or only injury that is serious or substantial? The meaning to be attached to "domestic industry" has a direct bearing on whether damage to a single company or a few companies can be injury to an industry: must it include all the companies in the country that produce goods competing with the imports concerned, or may it at the opposite extreme be limited to a single company?

An approach to an answer to these questions may be found in the report of a 1960 GATT Expert Group\(^2\) which recorded their agreement that "... anti-dumping measures should only be applied when material injury, i.e., substantial injury, is caused or threatened to be caused."\(^28\) In their interpretation of the word "industry" the group concluded "[a]s a general guiding principle judgments of material injury should be related to total national output of the like commodity concerned or a significant part thereof."\(^29\) The group added further confusion to this equivocal formulation by condemning the use of an antidumping duty "... to offset injury to a single firm in a large industry (unless that firm was an important or significant part of the industry...)."\(^30\)

As a further aid to interpretation of the material injury provision, the International Antidumping Code (Code),\(^31\) subscribed to by most of the major contracting parties to GATT, spells out in considerably greater detail the criteria to be used by the signatories in making injury determinations. Since the provisions of the International Antidumping Code are not limited to the interpretation of obligations already in the GATT, its elaboration of the injury criteria does not necessarily constitute an accepted interpretation of "injury" for the purpose of counter-

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30. Id.
vailing under existing provisions of the GATT. Nevertheless, the Code provisions may serve as a model in any future effort to give greater precision to the concept for purposes of countervailing. Briefly, the Code provides that:

1. The dumped products must be “demonstrably the principal cause” of the injury.\textsuperscript{32}

2. “Domestic injury” refers to the domestic producers as a whole of the like product or “those of them whose collective output [of the product] constitutes a major proportion” of the domestic production, \textit{except that}:

3. Under certain circumstances (briefly, where there is a genuine separation of a country into regional markets) the industries supplying each such market may be treated as separate industries.\textsuperscript{33}

\textbf{III. Meaning of “Subsidy” and “Injury” In U.S. Practice}

\textbf{A. Countervailing Duties}

The U.S. countervailing duty statute\textsuperscript{34} is framed in terms of “bounty or grant” rather than “subsidy,” but this difference of nomenclature has not resulted in conflicts between enforcement of domestic law and international obligations.

In implementing the countervailing duty statutes, the Treasury Department has acted against straight subsidies benefiting

\begin{itemize}
\item \textsuperscript{32} Code, Art. 3.
\item \textsuperscript{33} Code, Art. 4.
\item \textsuperscript{34} 19 U.S.C. § 1303(a) \textup{(Supp. V 1975)}:
\begin{enumerate}
\item (a) Levy of countervailing duties.
\begin{itemize}
\item Whenever any country, dependency, colony, province, or other political subdivision of government, person, partnership, association, cartel, or corporation, shall pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export of any article or merchandise manufactured or produced in such country, dependency, colony, province, or other political subdivision of government, then upon the importation of such article or merchandise into the United States, whether the same shall be imported directly from the country of production or otherwise, and whether such article or merchandise is imported in the same condition as when exported from the country of production or has been changed in condition by remanufacture or otherwise, there shall be levied and paid, in all such cases, in addition to any duties otherwise imposed, \textit{a duty equal to the net amount of such bounty or grant}, however the same be paid or bestowed.
\end{itemize}
\end{enumerate}
\end{itemize}
exports, excess rebates of indirect taxes, multiple exchange systems involving a preferential rate for exports, rebates of indirect taxes not on the product exported, governmental preferential credits on exports and tax deferrals on income derived from exports.\textsuperscript{35} All of these categories are export subsidies by their nature, except the first category, which could include domestic production subsidies. In fact, until recently,\textsuperscript{36} positive Treasury countervailing duty decisions have been limited to subsidies that clearly differentiated sales for export from domestic sales. Treasury actions thus seem to have limited the broad terms of the statute.\textsuperscript{37}

The U.S. countervailing duty provisions differ from the GATT provisions in other respects.

The extension of the use of countervailing duties is not only contrary to GATT decisions concerning the scope of Article VI, but is difficult to justify either on its merits or under any reasonable interpretation of the GATT. Once the criterion of "cost to government" is lost, there is no objective basis for separating subsidies from a myriad or other measures that can affect the conditions of competition.

A potentially more serious difference between the U.S. statute and Article VI is the reference in the former to a bounty or grant, not only by a government but by a "person, partnership, association, cartel or corporation..." This extension of the right to countervail against actions by non-governmental entities is not only contrary to the GATT but is difficult to justify in logic.

The only case in which such a private "subsidization" has a clear meaning is in which a company or cartel uses profits derived in a monopoly market in order to lower its price for a different product or for the same product in another market.

\textsuperscript{35} For a convenient compilation of decisions by the Treasury Dept., see Marks and Malmgrem, \textit{Negotiating Nontariff Distortions to Trade}, 7 \textit{Law \\& Pol. Int'l Bus.} 327 at 346 n.85 (1975) [hereinafter cited as Marks and Malmgrem].

\textsuperscript{36} \textit{See X-Radial Steel Belted Tires from Canada}, Treas. Dec. 73-10, 7 CUST. B. \\& DEC. 11 (1973). The Treasury Department made the decision that assistance furnished to the Michelin Tire Corp. by all levels of the Canadian government is a "bounty or grant" within the meaning of section 303 of the Trade Act of 1974; thus subjecting the imported tires to countervailing duties. The assistance in this case was in the form of cash payments, tax credits, and low interest rates; the purpose of these measures was to stimulate two economically depressed municipalities in Nova Scotia. \textit{See 6 Law \\& Pol. Int'l Bus.} 237 (1974).

\textsuperscript{37} \textit{Supra} note 34.
However, in such a case, the existence of dumping would normally be easier to establish than subsidization.  

B. The Injury Requirement

The U.S. countervailing duty statute also differs from the GATT in its treatment of the injury requirement. Until the passage of the Trade Act of 1974, the controlling U.S. statute contained no requirement of a finding of injury as a prerequisite to countervailing.  

The imposition of countervailing duties without a prior finding of injury is contrary to GATT, though, in the case of the United States, not a violation, because the instrument of acceptance exempts actions required by legislation in effect at the time of acceptance.

In one respect, the U.S. law at the time of its provisional accession was narrower in scope than GATT's Article VI: it provided for countervailing only against dutiable imports. In the Trade Act of 1974, Congress amended the previous law to subject non-dutiable articles to countervailing and included, with respect to those articles only, the prerequisite of an injury finding by the Commission, specifying that this requirement should apply only so long as required by the international obligations of the United States.  

It is clear that the Congressional purpose was to avoid a conflict with the GATT with respect to countervailing duties on articles to which the exemption of the grandfather clause does

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38. It would appear that an American industry adversely affected by foreign dumping of a dutiable article as a result of cartel action would find some advantage in seeking redress under the countervailing duty law, since it would thus be spared the necessity of establishing injury.

Interestingly, it was recognized by the drafters of the International Trade Organization Charter that trade distortions arising out of "restrictive business practices" were quite different from those resulting from subsidies, and they provided two separate mechanisms for dealing with them. The Charter contained a chapter that would have engaged governments in a cooperative effort to regulate cartel action, and a countervailing duty provision essentially in the form in which it was carried over into the GATT.

39. Supra note 34.

40. Supra note 9.

41. Trade Act of 1974, § 331, amending 19 U.S.C. § 1303 (Supp. V 1975). Subsection (a)(2) of § 1303: "In the case of any imported article or merchandise which is free of duty, duties may be imposed under this section only if there is an affirmative determination by the Commission under subsection (b)(1) of this section; except that such a determination shall not be required unless a determination of injury is received by the international obligations of the United States."
not apply, while continuing to countervail without a finding of injury in the cases where it was required by the statute existing at the time of U.S. accession to the GATT. This suggests that Congress considered that the remaining criteria in the provisions for countervailing against non-dutiable articles did not differ in substance from the GATT — a point worth noting in connection with the question of whether “private subsidies” are countervailable under U.S. law.

The language of the injury requirement in the Trade Act, with respect to non-dutiable articles, is identical with that in the Antidumping Act, which has always included an injury requirement. It follows that, under U.S. law, any principles established in the administration of the injury provision in antidumping cases can be applied to injury findings in countervailing duty cases where injury is relevant, that is, cases involving non-dutiable articles. In spite of the absence of the qualifying word “material” before “injury” in the antidumping statute, the Tariff Commission [now International Trade Commission] for many years based its positive determinations on the establishment of material injury. However, in 1968, after U.S. signature of the International Antidumping Code, the Tariff Commission adopted a new de minimis standard, under which positive findings increased dramatically; this trend has been reversed in more recent years.

A clear divergence between U.S. practice and the provisions of the International Antidumping Code involves the question of the degree to which the injury must be attributable to the dumped imports before antidumping measures may be taken. The Code requires that those imports be “demonstrably the principal cause” of the injury; the U.S. statute uses the wording “by

42. 19 U.S.C. § 160(a) (1970). Section (a) provides in pertinent part: “[T]he Commission shall determine . . . whether an industry in the United States is being or is likely to be injured, or is prevented from being established, by reason of the importation of such merchandise into the United States.”

43. Between 1964 and 1967, only 28% of the Tariff Commission decisions found injury; from 1968 to 1970, injury was found in nearly 86% of the cases decided. See Marks and Malngrem, supra note 35, at 375 n.205.

44. For example, from January 1974 through October 1975, the Commission found injury in 11 of 16 cases; it has not repeated its earlier application of the de minimis standard. Nevertheless, the post–1968 practice, if repeated, would differ radically from the position endorsed by the GATT membership in 1959, when they adopted the report of the Group of Experts, supra note 18.

45. Code, Art. 3(a).
reason of the importation."

After accepting the Code, the Johnson administration conformed administrative regulations to the provisions of the Code and took the position that there was no inconsistency between Code regulations and U.S. law. Congress, however, evidently disagreed; they authorized the tariff commissioners to ignore the Code and apply the terms of the law as they saw it. If the view of the Johnson administration were right, and there were no conflict between the Code and the U.S. statute, this would not necessarily have resulted in any change in the tenor of the Tariff Commission's findings. But, once the Commission was permitted to ignore the Code, they adopted the *de minimis* standard, with the results noted above.

IV. CURRENT ISSUES FOR NEGOTIATION: RELATED PROBLEMS

As the preceding discussion should suggest, the existing GATT rules could do with a thorough house-cleaning. Even if the only purpose were to sweep out the cobwebs and illuminate some of the darker corners, there is plenty of work to be done. Rather than focusing on existing rules, however, most of the GATT members participating in the current MTN are demanding fundamental structural changes and raising problems that the original architects did not even address. The present section of this study considers some of the substantive issues that are almost certain to be debated, if not resolved, before the negotiations are concluded.

A. Subsidies and Notification

The drafters of the GATT were aware that the Agreement fell far short of providing the means for eliminating trade distortions caused by subsidies, but they hoped that it would be possible to build a more complete structure over time by means of case law. The notification mechanism they relied on to start this process required the CONTRACTING PARTIES to consider the sub-

46. *Supra* note 42.
mitted information and provided for consultations with affected parties. It was thought that notifications would at least provide the information that was needed for improving the rules, especially since each notification was to include an estimate of the amount of the subsidy and its effects on trade.

That this commitment was widely ignored from the outset is not surprising. In the act of notifying a subsidy, a party was in effect confessing that the measure was trade-distorting. Worse still, the notifying party was expected to provide others with a statement of the damages they had a right to collect by countervailing, or in the case of import substitution, by use of the more general complaint procedure of the GATT. Because the requirement to notify subsidies had been so generally ignored, the Contracting Parties in 1950 instituted the procedure of broadcasting periodic appeals to all parties to submit comprehensive notifications of all their subsidies within a stated deadline. Later, in 1962, they adopted the present system, involving circulation of a questionnaire and a request for comprehensive notifications every three years, with interim notification of changes.

The relatively small number of contracting parties that have made even a token obeisance to the commitment to notify have done so selectively and have chosen for the purpose those measures

49. Under Art. XXIII, a contracting party which considers that any benefit accruing to it under the agreement is being nullified or impaired by the action of another contracting party may take its case to the Contracting Parties. If they consider that the circumstances justify, they may authorize the injured contracting party to take compensatory action against the trade of the contracting party causing the impairment, for example, to withhold from the latter the benefits of a negotiated tariff concession. Either a country to whom the subsidized exports are being exported or a contracting party which exports a competing product could, in the light of the sort of notification described, bring a case under this procedure, with an excellent chance of success.

50. GATT, II BISD 19 (1952).

51. With respect to a recent group of questionnaires (January 1972 to February 1973), 22 parties replied, some 60 remained silent. The commodity composition of the notifications that were received is as significant as the number of replies. Of 117 subsidies notified, 93 covered agricultural products or groups of such products; 6 more were for the benefit of agricultural producers (fertilizers and tractors). The industries favored by most of the remaining subsidies were producers of primary products (coal, coke and basic chemicals), with a few consisting of shipbuilding and cultural aids (films and books).
Present Law and Future Prospects

ures concerning which the substantive restraints of Article XVI are the least onerous.\(^5\)

In the current MTN, two different methods have been proposed for making the notification commitments more realistic and more effective, both of which would narrow the provision's application to those subsidies of greatest interest to other parties. One proposal is to define and exempt subsidies maintained for legitimate social purposes, such as the development of backward areas. The other proposal is to define or prepare a list of potentially trade-distorting categories, including domestic subsidies that are likely to result in the curtailment of imports, and to impose binding limitations on the use of such subsidies. While either approach might be helpful, it is doubtful that full compliance would result. The chance of success would be enhanced, however, if there were a procedural change that has also been proposed by some of the negotiating parties: a reverse form of notification, similar to that which has been used in the MTN. Under this procedure, the notification obligation of the subsidizing party is reinforced by the right of each party to "notify" a subsidy maintained by another. If the notification occurred in this way, the subsidizing country would then be required to submit all relevant information; that submission would then trigger the Article XVI procedures.

B. Export Subsidies

A prerequisite of any enforceable restraint on export subsidies in the GATT is that it be applicable to most contracting parties, and to all categories of products, subject to appropriate exceptions in the interest of economic development of the non-industrialized countries. It is doubtful that such universality can be achieved, however, as long as the costs and benefits are so unevenly distributed among the contracting parties. It is also unlikely that the commitment to refrain from the use of certain

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\(^5\) This impression has recently been reinforced by an inventory that has been constructed in preparation for the MTN. Each party submitted lists of subsidies maintained by other parties. The resultant inventory includes a number of subsidies on industrial products that had never been notified by the subsidizing country. More importantly, it exposes the widespread use of a category of subsidy that had been omitted from Article XVI's notification provision, that is, across-the-board export inducements in the form of tax rebates, concessional credit terms, or governmental financing, on all industrial products.
export subsidies will be taken seriously as long as there are no restraints imposed on other measures with similar effects on the flow of trade.

During the current trade negotiations, some countries, including the United States, have proposed that the XVI:4 prohibition against export subsidies that result in differential pricing be applied to primary as well as non-primary products. Such a change, should it prove negotiable, would have the additional advantage of rendering unnecessary the presently useless exhortations in XVI:3. If XVI:4 were further broadened to cover all export subsidies (i.e., all subsidies the payment of which is conditioned upon the export of the final product) then the export subsidy provisions would at least be consistent and rational. This provision would also go far toward solving the difficult problem of third-country injury. Obtaining acceptance of these changes will be far from easy. The first proposal, with reference to primary products, has met with strong opposition from some developed countries, which want to retain maximum freedom to support their often inefficient agricultural sectors. Export subsidies on industrial goods are as firmly entrenched and almost as ubiquitous in light of the failure of the present provisions to bring about their dismantlement or even to prevent their introduction.

Some compromise that will take these facts into account will almost certainly prove necessary. One possible solution is to put the revised rules into effect gradually and to temper them with exceptions for measures selected on a case-by-case basis. An expert panel, created by the CONTRACTING PARTIES would examine each measure notified by the subsidizing country or by another party and determine whether it falls within the prohibited category. If so, the subsidizing country would then be required to eliminate the practice within a standard time period (for example, three years). The Panel, however, would be empowered to grant exceptions for subsidies they found to be minimally trade-distorting or justified on the grounds that their removal would involve unacceptable economic hardship. While such a solution would entail less than a complete prohibition of export subsidies, it would represent a substantial improvement, and one that would justify the efforts now being expended on the subject in Geneva.
C. Countervailing Duties

The most frequent demand heard during the MTN preparatory work on subsidies has been that all countries comply with the letter of Article VI and impose a countervailing duty only after a finding of injury to a domestic industry. This demand is entirely reasonable. Initially, in order to carry out the mandatory provisions of the U.S. statute, U.S. administrations had only to invoke the grandfather clause of the Protocol of Provisional Application, thereby escaping from the injury requirement. Thirty years have now passed, however, since the inception of the GATT, and it is difficult to defend the failure to try to bring the U.S. statute into conformity with the GATT. The United States has made an effort to condition its compliance on a modification of the injury rule, under which any country would have the right to countervail, without finding injury, against imports that have enjoyed a subsidy that is prohibited by Article XVI. The logic of this proposal would be unassailable if the characterization of a subsidy as prohibited were never in doubt. Thus, its feasibility must rest on the success of the negotiators in removing all ambiguity from the export subsidy provisions, or on the creation of an impartial body that would rule on the legality of each subsidy, as has been suggested above.

1. Countervailing as a Last Resort

An alternative issue arising from Article VI is whether the present unilateral right to decide to countervail should be modified so that the action would be reserved for only the most serious cases. With a few exceptions, the thrust of most proposals regarding Article VI in the MTN has been to increase the difficulty of countervailing. Most parties appear to be less concerned by the trade-distorting effects of subsidies than by the danger that a countervailing duty may be excessive or imposed when not required by overriding necessity. A popular approach has been to seek the formulation of "statistically verifiable" criteria for determining the existence of "injury" in the sense of Article VI. To accomplish this it has been proposed: that the injury must be substantial; that there be irrefutable evidence that it is caused by the subsidized imports; that there has been a "rapid increase" in the share of the market preempted by the subsidized imports;
and that those imports must have been responsible for "a substantial undercutting of the price of the competing domestic product." Even after all these conditions have been met, according to at least one major participant in the negotiations, the imposition of a countervailing duty should not be "automatic"; the responsible authorities of the importing country should be empowered to decide for or against action after taking all factors into consideration — an apparent reference to the mandatory nature of the U.S. statute.

To reinforce these proposed restraints on countervailing, a number of contracting parties have proposed the introduction of obligatory procedures that would have to be complied with before a countervailing duty could be imposed. For example, a consultation would be required, first with the country whose exports would be subjected to the duty. If this consultation did not result in agreement, consultations would then be held in a multilateral forum to be established in the GATT.

If a substantial part of these proposed restraints is adopted it is predictable that the fear of countervailing would cease to play its present role as the only effective check on competitive subsidization. As a result, the principal future safeguard against the use of trade-distorting subsidies would then be the limits on their use in Article XVI.

2. Third-Country Injury

The provisions of VI:6(b)\(^53\) have proved useless as a means of protecting an exporting country against the loss of its foreign markets to the subsidized exports of another country; nevertheless there appears to be an almost unanimous lack of enthusiasm

\(^{53}\) Article VI:6(b) provides:

The CONTRACTING PARTIES may waive the requirement of sub-paragraph (a) of this paragraph so as to permit a contracting party to levy an antidumping or countervailing duty on the importation of any product for the purpose of offsetting dumping or subsidization which causes or threatens material injury to an industry in the territory of another contracting party exporting the product concerned to the territory of the importing contracting party. The CONTRACTING PARTIES shall waive the requirement of sub-paragraph (a) of this paragraph, so as to permit the levying of a countervailing duty, in cases in which they find that a subsidy is causing or threatening material injury to an industry in the territory of another contracting party exporting the product concerned to the territory of the importing contracting party.
for rectifying the deficiency. Although the United States and Australia have made proposals for dealing with third-country injury, their quite different approaches have enjoyed no visible support, and understandably so.

One proposal would amend VI:6(b) to give the injured exporting country the right to restore the balance of advantage by taking unilateral action against the trade of the subsidizing country. There is legitimate opposition to giving a party the unilateral power to determine the extent of the damage it has suffered and the size of the compensation it may extract. This is a problem that does not arise when the importing country countervails in the interest of its own industry; if the existence of the subsidy is known, its unit amount is usually calculable, and that amount determines the limit of the countervailing duty that may be assessed.

This defect in the first proposal is not beyond correction; it could be modified by a provision for multilateral review of the proposed unilateral compensation, a solution for which there is precedent in the GATT. For example, in Article XIX:3 (a) the Contracting Parties are given the power to disapprove the compensation which a single party has granted to itself, when it has been adversely affected by an escape-clause action to which it has not assented. Similarly, Article XXIII provides that the Contracting Parties must give their positive approval to action by a party that claims it has been deprived by another of benefits under the GATT. This approach would require, however, that the Contracting Parties act responsibly. In the present climate of widespread opposition to countervailing, and given the present size and composition of the GATT membership, it might be diffi-

54. If agreement among the interested contracting parties with respect to the action is not reached, the contracting party which proposes to take or continue the action shall nevertheless, be free to do so, and if such action is taken or continued, the affected contracting parties shall then be free, not later than ninety days after such action is taken, to suspend, upon the expiration of thirty days from the day on which written notice of such suspension is received by the Contracting Parties, the application to the trade of the contracting party taking such action, or, in the case envisaged in paragraph 1(b) of this Article, to the trade of the contracting party requesting such action, of such substantially equivalent concessions or other obligations under this Agreement the suspension of which the Contracting Parties do not disapprove.

55. “The Contracting Parties shall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter as appropriate.”
cult for an injured third country to obtain an impartial judgment from a plenary session of the parties. A more useful procedure would be to establish an impartial panel that would first determine the existence of the injury and, after consultation with both parties, approve or disapprove the nature and level of the retaliatory action proposed by the injured party.

The second proposal would amend VI:6(b) to make countervailing action by the importing country mandatory when the CONTRACTING PARTIES determine that a third exporting country has been injured. Because it would involve a delegation of sovereignty by parties to the GATT that goes beyond anything now in the Agreement, it is hard to believe that it would have a chance of acceptance.

D. Border Tax Adjustments

In the Trade Act of 1974, the Congress instructed the President “as soon as practicable” to renegotiate certain provisions of the GATT and required as one of the objectives of such renegotiation “the revision [of GATT] with respect to the treatment of border adjustments for internal taxes to redress the disadvantages to countries relying primarily on direct rather than indirect taxes for revenue needs.”

Both the economic rationale for the Congressional position and the practicability of its instruction are questionable. The issue is related directly to the meaning that should be applied to “subsidy” for the purposes of the GATT. The Agreement is unequivocal on this point. “Border tax adjustments” have been a particularly sensitive subject in U.S. international trade relations because of the widely held view that the structure of the U.S. tax system, with its reliance on direct taxes (i.e., taxes on business income) puts this country at a competitive disadvantage under the GATT rules with respect to most of our major trading partners, who rely strongly on indirect taxes (i.e., taxes on products).

Under the GATT, the remission, by exemption or rebate, to an exported product of a tax imposed on the like product when sold for domestic consumption is not a subsidy. In contrast,

57. Article VI:4 and Interpretive Note to Art. XVI, GATT, Annex I, Ad. Art. XVI. The remission may not exceed the accrued amount of duties or taxes paid.
the rebate of a tax on income derived from exports is not included in the exemption and, as confirmed by GATT case law, is a subsidy. The above two rules may be simply stated: Rebates of indirect taxes are not subsidies; rebates of direct taxes are subsidies.\(^{58}\)

The proposition that the United States is competitively disadvantaged by the GATT tax/subsidy treatment is based somewhat on a misunderstanding of the scope of these rules. It is generally accepted that the United States applies them to the benefit of its competitive position when it excuses exports from federal excise taxes and imposes those taxes on imports. What is often overlooked, however, is that the United States applies the same rules — again, to its competitive advantage — in not imposing on exports a charge equivalent to state and local excise or sales taxes and in permitting states and municipalities to impose such taxes without regard to whether the products taxed are produced domestically or imported.

Even if the distinction between direct and indirect taxes did give rise to uncorrected trade distortions, there would be no feasible or logical remedy. There are theoretically two ways in which to eliminate the distinction, both of which present insurmountable administrative and computational difficulties:

(1) If the present direct-tax provisions were applied to indirect taxes, the exemption of an exported product from an excise or sales tax that is imposed on domestic sales would be deemed a subsidy. Ignoring the economic anomalies involved, the problem of equitable administration would be insuperable. Widgets when sold domestically may be subject to widely differing levels of

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\(^{58}\) An example will illustrate the operation of these rules. First, assume that the Widget Corporation makes widgets for domestic consumption and export; widgets are taxed domestically at $5 each. If the Corporation pays a tax on its entire output, domestic law may remit the taxes on the portion that was actually exported. Such a remission is not a subsidy and consequently does not trigger the GATT notification provisions and so on. Second, assume that Widget Corporation pays tax on X dollars of income, of which Y dollars are derived from domestic sales and X-Y dollars are derived from export sales. A tax rebate on the X-Y dollars derived from export sales is, under GATT law, a subsidy.

These rules are the counterpart of the import rules of Art. III:2. That provision permits the imposition against imports of any tax that is levied on the like domestic product when destined for internal consumption (i.e., imported widgets may be taxed as are locally produced widgets), but any other tax levied on imports is an additional tariff.
state and local taxation. The correct tax to be imposed when the widgets are exported would therefore be indeterminate.

(2) If the present indirect-tax rules were applied to direct taxes, a country could then impose on imports a direct tax equivalent to that imposed on the domestic producer of the like product. But the incidence of an income tax on a unit of the domestic product, even if it could be determined, would not be the same for any two producers. When an effort is made to determine the tax that might be rebated when a product is exported the problem would be compounded by the need for determining the income taxes that had been paid not only by all those involved in the production chain but by others involved in its delivery to point of export. And even if this could be determined for a given shipment it would mean that for each lot exported a different level of rebate would be permissible.

The impossibility of eliminating the GATT distinction between direct and indirect taxes supports the initial assumptions behind the GATT tax/subsidy treatment. The authors of the GATT provisions and their critics agree that tax policies should be neutral with respect to trade; i.e., a change in domestic tax should neither improve nor harm a country's international competitive position. The GATT rules were based on the classic theory of tax shifting, namely that under conditions of competition, indirect taxes will normally be shifted forward into the price of the product and that direct taxes will not. The opponents of the GATT rules have argued that the classic theory does not apply when competition is imperfect and, therefore, that rules based on the distinction cannot result in true trade neutrality.

It is, of course, true that producers will attempt to price their products so as to yield a net profit after the payment of income taxes. In this sense it can be said that some shifting forward of a direct tax can and does occur (except in the case of the marginal producer under conditions of competition). However, a change in the level of direct (income) taxation would have a much smaller proportional effect on the price of an item than would a change in the level of indirect taxation, which is charged equally on all units. In this sense, then, the classic theory of tax shifting forms a reasonable basis for the GATT distinction.
E. Trade of Less Developed Countries

A complete analysis of the economic effect of subsidies on the development of less developed countries (LDCs) is beyond the scope of this paper. But the issue cannot be omitted from a catalog of negotiating issues, since it has already occupied much of the attention of the MTN negotiators. Some of the LDCs have maintained that their subsidies should be totally exempt from any restraints, bilateral as well as multilateral. In support of this contention they have argued: that nothing in Article XVI should prevent them from using any subsidy they consider necessary for their economic development; that the GATT provisions on export subsidies do not legally apply to them because they have not accepted the restraints of Article XVI:4; that developed countries should not countervail against subsidized imports from LDCs, or, alternatively, that they should not do so without prior consultation with the LDC and the approval of the membership; and, that the developed countries, in accepting Part IV of the GATT, undertook to differentiate between developed and less developed countries when considering whether to countervail.59

There are some valid arguments for the application of different standards to the trade of LDCs than those the developed parties are willing to apply to each other; perhaps the most persuasive of these is the desire to avoid apparent inconsistency. The developed countries have agreed to the desirability of granting generalized tariff preferences to imports from those countries. From the same principle, it would seem to follow that the LDCs should be allowed to stimulate their exports internally, by whatever means. However, the effects of subsidies do not parallel those of tariff preferences. Preferences, if generalized to all LDCs, even though by definition discriminatory, preserve some of the benefits of competition and serve to promote the optimum allocation of resources, at least among the LDCs themselves. On the other hand, the unrestrained use of a subsidy by an LDC can result in its sacrificing its overall economic development, along with that of competing LDCs, in order to stimulate a line of production that will never be able to compete without artificial aid. The economic effect on the importing coun-

59. Article XXXVII:3(c) requires developed contracting parties to have “special regard to the trade interests of less-developed contracting parties” and to “explore all possibilities of constructive remedies” before applying GATT-sanctioned trade-protection measures.
try can also be quite different from that which results from the granting of a tariff preference. Under preferences, the worst that can happen to a domestic producer in the importing country occurs in the limiting case of a duty-free preference, when the producer is deprived of all artificial advantage over equally efficient LDC producers. But if the importing country should renounce its right to countervail against subsidized imports, the margin by which an inefficient LDC exporter could sell below cost would be limited only by the extent to which his government is willing to tax its total economy in order to pay the subsidy.

Although the outcome of the discussion of this issue in the MTN cannot be predicted with any assurance, some of its dimensions are foreseeable. It is unlikely that the developed countries will try to force the LDCs to accept any restraints on their right to subsidize. It can also be predicted that, even though another LDC might be the victim of that subsidization, the political solidarity of the LDCs as a bloc will prevent the adoption of any rules that focus attention on the differences of interest among LDCs. In any event victory for the LDC position concerning their own use of subsidies would leave them with no bargaining tool to force the developed nations to relinquish their right to countervail. If even a partial renunciation of that right should occur, it would result not from bargaining but from the politically motivated reluctance of each major developed country to appear less than sympathetic to the problems of the third world. A possible outcome of the maneuvering taking place in the MTN is one in which each party would retain the ultimate right to countervail, but would agree to exercise that right only after consulting with the exporting LDC and after giving serious consideration to its view of the importance of the subsidy to its development.

F. Non-Market Economies

One question the Geneva negotiators are not likely to solve, should they even choose to deal with it, is whether the GATT subsidy provisions are relevant to the trade of non-market economies (NMEs).\[60] In terms of economic effect, the answer must

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60. The issue goes beyond the meaning of the GATT rules and extends to the interpretation of national countervailing duty statutes. For example, is it possible
be affirmative; the objective behind the traditional right to countervail, and behind its reaffirmation in the GATT, is as applicable to the trade of NMEs as to that of market economies: *i.e.*, to permit the neutralization of trade distortions that can result when a country diverts resources from the rest of its economy to a particular industry or enterprise, enabling it to compete internationally. It makes little economic difference whether the transfer is accomplished by a direct governmental bounty, or, when the state and the enterprise are identical by less overt means of favoring a particular economic activity at the cost of the rest of the economy.

The difficulty in applying the GATT subsidy rules to NMEs is not that their methods of export stimulation fall outside the intended scope of those rules; rather it is that there are no objective criteria for determining whether a particular industry in an NME is the beneficiary of resource transfer, and, if so, by what amount per unit of product. Given the impossibility of proving the existence of a subsidy, it would also be naive to expect an NME, even if bound by the provisions of the GATT, to observe the restraints of Article XVI. The decision thus remains for the importing country of whether, and by what amount, to countervail.

One way to bring NMEs within the intent of Article VI, while avoiding the ill-fitting framework that was constructed for competitive economies, is to rely on the escape clause in cases where competition from an NME is injuring a domestic industry. Before endorsing such an approach without qualification, however, it is necessary to look briefly at the philosophical and legal differences between the escape clause and the right to countervail.

Article XIX of GATT was designed to permit a party, in case of need, to suspend a commitment, such as a previous tariff concession, without upsetting the balance of advantages among the participants. It requires that any action that is taken be applied to all imports of the article in question regardless of provenance, and that the country suspending the commitment grant compensation to those countries adversely affected, or suffer equivalent restrictions by them. In contrast, the assumption behind Article VI is that the subsidizing country is responsible for introducing the distortion that upsets the balance of the agree-

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that in a communist economy exports can benefit from a bounty or grant in the sense those words are used in the U.S. statute?

61. GATT, Art. XIX.
ment; the importing country may then restore the balance by directing its countervailing action against that country, without payment of compensation.

In addition to this difference between escape clause actions and countervailing, the injury provisions of these two GATT articles are not identical. Although the existence of injury or threat of injury to a domestic industry is a prerequisite to both escape clause actions and countervailing, the two methods of offsetting the injury differ, both with respect to the restraints on their use and the costs imposed on the user. The level of a permissible countervailing duty is limited to the unit amount of the subsidy, whereas the only limit under the escape clause is the degree of restriction needed to remove the injury or threat of injury. An advantage of countervailing is that it involves no compensation cost; countervailing also imposes lower costs to domestic consumers than the nondiscriminatory action required under the escape clause. In short, the escape clause of the GATT is an imprecise and generally unsatisfactory instrument for dealing with imports of subsidized products and is worth considering only if no better substitute can be devised.

Some of the difficulty arises out of the attempt to apply GATT rules that were devised to meet a different set of problems. If it could be assumed that the contracting parties to GATT were not bound and would not in the future be bound toward any NME by existing GATT restraints, they could deal with potentially subsidized exports from NMEs by whatever measure was needed, without regard to the limits imposed by Article VI or the requirements of Article XIX with respect to non-discrimination and compensation. Such a solution would resemble that contemplated by the Congress in section 406 of the Trade Act of 1974. That section, which applies in the case of "market disruption" resulting from imports from any communist country, establishes less rigid standards for triggering restrictive action than in the case of imports from other sources. More importantly, it not only permits but requires that that action be discriminatory, i.e., directed solely against imports from the communist country concerned.62

The enactment of section 406 has not solved the problem of how to deal with subsidized imports from NMEs in a manner that is the equivalent of the treatment accorded imports from

market economies. So long as the countervailing duty statute is also available to competing domestic producers, the availability of the section 406 remedy subjects East-West trade to an unnecessarily heavy risk. Nor would equity be served by amending the statutes to exempt NME trade from countervailing, as imports from other sources would still be subject to countervailing without a test of injury. Both of these considerations suggest a realignment of the U.S. law, under which imports from NMEs would be subject to restriction as if they were subsidized, the only prerequisite being an injury test. The countervailing duty statute should then be made inapplicable to imports from NMEs, but amended to include an injury test for other imports.

V. THE OUTLOOK

One of the few predictions that can be made with any confidence is that the subject of subsidies will persist as one for contention and negotiation among trading countries. Many of its elements defy simple solution. Almost any solution proposed at the current MTN will be opposed by some of the countries whose adherence would be essential to its adoption. In fact, it may well require the passage of much time, as well as an intensification in the use of competitive subsidies, before many governments will be willing to sacrifice any of their present freedom of action in order to reverse the trend. The following are elements that would need to be contained in any code of conduct that would have a chance of enduring by providing a fair balance of advantages and disadvantages.

A. Domestic Subsidies

1. Identification and prohibition of those categories of subsidies the principal effect of which is to give domestic production a competitive advantage over the imports or exports of other countries in world markets.

2. Identification, and approval, of those categories of subsidies the principal effect of which is to further social ends agreed to be desirable.

3. Establishment of a procedure for multilateral appraisal of individual subsidies that do not fall clearly into one of these two extremes.
B. Notification

1. Modification of the commitment of countries to notify the Contracting Parties of the subsidies they maintain, so as to remove the present implication that a notified subsidy is ipso facto trade-distorting.

2. Establishment of a procedure under which a GATT member may "notify" a subsidy maintained by another member and obtain a multilateral examination of its effects and its conformity with the rules.

C. Export Subsidies

A broadening of the description of prohibited export subsidies to include:

1. Such subsidies whether or not they result in lower prices for export than for domestic sales;
2. Primary as well as non-primary products.

D. Countervailing Duties

1. Establishment of an export panel empowered to review each case before a countervailing duty may be imposed and to determine whether the agreed prerequisites have been met.

2. Elimination of the injury prerequisite when the imports in question have benefited from a subsidy that is illegal under the code.

3. A grant of power to the panel to approve compensatory trade action by an exporting country against another country whose subsidized exports are curtailing its market.

E. LDCs

Although it is unlikely that there will be a codification of the rules governing relations with the LDCs, there will at least be a reference made to the rights, if not the obligations, of LDCs. Ideally, for the least developed countries, such a reference should include recognition of the fact that the economic development of one LDC can be retarded by the subsidized production or exports of another.
It is even less likely that the MTN will produce any rules to govern the treatment of subsidies in trade between NMEs and market economies, but the subsidy subject should be an element in the protocol under which any NME may in the future achieve the status of a contracting party to the GATT.

G. Summary

None of these proposals is likely to survive the process of negotiation in the form in which it appears above. Some may be omitted entirely; depending upon circumstances, this would not necessarily be a net loss. Not all the suggested elements are of equal importance, and the need for some of them depends on the success achieved in negotiating and enforcing the more fundamental commitments.

VI. Future Prospects

It would be misleading to leave the impression that a failure of the MTN negotiation in the area of subsidies would be comparable in its effects on world trade to a failure of the negotiations in other areas such as the further reduction of tariffs. Fortunately, there are disincentives to the unlimited use of subsidies even in the absence of internationally agreed restraints. This is especially true of domestic production subsidies, which will usually appear to the taxpayer as a device for transferring resources to one sector at the expense of the rest of the economy. This is fortunate in view of the difficulty of measuring the trade effects of production subsidies and of distinguishing between those that are granted for the purpose of gaining competitive advantage in international trade and those that are adopted for desirable social ends, such as the development of backward regions, conservation of natural resources and protection of the environment. Present indications are that a good deal of attention will have to be paid in future negotiations to the identification of those subsidies whose social importance outweighs their contribution to the distortion of international trading patterns.