

Notes for intervention in FMG session on “How to Address the Subsidies Challenge to the Trading System”. Patrick Low, 23/3/23

Defining subsidies has always been a challenge for policymakers and analysts

In the broadest sense, a subsidy is like any government measure that affects relative prices in an economy. It is an intervention that changes the conditions of competition, within and/or between jurisdictions. A possible all-encompassing broad definition of a subsidy could read something like:

“Any price-based or regulatory intervention that changes relative costs or returns in the market – nationally and/or internationally – to the advantage of a subset of producers or consumers”. Thus, one economic agent’s subsidy, implicitly or otherwise, is a tax on others.

Subsidies or subsidy-like instruments can, for example, be:

- Regulatory in nature, implicit in the design of, say, standards, technical regulations, labelling requirements, etc.
- Financial or fiscal, involving grants or preferential tax treatment;
- The result of exclusive rights granted to subsets of economic actors that reduce competition in the marketplace;
- Embedded in exclusive equity ownership arrangements – e.g. state-owned enterprises.

The point here is that, in terms of the problematic elements of subsidies, there is plenty of scope for policy substitution, and this can encourage governments to think in terms of broad definitions that have not been agreed.

The current sources of tension

Subsidies are more narrowly defined in the WTO Agreements, and it is in this domain in particular that trade tensions have been mounting.

The four key areas where explicit subsidy disciplines are relevant in relation to the WTO’s current work relate to manufactures, fisheries, agriculture and services.

The Agreement on Subsidies and Countervailing Measures (SCM), the Agreement on Agriculture and the Agreement on Trade in Services (GATS) provide the legal structure.

Services account for ever-growing shares of GDP in virtually all countries – generally the higher is GDP per capita the greater is dependence of services. Despite this, GATS Article XV on subsidies remains a place-holder for future negotiations.

Agriculture has always been a source of tension and remains so, although less in terms of export subsidies since the 2015 decision that largely eliminated the right to apply export subsidies.

SCM

Most of the current tension relates to subsidies that could fall under the purview of the SCM. Here subsidies are defined as financial contributions by a government or public body that confer a benefit. Any subsidy deemed specific in terms of its coverage may be considered either prohibited or actionable.

Good and bad subsidies

Few would argue with the proposition that there are good as well as bad subsidies. Only ideologues would be inclined to insist that markets, although not necessarily perfect, will always yield better outcomes than governments. So how do we distinguish between good and bad subsidies?

The whole thrust of anti-subsidy provisions is to minimize what are considered their distortive effects. Specificity is central to the notion of distortion. From an economic perspective specificity is not a satisfactory measure of distortion nor of the potential economic benefits (or costs) of a subsidy.

This was recognized in Article 8 of the 1995 Subsidies Agreement. The Article introduced categories of subsidies that could be specific but were non-actionable, either in the sense of being countervailable or deemed illegal. These exemptions included certain research-related subsidies, subsidies given to support disadvantaged regions, and subsidies to adapt existing facilities to new environment-related requirements.

Many of us thought that Article 8 represented the beginnings of a serious attempt to accommodate subsidies believed to be socially beneficial and not adequately supplied by the market. Article 8 was, however, treated as experimental and made subject to renewal after 5 years. Renewal was not forthcoming.

Subsidies that might be permissible, but accompanied by legally questionable conditions

A particular problem causing tension today may go beyond government responses taking the form of a legality challenge or countervailing action, since there appears to be a growing tendency to lace subsidy actions with explicitly discriminatory conditions that limit access through buy local provisions or other means of exclusion.

This is occurring against a background of widespread, shared tendencies to disregard WTO rules or even bothering to exercise WTO rights.

If governments were so inclined, such provisions could be challenged on MFN grounds under GATT Article I or GATS Article II provisions, but not National Treatment provisions under GATT Article III or GATS Article VXII (unless NT has been scheduled).

So, what might be done?

We should bear in mind that subsidies are an important area of trade-related regulation that cannot be dealt with effectively through preferential trade agreements (PTAs). A multilateral approach is needed.

So, I end with three related questions:

1. Assuming a willingness to take the WTO seriously, are the WTO rules in need of revision? Perhaps, when it comes to reviving an approach akin to that contemplated by the expired SCM Article 8. But is it not the case that members are increasingly disregarding the WTO and its rules, and not seeking to use legal remedies either?
2. If subsidies can be deemed “good” in the sense of making up for market failures and capturing positive externalities (external effects that the market does not capture), should we not be finding ways of securing cooperative outcomes in terms of sharing the subsidy costs of dealing with shared problems, such as climate change? Growing numbers of people would argue that a failure of governments to do so risks the onset of catastrophic climate change.

3. Is there a sense in which subsidy actions by different governments display a kind of inter-dependency. Recent work by the Global Trade Alert (GTA) seems to suggest that there is a co-dependent “action-reaction” relationship at work. When one country subsidizes something, another tends to do the same. Does this not suggest the possibility of cooperation rather than uncoordinated action-reaction responses that generate tension and encourage supplementary protectionist actions to favour domestic interests?

Thank you.