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INTRODUCTION

Principle Features of the ASCM and Intervention Logic*Principle Features of the ASCM*

The subsidy disciplines set out in the ASCM apply to goods, but not to services.¹ Three constituent elements define a subsidy according to the ASCM, i.e.

- (1) a financial contribution (or alternatively any form of income and price support in the sense of Article XVI of GATT 1994)
- (2) given by the government or a public body that
- (3) confers a benefit on the recipient of such contribution.²

Moreover, only subsidies that are specific to an enterprise or industry or groups of enterprises or industries (as opposed to being broadly available in the exporting country) fall under the remit of the ASCM.³

The ASCM distinguishes two types of subsidies. First, certain subsidies are prohibited *per se*. These are export subsidies and import substitution subsidies as defined by Article 3. Second, all other subsidies that meet the definition of Article 1 and that are specific can only be challenged if they cause certain negative effects. The ASCM, as it emerged from the Uruguay Round negotiations also contained a third type of subsidies, namely ‘non-actionable’ or ‘green light’ subsidies (certain R&D, environmental and regional subsidies). However, the provisions creating this carve-out expired by the end of 1999.⁴

As can be inferred from the aforementioned definition of a subsidy, the ASCM does not take into consideration whether or not the government pursues a legitimate purpose by granting the subsidy. Since the expiry of

¹ A detailed study on subsidies in the GATS context can be found in *Poretti* (2009).

² Article 1.

³ Article 2.

⁴ Articles 8, 9 and 31.

the provisions on green light subsidies, the objectives pursued by a government when providing subsidies are no longer relevant for the analysis under the ASCM.⁵

Under the WTO Dispute Settlement System, subsidies other than those that are prohibited pursuant to Article 3 can only be challenged if imports benefitting from such subsidies cause injury to the industry producing the like product in the importing country (cf. Article 15) or if the subsidies result in the adverse effects listed in Articles 5 and 6. Such phenomena include displacement or impedance of imports of the competing product into the market of the subsidizing WTO Member or a third country market, loss of market share, price undercutting etc. In short, and as *Hahn/Mehra* (2013) have put it, if a WTO Member grants a subsidy, the ASCM imposes only an obligation to do no harm to fellow Members, unless such subsidy is prohibited pursuant to Article 3.⁶

Self-help against subsidies is also permitted in the form of countervailing duties (a synonym for anti-subsidy duties). In other words, an importing country can impose an anti-subsidy duty on imports of a product found to be subsidized, if it has respected the provisions of Part V of the ASCM. This implies a number of steps. First, normally the industry of the importing country has filed an application containing sufficient *prima facie* evidence that the imports of a product are benefitting from a subsidy and that these imports have caused injury to the competing domestic industry of the importing country.⁷ Second, if the investigating authority of the importing country considers the evidence submitted sufficient, it will open an investigation by giving public notice and requesting interested parties (including the government of the exporting country allegedly engaging in subsidization) to submit evidence (the information requirements are usually specified in a questionnaire issued by the investigating authority). Interested parties known to the investigating authority will also be informed directly. Parties have a minimum of 30 days to reply to the questionnaire.⁸ Third, the investigating authority will then assure itself of the accuracy of the information submitted, typically by carrying out on-the-spot verifications on the premises of the government of the exporting country, exporters, the domestic industry and importers.⁹ Fourth, based on the totality of the evidence on file, the investigating

⁵ See also *Cosbey/Mavroidis* (2014) p. 16 *et passim*.

⁶ *Hahn/Mehra* (2013) p. 141.

⁷ Article 11.

⁸ Article 12 (see also footnote 40 attached to Article 12.1.1).

⁹ Articles 12.5 and 12.6.

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authority will then draw up its conclusions as to the existence of injurious subsidization of the subject imports. Before imposing any definitive countervailing duties, all parties receive disclosure of these findings and have the possibility to comment.¹⁰ The investigation can last up to a maximum of 18 months.¹¹ A countervailing duty can remain in force as long and to the extent necessary to counteract injurious subsidization. However, if the duty is to remain in force longer than five years, the investigating authority of the importing country will examine in a review whether there is a likelihood of continuation or recurrence of injurious subsidization. This type of review is commonly referred to as ‘expiry review’ or ‘sunset review’.¹²

Four more features of countervailing action are noteworthy for the purposes of an introduction:

- In ‘special circumstances’ (which remain undefined in the ASCM), the investigating authority can also initiate an investigation on its own initiative, i.e. without an application submitted by the industry of the importing country. However, an investigating authority can only do so if it has sufficient *prima facie* evidence of injurious subsidization.¹³
- Exporting producers, the third country government and importers are not obliged to cooperate in a countervailing duty investigation. To the extent these parties do not cooperate, the investigating authority can use so-called ‘facts available’ in order to replace the information that was missing as a result of such non-cooperation. The possibility to use ‘facts available’ is therefore an important mechanism to induce cooperation by interested parties.¹⁴
- A provisional countervailing duty can be imposed not sooner than 60 days after initiation of the investigation. It can be applied for a maximum period of four months.¹⁵
- As an alternative to a countervailing duty, exporters and the government of the country of exports of the subsidized merchandise can also undertake to eliminate the subsidy or to raise export prices so that the effect of the subsidy is eliminated. The investigating authority enjoys considerable discretion when deciding whether or not to accept such an undertaking.¹⁶

¹⁰ Article 12.8.

¹¹ Article 11.11.

¹² Articles 21.1 and 21.3.

¹³ Article 11.6.

¹⁴ Article 12.7.

¹⁵ Articles 17.3 and 17.4.

¹⁶ Article 18.

As can be inferred from the above, the ASCM generally structures any action against subsidies by linking them to a product and the effect of such subsidized merchandise on like products of other WTO Members. The term ‘like product’ is defined in Footnote 46 of the ASCM. A rough working hypothesis would suggest that the like product is typically the product competing with the subsidized export.

The WTO dispute settlement track is only open to governments of WTO Members while the countervailing duty track is normally triggered by an application of the industry in the importing country that competes with the subsidized merchandise. This differentiation is justified by the supposition that governments, when engaging in formal dispute settlement, will balance other considerations against the demand of its domestic industry to have relief from the effects of subsidized imports.¹⁷

Special rules apply with regard to subsidies provided by developing country Members (see Article 27) and to agricultural subsidies (see *infra* pp. 37–46).

Rationale of Anti-Subsidy Action

Subsidies as a Means to Influence Market Access

The object and purpose of the ASCM is described in more detail *infra* pp. 16–19. In a nutshell, and based on DSB rulings, its object and purpose can be summarized as to increase and improve disciplines relating to the use of both subsidies and countervailing measures.

The discussion of this topic amongst scholars is broader. Their position on subsidy control depends to a large extent on their perception of the aim and the effects of subsidies. At the outset, it should, however, be noted that economic theory has not provided yet a definition of the term ‘subsidy’ with sufficiently clear contours.¹⁸

Multilateral trade liberalization, and hence also the focus of the WTO project, is about creating opportunities for access to foreign markets. Prior to the Uruguay Round such improved market access was essentially achieved through various multilateral rounds of tariff reductions. These were conducted within the GATT framework. The Uruguay Round went beyond this by providing in addition market access in the fields of

¹⁷ Hufbauer/Erb (1984) p. 24.

¹⁸ Rubini (2009) p. 4.

services and public procurement.¹⁹ It also resulted in a number of further agreements which had the purpose of further safeguarding agreed tariff reductions and services liberalization, e.g. the TRIPs Agreement and the ASCM.

Turning to the trade effects of a subsidy, the effect that first comes to mind is that a subsidy can have similar effects as an import tariff. A tariff increases the cost of the imported merchandise and thus makes it easier for the domestic industry to compete with imports. A government that subsidizes an industry simply reduces the costs of the subsidy recipient. This in turn allows the subsidized industry to lower its prices and to become more competitive *vis-à-vis* imports. Thus, a subsidy may represent a government-induced obstacle to international trade in the same way as an import tariff. Or, put differently, a government that has accepted to reduce or dismantle its import tariffs in a round of tariff liberalizations may undo its promise by providing subsidies.²⁰ This was the underlying logic for introducing some subsidy disciplines into the GATT 1947, notably its Articles VI and XVI.²¹

The effects of a subsidy may also be felt beyond the boundaries of the domestic market of the subsidizing country. Indeed, products benefitting from a subsidy can possibly compete more easily on overseas markets. This is true both with regard to overseas markets which do not have their own proper domestic production and which are therefore exclusively served by imports from various countries. But it is also true with regard to markets where domestic producers offer competing merchandise. Whether a subsidy for a given product has effects beyond the borders of the subsidizing country depends on the competitive position of the producers receiving such subsidies. The subsidy may indeed simply have the effect of fending off import competition if the domestic industry is not globally competitive. In short, in the context of influencing market access, the objectives pursued by the provision of a subsidy are structurally not much

¹⁹ The Agreement on Government Procurement is, however, only a plurilateral agreement.

²⁰ According to *Janow/Staiger* (2003) p. 207, in order to replicate the economic effects of any particular (non-prohibitive) tariff on any particular import good, the removed tariff needs to be replaced not only by (i) a subsidy to domestic production of that particular good, but in addition also by (ii) a tax on domestic consumption of that particular good. Moreover, both the subsidy and the consumption tax must be applied at the same rate as the import tariff they replace.

²¹ See e.g. *Wouters/Coppens* (2010) p. 50 with further references and *Bagwell/Mavroidis* (2010) p. 170. Note, however, that the WTO system of remedies against actionable and prohibited subsidies is in no way linked to the level of tariff concessions made by the subsidizing country.

different as compared to those underlying tariffs, quotas and other more broader obstacles to market access.

But granting a subsidy does not necessarily only pursue ‘defensive’ purposes. It can also be a strategic tool to strengthen the competitive position of the domestic industry and to facilitate its expansion in overseas markets. A government may for instance attempt to create national champions which gradually develop into global champions, and this process is facilitated because the company operates from an incontestable home market base.²² Producers benefitting from a protected home market have the possibility to earn enough money (combined with increased economies of scale because such a firm will produce and sell more than it would do without such protection) to challenge export markets. In addition to being able to charge lower prices (as described above) a company can also exploit the subsidy received to develop products which it could not have developed absent that subsidy, or market such products much earlier than without being subsidized.²³ In this context, subsidies used to bail out a company, i.e. to keep it artificially alive, can also play a role.²⁴

In other words, subsidies can have a lasting impact on competition because they improve the competitive situation of exporters benefitting from them, at the expense of overseas competitors that do not enjoy such support.

Subsidies as a Means to Remedy Market Failures or to Pursue Other Policy Objectives

The purpose of providing a subsidy is not necessarily linked to the conquest of markets or to keep ailing industries on a lifeline. Subsidies can also be designed to remedy market failures (in particular, public goods and externalities). For instance, companies tend to spend on R&D only to the extent that they expect to internalize the benefits from such expenditure. Thus, the private sector underinvests in R&D and subsidies could compensate for this suboptimal level of R&D. By providing subsidies, a government can also pursue other policy objectives (e.g. those linked to equity and justice).

²² On the issue of strategic trade policy see also the next section.

²³ See *infra* the commentary to Article 6, pp. 347–350.

²⁴ See *infra* Article 1, pp. 115–122.

Therefore, subsidies may tackle a variety of objectives, e.g. reducing pollution, addressing climate change and environmental degradation, enhancing energy security, boosting R&D, encouraging the development of disadvantaged regions, facilitating the (re-)integration of unemployed in the labour market. Subsidies were indeed instrumental in promoting renewable energies. Note, however, that subsidies are not necessarily the only means to achieve these objectives.

The argument has been made that trade policy, in general, and subsidies, in particular, should be put at the service of infant industries in less developed countries and/or be used in developed countries to support high-technology industries and/or industries characterized by imperfect competition. These issues are sometimes discussed under the heading ‘strategic trade policy’, which, however, covers a broader range of issues. The special cases of market failures that are put forward in this context are imperfect capital markets and the problem of appropriability. The latter occurs if – in order to enter a market or develop a product – firms should generate knowledge that other firms can use without paying for it, e.g. by imitating the ideas of the first mover. A firm has normally no incentive to ‘produce’ such knowledge. Therefore, to make the development of the industry, the high-tech product etc. happen, there could be a case for subsidizing such industry. However, there are also a number of pitfalls associated with this approach. It will be difficult to identify good candidates, i.e. industries or companies that fit into this category because innovation and technological spillovers also happen in industries that are not all high-tech. Moreover, as described in the preceding section, this type of government intervention typically negatively affects overseas competitors that in turn will urge their governments to take appropriate counteractions. In short, this could provoke a ‘subsidy war’, i.e. the provision of subsidies by one government can trigger similar actions by other governments, or even risk trade wars. None of these are desirable.²⁵

It is not the purpose of this book to review the discussion as to when subsidy action in the pursuit of policy objectives is economically efficient or politically justified let alone to develop a theory of such intervention.²⁶ Suffice it to mention that the current text of the ASCM does not distinguish between acceptable and non-acceptable subsidies on the basis of the policy

²⁵ *Krugman/Obstfeld/Melitz* (2015) p. 308 *et seq.*, p. 324 *et seq.*

²⁶ For a discussion of an intervention logic against subsidies (including appropriate remedies) based on economic criteria, see e.g. *Howse* (2010) p. 87 *et seq.* and *Coppens* (2014) pp. 588–600, *Cosby* (2013) pp. 8–10, all with further references.

objectives underlying the provision of the subsidy. Article 8 contained a number of provisions that classified certain subsidies as non-actionable. These non-actionable subsidies concerned assistance to R&D activities, assistance to disadvantaged regions and assistance to promote the adaptation of existing facilities to new environmental requirements. However, Article 8 expired by the end of 1999 by virtue of Article 31.²⁷ Therefore, today the scope of subsidy control under the ASCM is determined by its Article 1 that contains the definition of a subsidy and thus fixes the outer boundaries of the application of the ASCM. This definition does not distinguish between policy objectives. Rather, the ASCM employs a formal definition. The dividing line between government intervention that is permitted/not actionable and that is not permitted/actionable is essentially defined by criteria that are closely linked to the neutrality of such government action *vis-à-vis* the competitive process. Indeed, no subsidy exists if there is no financial contribution by the government to its industry (i.e. if the government action is purely regulatory),²⁸ if the government action is not specific (i.e. the subsidy is widely available in the economy),²⁹ or, if the recipient does not receive a benefit (i.e. if the financial contribution is given on market terms).³⁰ Moreover, with the exception of export subsidies and local content subsidies that are prohibited pursuant to Article 3, subsidies provided by a WTO Member can only be challenged if they create some sort of harm to the interests of another Member, i.e. injury to the domestic industry in the importing country as defined by Article 15 or if the subsidy causes one or more of the phenomena listed in Articles 5 and 6.

Why Anti-Subsidy Action?

The preceding two sections described the effects of subsidies on international trade as well as the function of subsidies to compensate for market failure. This section explores some of the rationales underlying the WTO system of remedies against subsidies (countervailing duties and the dispute settlement track). It would, however, go beyond the scope of this book to provide a comprehensive analysis as to why such action is taken or should (or should not) be taken.

Some scholars view action against subsidies (but also subsidies themselves – see the preceding section) in a much nuanced way. Certainly,

²⁷ See *infra* the commentary to Article 31.

²⁸ See *infra* pp. 73–105.

²⁹ See *infra* the commentary to Article 2.

³⁰ See *infra* pp. 125–160.

from the perspective of the welfare of an importing country that has no domestic industry competing with the subsidized imports, one could argue that such imports are beneficial (except in the rare case of predation). Consumers in such a third country simply get cheaper products while the negative effects of subsidies are felt elsewhere. Subsidies reduce the welfare of the subsidizing country and of exporters located in countries that do not receive subsidies and whose exports to that third country might therefore be displaced or be subject to increased price pressure.³¹ Economic theory has also advanced the argument that subsidies have overall positive welfare effects for the importing country even if this country has a domestic industry competing with the imported subsidized product.³² Or, as *Jackson* has so succinctly summarized this position, the importing country should just send a ‘thank-you note’ to the subsidizing nation.³³

The system of remedies against subsidies provided for in the ASCM has also been viewed critically. Some recall the link between tariffs and subsidies and distinguish between ‘new’ and ‘existing’ subsidies in relation to the time when the tariff concession was made. As subsidies can frustrate tariff concessions made previously, they accept action against such new subsidies as a means to enhance the value of the tariff concession. However, challenges of subsidies that existed at the time when the tariff concession was made would not be compatible with that opinion.³⁴ Others that are critical against any anti-subsidy action point out that the ASCM does not necessarily distinguish adequately between ‘good’ subsidies (that address market failures) and ‘bad’ subsidies (that are trade distorting).³⁵ It is submitted that this criticism is ultimately not convincing. The text of Article 1 ASCM as interpreted by relevant DSB rulings has by and large ensured that anti-subsidy action does not hamper in any major way the pursuit of legitimate policy concerns.³⁶

Using as a starting point the view that some subsidies are ‘good’, it has also been argued that action against subsidies as foreseen by the ASCM is overshooting. This view points out that the level of a countervailing duty is

³¹ *Janow/Staiger* (2004) pp. 284–285.

³² *Evaluation Study* (2012) p. 21; *Bagwell/Staiger* (2004) pp. 179–180.

³³ *Jackson* (2000) p. 281. See also *Janow/Staiger* (2003) p. 204 and p. 205.

³⁴ *Janow/Staiger* (2003) pp. 210–215. The appropriate action would, however, be something more in the form of a non-violation complaint pursuant to Article XXIII:1(b) GATT 1994 than the system of remedies provided in the ASCM.

³⁵ *Sykes* (2005) p. 105.

³⁶ See also *infra* pp. 12–16.

not mandatorily governed by the lesser-duty rule.³⁷ The lack of a mandatory lesser-duty rule means in practice that the level of a countervailing duty can be higher than what is necessary to remove from the industry of the importing country the injury resulting from the subsidized imports.³⁸ However, given that there is no universally accepted methodology to measure injury and that it is inherently difficult to quantify injury, and given that a countervailing duty typically only intervenes after a lengthy investigation, this criticism is not convincing either. The ASCM system is designed in such a way that some injury caused to the industry adversely affected by subsidies will necessarily remain unaddressed. Note also that under the WTO dispute settlement system, anti-subsidy action is prospective.³⁹

However, the need for multilateral disciplines concerning the control of the provision of subsidies can be justified from a variety of angles that take a broader perspective than a purely economic one. First, as pointed out above, subsidies can have an effect very similar to import tariffs. Therefore, granting subsidies can frustrate market access expectations that originate in tariff concessions obtained in the WTO framework.⁴⁰ More generally, it would appear that the confidence in the WTO system of trade liberalization, its credibility and viability could be undermined in the absence of subsidy disciplines. Second, the danger of a subsidy ‘race’ or even a subsidy ‘war’ should be mentioned. Subsidies given by one country may generate requests by overseas competitors for similar or even higher levels of subsidies. In the political discourse, a plea for subsidies will often find support and even appear compelling if it is made by manufacturers (and their workers) that compete against subsidized overseas competitors. The resulting response to such unfair trade could prove more restrictive than the complicated subsidy disciplines under the ASCM.⁴¹ In that

³⁷ See the second sentence of Article 19.2.

³⁸ *Hufbauer/Erb* (1984) p. 19.

³⁹ See *infra* Article 4, pp. 236–243.

⁴⁰ See *Sykes* (2010) pp. 496–497 who, however, also points out that this problem could be sufficiently addressed by non-violation complaints pursuant to Article XXIII of the GATT 1994, possibly combined with specific commitments limiting subsidies and modelled on the Agreement of Agriculture. Indeed, the ASCM subsidy disciplines apply across all products while market access expectations will typically be focused on the specific concessions obtained in a trade negotiation.

⁴¹ *Hufbauer/Erb* (1984) p. 8, p. 17 and p. 21. According to *Sykes* (2010) p. 499, the aim to avoid competitive subsidization is not linked to the frustration of market access commitments. Rather, governments may have an interest in cooperating to reduce competitive subsidization to avoid unnecessary subsidy wars.