Chapter 6

SUBSIDIES AND COUNTERVAILING MEASURES

OVERVIEW OF RULES

Subsidies have been provided widely throughout the world as a tool for realizing government policies. They can take the form of grants (normal subsidies), tax exemptions, low-interest financing, investments, and export credits. There are six primary categories of subsidies, divided by purpose: 1) export subsidies, 2) subsidies contingent upon the use of domestic over imported goods, 3) industrial promotion subsidies, 4) structural adjustment subsidies, 5) regional development subsidies, and 6) research and development subsidies. By beneficiary, there are two primary categories: 1) subsidies not limited to specific businesses or industries (non-specific subsidies), and 2) subsidies limited to specific businesses and industries (specific subsidies).

Although governments articulate ostensibly legitimate goals for their subsidy programmes, it is widely perceived that government subsidies may give excessive protection to domestic industries. In such cases, subsidies act as a barrier to trade by distorting the competitive relationships that develop naturally in a free trading system. Exports of subsidized products may injure the domestic industry producing the same product in the importing country. Similarly, subsidized products may gain artificial advantages in third-country markets and impede the exports of other countries to those markets.

Because of this potential, the WTO Agreements prohibit with respect to industrial goods any export subsidies and subsidies contingent upon the use of domestic over imported goods as having a particularly high trade-distorting effect. Furthermore, even for subsidies that are not prohibited, it allows Member importing subsidized goods to enact countermeasures such as countervailing duties if such goods injure domestic industry and if certain procedural requirements are met. For agricultural products, the WTO Agreements require obligations such as reducing export subsidies and domestic supports.

THE STATUS QUO OF THE SUBSIDIES AGREEMENT

The legal disciplines on subsidies are found in Articles VI and XVI of the GATT, which define the basic principles for this area. General implementation provisions for subsidies are found in the “Agreement on Subsidies and Countervailing Measures” (the “Subsidies Agreement” hereinafter; see Note 1 below).

The current Subsidies Agreement was stipulated during the Uruguay Round negotiations as a new discipline to take the place of the 1979 “Agreement on the Interpretation and Application of Article VI, Article XVI and Article XXIII of the General Agreement on Tariffs and Trade”. In comparison with the previous agreement, it provides more explicit definitions of subsidies and stronger and clearer disciplines on countervailing measures.

The current Subsidies Agreement (“the Agreement” hereinafter) begins by defining the subsidies covered and classifying them into three types depending upon their purpose and nature. It then defines the relationship of each category to countervailing measures and relief measures as well as the procedures to be followed. It concludes with special and differential treatment for developing country members and transitional arrangement for members in the process of transformation from a centrally planned economy into a market, free-enterprise economy.

However, the disciplines on 1) “serious prejudice” as defined in Article 6.1, and 2) “green subsidies” as defined in Articles 8 and 9 were only provisionally applied, and had a termination date of the end of 1999 (Article 31). A decision was supposed to have been made by the end of 1999 on extending the application of these provisions, but no consensus was reached because of disagreement between developing country members, who would only accept extension if accompanied by further preferential measures for developing country members, and developed country members who sought an extension of the disciplines without linkage to preferential treatment.

The review of the definition of “export competitiveness” of developing country members" (Article 27.6—see Note 3) is currently being discussed in the “Implementation-related issues” arena (see Note 4).

Notes:

1) The “Agreement of Agriculture” provides separate disciplines for agriculture, but the Subsidies Agreement covers forestry and fishing products.

2) a) *Definition of “serious prejudice” (Article 6.1).* The Agreement defines three main categories of subsidy that are deemed to have “serious prejudice” to the interests of the other members: 1) the total *ad valorem* subsidization of a product exceeding 5 percent, 2) subsidies to cover operating losses sustained by an industry or an enterprise, and 3) direct forgiveness of debt. The existence of “serious prejudice” brings a subsidy up for elimination or other remedies.

   b) *Scope of green subsidies (Article 8) and remedies (Article 9).* Subsidies that are not subject to countervailing measures (“green subsidies”) include generally available subsidies that lack specificity and subsidies that have specificity but meet certain criteria. For example: 1) research and development subsidies, 2) regional development subsidies, and 3) environmental conservation subsidies (Article 8). Green subsidies that have specificity and exert significant detrimental impact on trading partners are subject to consultations and relief measures (Article 9).

3) *Definition of export competitiveness of developing country members (Article 27.6).* Developing country members are allowed to offer export subsidies for a specific period of time (or in perpetuity for some members), but are required to eliminate the export subsidy within two years (for some, eight years) after export competitiveness is achieved. The Article says that “export competitiveness in a product exists if a developing country Member’s exports of that product have reached a share of at least 3.25 percent in world trade of that product for two consecutive calendar years”. This definition was to be reviewed five years after the WTO Agreement took effect.

4) *Implementation-related issues.* Implementation-related issues are discussions of measures required to facilitate adherence to the current Agree-

ment as a means of building confidence among developing country members in the wake of the Seattle Ministerial Meeting of December 1999.

Figure 6-1

General Rules on Preferential Measures
and Transitional Arrangements of Red-light Subsidies

	Export Subsidies	Subsidies Contingent upon the Use of Domestic over Imported Goods
Least-Developed Country (LDC) Members	Not applied	Not applied for a period of eight years from the date of entry into force of WTO Agreement
Developing Country Members described in Annex VII (b)	Not applied	Not applied for a period of five years from the date of entry into force of WTO Agreement
Other Developing Country Members	Not applied for a period of eight years from the date of entry into force of WTO Agreement	Not applied for a period of five years from the date of entry into force of WTO Agreement
Developed Country Members	Not applied for a period of three years from the date of entry into force of WTO Agreement for the member	Not applied for a period of three years from the date of entry into force of WTO Agreement for the Member
Members in the process of trans-formation from a centrally–planned economy into a market one	Not applied for a period of seven years from the date of entry into force of WTO Agreement	Not applied for a period of seven years from the date of entry into force of WTO Agreement

AGREEMENT ON AGRICULTURE

In the area of agriculture, treatment of subsidies on agricultural products will follow the disciplines laid out in the Agreement on Agriculture, even though such subsidies may appear to come under the provisions of the Subsidies Agreement.

Domestic Supports (Article 6 and 7)

(a) Domestic supports are divided into “yellow” (subject to elimination) and “green”/ “blue” (not subject to elimination) categories.

(b) The following policies are deemed “green” as long as certain conditions are met:

- Research, promotion, education, inspection, and other general services
- Infrastructure services for agricultural areas and rural communities; creation of markets for agricultural products
- Public stockholding for food security purposes.
- Domestic food aid
- Decoupled income support (i.e., not directly linked to production)
- Income insurance and safety-net programmes
- Relief from natural disasters
- Structural adjustment assistance provided through producer retirement, resource retirement, and investment aid programmes
- Payments under environmental programmes
- Payments under regional assistance programmes

“Blue” categories include direct payments under production restriction plans as long as any of the following conditions are met.

- Payments are based on fixed area and yield (the deficient payment system under the US Agriculture Act of 1990 (abolished by the US Agriculture Act of 1996)).
- Payments are made on 85 percent or less of base level of production (subsidy payments for idle fields under the EU Common Agriculture Programme).
- Livestock payments are made on a fixed number of head (incentives for the bovine sector under the EU Common Agriculture Program).

(c) All programmes not considered to be "green" are included in an "Aggregate Measurement of Support (AMS)", which is to be reduced by 20 percent over a period of six years. The AMS represents the amount of market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment provided by a given country. They are concluded using the fixed external reference price, based on the years 1986 to 1988. The AMS expresses the extent of protection given to agricultural products. Specific guidelines are set for individual basic items, with non-specific supports measured in aggregate monetary amounts. But it is not required to include product-specific domestic support, which does not exceed five percent of the total value of its domestic production in the calculation of total AMS.

Export Competition (Articles 8 to 11)

(a) Over a period of six years, direct export subsidies are to be reduced by 36 percent and the volume of subsidized exports by 21 percent.

(b) Measurements are based on the period 1986-1990.

(c) Each Member undertakes not to provide export subsidies other than those in conformity with this Agreement and with the commitments as specified in that Member's Schedule.

The uniform dispute settlement procedures of the WTO apply to consultations and dispute settlements under this Agreement.

RECENT TRENDS

Subsidies and countervailing measures are not subjects with which people in Japan are very familiar. Japan has only conducted one subsidy investigation in its history[1]; it has never been subject to an investigation by another country. But elsewhere in the world, countervailing duties are almost as widely used as anti-dumping duties (see Figure 6-3). The United States, the most frequent imposer

[1] Japan did initiate an investigation into imports of cotton thread from Pakistan in April 1983 but did not impose a countervailing duty because Pakistan eliminated the subsidy in February 1984. An application was also filed for a countervailing duty against Brazilian ferro-silicon in March 1984 but was withdrawn in June of that year. No investigation was ever initiated.

of countervailing duties, initiated 11 subsidy investigations between July1999 and June 2000, and had 44 countervailing duties in place at the end of June 2000.

Figure 6-2

Number of Countervailing Duty Investigations and Outstanding Countervailing Measures in Selected Countries

Number of Investigations

	1/85-6/95	7/95-6/96	7/96-6/97	7/97-6/98	7/98-6/99	7/99-6/00
US	206 (24)	4 (2)	4 (0)	6 (0)	15 (2)	11 (1)
Australia	28 (19)	0 (0)	1 (0)	6 (0)	0 (0)	2 (0)
Chile	25 (7)	0 (0)	0 (0)	6 (0)	0 (0)	4 (4)
Canada	14 (5)	1 (1)	0 (1)	0 (0)	1 (0)	9 (4)
NZ	7 (4)	0 (0)	2 (2)	1 (1)	0 (0)	0 (0)
Brazil	5 (3)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)
EU	2 (0)	0 (0)	1 (1)	8 (2)	17 (0)	12 (0)
Japan	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)

Number of Outstanding Measures as of the End of June 2000

US	Australia	Chile	Canada	NZ	Brazil	EU
44	5	0	6	2	6	12

Source: GATT/WTO Documents

Notes: 1. Figures in parentheses indicate number of cases for agricultural products.

2. There have not been any investigations in Japan.

Subsidies and countervailing measures have triggered many disputes. One reason for the frequency of subsidy complaints under the GATT was the ambiguity of the previous Subsidies Agreements. Countries interpreted differently the procedural rules for invoking countervailing duties. Underlying this disagreement was a basic conflict between the various contracting parties as to how to view government assistance designed to protect and nurture domestic industry.

Exporting countries frequently initiated GATT disputes involving subsidies. The exporting countries generally claimed that countervailing duties had been imposed unfairly on the basis of arbitrary determinations of subsidies, injury, or causation. Other disputes concerned domestic subsidies that nullify the benefits gained through tariff reductions by effectively excluding exports from the domestic market. While there has been a decline in the number of cases brought before panels since the WTO Agreement went into force, it is notable that prohibited subsidy disputes that have reached a panel have recently increased. (See Figures 6-3 and 6-4)

<u>Figure 6-3</u>

Number of Panel Cases Concerning Subsidies

	1981-1985	1986-1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
CVD Measures	0	5	1	2	1	0	0	0	0	1	0
Other Measures	3	2	1	0	0	0	0	1	7	2	0
Total	3	7	2	2	1	0	0	1	7	3	0

Source: GATT/WTO Documents.

Note: CVD = countervailing duties.

Figure 6-4

Major Disputes in Subsidies and Countervailing Measures since 1991

Date of Establish-ment	Claimant	Respond-ent	Description of complaint
March 1996	Philippines	Brazil	Countervailing Duties imposed by Brazil on Philippine dried coconuts is a violation of the Subsidies Agreement. (Appellate Body report adopted in March 1997)
June 1997	Japan	Indonesia	Indonesia's "National Car Programme" contains measures for automobiles and parts that violate the Subsidies Agreement. (Panel report adopted in July 1998)
July 1998	Canada	Brazil	Brazil's aircraft export finance programme violates the Subsidies Agreement. (DSU 21.5 Panel report adopted in August 2000)
July 1998	Brazil	Canada	Federal and provincial subsidies for civil aircraft exports violate the Subsidies Agreement. (DSU 21.5 Panel report adopted in August 2000)
June 1998	USA	Australia	Australian government subsidies for producers and exporters of automobile leather products violate the Subsidies Agreement. (DSU 21.5 Panel report adopted in February 2000)
February 1999	Japan/EU	Canada	US-Canada auto pact allowing duty-free imports into Canada of automobiles from some auto industries and associated measures violate the Subsidies Agreement. (Appellate Body report adopted in June 2000)
September 1998	EU	USA	US tax exemption for FSC (Foreign Sales Corporation) violate the Subsidies Agreement. (Appellate Body report adopted in March 2000)
February 1999	EU	U SA	US countervailing duties on British steel products (hot –rolled lead and bismuth carbon steel) violate the Subsidies Agreement. (Appellate Body report adopted in June 2000)

Source: GATT/WTO Documents.

ECONOMIC IMPLICATIONS

Government subsidization may have far-reaching implications. When a government subsidizes projects, such as research projects in advanced technology, the benefits may extend well beyond the industry directly concerned. This is true because the results of projects spill over into a wide range of fields. Government assistance for research activities can contribute not only to domestic economic development, but also to the development of the world economy as a whole.

Subsidies may also be used to encourage less competitive industries to reduce excess capacity or to withdraw from unprofitable fields. They may, therefore, smooth the way for structural adjustment and shifts in employment. Such subsidies therefore promote the appropriate allocation of resources and encourage imports of competitive goods.

On the other hand, subsidies can also distort trade when they are used to protect a domestic industry regardless of its competitiveness. Governments have often used subsidies to needlessly prolong the natural adjustment process in certain industries. Over the short term, such subsidies may place a domestic product in a better competitive position. They may maintain or increase the profitability of the products and keep employment in that industry stable. Over the longer term, however, the disadvantages of the subsidies become clear. They impede the productivity gains that come from intensely competitive environments and undermine the efforts of companies to rationalize. Thus from a medium- and long-term perspective, subsidies may obstruct an industry's development or impede the rational allocation of domestic resources.

For example, subsidies tend to impede the efforts of companies struggling to improve productivity and rationalize operations in an extremely competitive environment. Over time, therefore, subsidies actually obstruct the development of domestic industry and the appropriate allocation of domestic resources. On a global economic level, distortions in the allocation of resources and the international division of labour become serious problems as well. And even when subsidies are used to make up for short-term market failures, there is still potential for their purposes and terms to be subverted.

Subsidies that are used as part of a “beggar-thy-neighbour” policy ultimately may induce retaliatory subsidies, leading to “subsidy wars”. Subsidy policies will then be to blame not only for preventing a product from achieving its proper competitive position, but for needlessly draining the treasuries of the countries involved. The result is a larger burden for taxpayers. In no way, therefore, do such policies improve the economic welfare of anyone concerned.

Countervailing duties should be used properly or not at all. When improperly imposed, countervailing duties seriously affect the trade of the product concerned and distort the flow of world trade. (For countervailing duties improperly imposed, see "United States: Imposition of Countervailing Duties on Hot-Rolled lead and Bismuth Carbon Steel Products" below.)

PROBLEMS OF TRADE POLICIES AND MEASURES IN INDIVIDUAL COUNTRIES

INDUSTRIES OTHER THAN AGRICULTURE

At present, the following measures are called into question regarding their conformity with the Subsidies Agreement. For these measures, further information should be gathered and improvements should be monitored. When problems are found and no improvements are seen, these issues should be raised at the WTO and appropriate resolution under the Subsidies Agreement should be sought when necessary.

1. UNITED STATES

Imposition of Countervailing Duties on Hot-rolled Lead and Bismuth Carbon Steel Products

In January 1993, the United States imposed countervailing duties on certain hot-rolled lead and bismuth carbon steel products from France, Germany, and the United Kingdom.

The European Union maintained that in calculating the amount of the subsidy, the United States used arbitrary methods and argued that the US method was inconsistent with Article 4.2 of the previous Subsidies Agreement, which states: “No countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product”.

In June 1993, a panel was established at the request of the EU to examine countervailing duties on hot-rolled lead and bismuth carbon steel products. The panel reviewing the case published its report in November 1994, but the report was not adopted. Japan participated in this case as an interested third party, and submitted an opinion paper in October 1993 in agreement with the EU position.

The US Department of Commerce reviewed the countervailing duty rate on imports entering the United States from 1995 to 1997, retaining a countervailing duty on imports of hot-rolled lead and bismuth carbon steel products from Great Britain even though companies that had received subsidies sold their assets at market prices. The US claims that the benefit of the subsidy was nonetheless transferred to the selling companies. The EU argues that this measure violates Article 10 (“Application of Article VI of GATT 1994”) and Article 19.4 (“no countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist”) of the Subsidies Agreement. In February 1999, a panel was established at the request of the EU, and its report was issued in December 1999. The report found the 1995-1997 review to have violated the Article 10 stipulation to “take all necessary steps” because it failed to follow the provisions of Article 19.1, 19.2 and 21.1 of the Subsidies Agreement and Article VI.3 of the GATT.

The panel also upheld the argument made by the EU that in as much as purchases were made at fair market value, the benefit of subsidies did not accrue to companies further down the line than those receiving investments in kind. The US appealed the panel report to the Appellate Body in January 2000, but the Appellate Body in the main upheld the panel verdict. The Appellate Body ruling also touched on the Amicus Curae brief (submission of opinions by non-parties to the dispute), ruling that the panel “is under no obligation to accept briefs, but has the authority to do so”. The handling of this ruling on the Amicus brief will be a key issue to be discussed in the future.

The EU also has sought speedy elimination of similar countervailing duties imposed by the US on steel exports from EU member companies located in countries other than the United Kingdom, but the US argued that British hot-roll lead and bismuth carbon steel was a separate issue from steel from other EU companies. This produced a further conflict between the US and the EU, and in November 2000 the EU requested formal consultations with the US on 14 countervailing duties imposed on steel produced by EU companies. Japan will continue to analyze and monitor these cases.

Tax Treatment for Foreign Sales Corporations

The United States allows foreign sales corporations (FSC) domiciled within its tax havens or outside of its borders engaged in commercial activities to exempt a portion of their export income from their income taxes if exports contain a certain level or greater of US products. Parent companies can also deduct dividends paid to them by these FSC from their income taxes. The system is employed mainly by US parent companies exporting their products through foreign subsidiaries.

In November 1997, the EU requested consultations with the US, claiming that the system represented an export subsidy and subsidy contingent upon the use of domestic goods over imported goods prohibited under the agreement. Consultations in the case were held three times between the United States and the EU, but they were unable to reach an agreement. In September 1998, a panel was established. Japan participated in the panel as a third party and noticed that this programme was a potential violation of the agreement.

The panel report was issued in October 1999 and found that the tax exemptions granted under the FSC programme constitute export subsidies in violation of the Agreement. The report recommended the United States to eliminate the system by October 2000. It did not, however, find it to be a subsidy contingent upon the use of domestic goods over imported goods. The US appealed the "export subsidy" ruling, while the EU appealed the failure to find the programme a "subsidy contingent upon the use of domestic goods over imported goods". Japan again participated as a third party and pointed out that the FSC programme was inconsistent with the Agreement. In February 2000, the Appellate Body mainly upheld the panel ruling. In light of the Appellate Body ruling, the US declared the repeal of the FSC by 1 November 2000. Congress began to legislate the FSC Repeal and Extraterritorial Income Exclusion ("the FSC Replacement Scheme" hereinafter). On 17 November 2000, President Clinton signed the FSC Replacement Scheme.

The US claims that the amendments had two main effects: 1) to expand the scope of tax deductions by not requiring that products (including services) be produced within the United States, so that the FSC Replacement Scheme does not constitute an export subsidy; and 2) to amend the Internal Revenue Code of 1986 to exclude tax deductions for the income derived from foreign sales or leasing of products (including services) produced under certain conditions, therefore not creating a subsidy as defined in the Agreement. The EU criticized the FSC Replacement Scheme for: 1) maintaining the condition that sales be outside the United States, so that the FSC Replacement Scheme still provides an export subsidy; 2) requiring at least 50 percent US content, so that the Scheme also provides a subsidy contingent upon the use of domestic over imported goods; and 3) allowing FSC to continue to operate after November 2000 and for the foreseeable future as a transitional measure, thereby violating the Dispute Settlement Body (DSB hereinafter) decision that the system be eliminated by 1 November 2000. The EU argued that the FSC Replacement Scheme would continue to violate the WTO and Subsidies Agreements. When the legislation passed, it submitted a list of US products subject to sanction because the FSC Replacement Scheme was still inconsistent with the Agreement. The US and EU have agreed to establish a panel to judge the WTO consistency of the FSC Replacement Scheme (under Understanding on Rules and Procedures Governing the Settlement of Dispute “DSU” Article 21.5), and the EU will decide whether to invoke sanctions after hearing the panel ruling.

FSC were created to take the place of the DISC scheme that was created in 1985 annually. The benefits of the measure are estimated to be enormous—in excess of $4 billion. Japan will be carefully studying the WTO conformance of the FSC Replacement Scheme and will monitor subsequent developments.

Byrd Amendment (Agricultural Spending Law of 2001)

In October 2000, the US Congress passed the Agriculture Spending Law of 2001, which included a clause (the “Byrd amendment”) to amend a part of the Tariffs Act of 1930 so as to distribute the revenues collected from anti-dumping and countervailing duties to companies within the United States filing complaints. President Clinton signed the law in November.

This affects the Subsidies because the imposition of countervailing duties should be of sufficient scope to offset damages incurred by the domestic industry of the importing member. In spite of this, however, this measure would distribute the funds obtained from countervailing duties to industry within the United States, therefore going beyond the relief measures anticipated in the Agreement.

The clause also gives an unnecessary incentive to companies to file complaints requesting countervailing duties and has the potential to encourage abuse of countervailing duty measures. This is problematic for the maintenance of the free trading system. (For a detailed discussion see Chapter 5, “Anti-dumping” on the Byrd Amendment.)

2. AUSTRALIA

Subsidies to Producers and Exporter of Automotive Leather

The government of Australia signed two contracts with Howe, the country’s only manufacturer of automotive leather goods. Those contracts constitute 1) a grant contract under which it would provide the company with a A$30 million grant if it met certain set performance goals for the period between April 1997 and December 2000, and 2) a loan contract providing a A$25 million, 15-year loan at a preferential tax rate. In November 1997, the United States requested WTO proceedings, claiming that this measure was an export subsidy prohibited by the Agreement.

In June 1999, the panel ruled that Howe would necessarily have to increase its exports to meet the set performance goals in the grant contract, and therefore the achievement of export targets was a condition on which the subsidy was being made available to Howe. The panel found the grant contract to be an export subsidy.

On the other hand, the panel did not find a clear relationship between Howe's sales performance and the loan contract and dismissed the claim that the loan constituted an export subsidy. The panel recommended to Australia to withdraw the A$30 million grant that had been found to be an export subsidy within 90 days, pursuant to Article 4:7 of the Agreement.

In light of the panel recommendation, Howe returned to the government as a prospective element the A$8.06 million that had been paid to it for the sales goals from September 1999 to June 2000, and the government of Australia announced a new A$13.65 million loan for Howe’s parent company.

The United States referred this measure to the panel under Article 21.5 of the DSU, arguing that Australia had not eliminated the subsidy that was found to be inconsistent with the Agreement. In its complaint, the US said that it agreed with the Australian idea of returning only the prospective portion, but argued that in the return of the subsidy the prospective portion distributed prior to the adoption of the panel report would have an effect on the future and asked the panel to increase the repayment by that portion and the interest associated with it.

The panel ruled that the government of Australia had not followed the panel's recommendation because 1) the elimination of the subsidy under Article 4.7 of the Agreement requires the full return of the prohibited subsidy so as to eliminate the benefits of the subsidy and is not limited to the prospective portion, and 2) the new loan to Howe's parent company nullifies the return of a portion of the subsidy. The panel also ruled that there was no obligation to return interest.

Australia opposed adoption of the report, arguing 1) that it contained retroactive application and had a punitive nature, and 2) that the panel recommendation exceeded the requests made by the United States. The United States supported adoption of the report, arguing that the panel recommendation meant that the elimination of prohibited subsidies must be a meaningful elimination rather than a formal elimination. Canada, Brazil, and Malaysia expressed concern over the panel verdict in the interpretation of Article 4.7 and the impact that the ruling would have on the future. The panel report was, however, adopted in February 2000.

The panel recommended that Howe should return A$22 million, but it was difficult for the company to return the full amount and Australia and the US attempted to reach a suitable solution. In June 2000, Australia agreed to eliminate tariffs on 30 industrial items of high interest to the United States (condoms and kitchen knives, among others), the partial return of the export subsidy provided to Howe, and the exclusion of Howe from eligibility for future subsidy programs.

This case has bearing on Japan's policy because it is impossible to require repayment of subsidies for government at reasons that have been distributed and effected according to domestic law (Subsidy Rectification Law). The panel does not have any binding force as precedent, but we must carefully consider the acceptability of the report and the impact that it will have on future panels and Appellate Body rulings. We must also monitor developments for consistency with domestic law.

3. CANADA

Auto Pact

Japan requested that a panel be established, alleging that tax measures taken by the government of Canada on the basis of the Auto Pact constitute export subsidies and subsidies contingent upon use of domestic goods over imported goods as defined in the Subsidies Agreement. The panel found them to constitute export subsidies, but not subsidies contingent upon use of domestic goods over imported goods because it was possible to receive tax waivers even without using domestic products. Canada appealed the decision, but the Appellate Body upheld the Panel Ruling.

4. REPUBLIC OF KOREA

Shipbuilding Subsidy

Korea and the EU have attempted to reach agreement on shipbuilding in bilateral negotiations, but negotiations on the financial support provided to Korea's shipbuilding industry in recent years have foundered. European shipbuilders argue that the financial support provided by Korea unfairly reduces the unit prices charged by Korean companies for ship orders and therefore disadvantages shipbuilding within the EU. In October 2000, the European Commission began to consider the possibility of taking steps against the measure in accordance with the rules on technical barriers to trade. WTO retaliatory measures are among those being considered.

As background to the case, the Korean shipbuilding industry has expanded rapidly and now claims approximately two-thirds of total worldwide ship demand (approximately 30 million tons). The share of European companies has fallen by a commensurate amount. Ship prices have also fallen 15-35 percent since 1997. Europe points to Korea's financial assistance policies as the prime factor in this. In particular, Europe argues that the loans and debt guarantees provided to the shipbuilding industry by the Korea Development Bank, considered to be a government-controlled financial institution by the EU, wilfully maintain excessive capacity and prevent shipbuilding cost structures from reaching appropriate levels. Korea vigorously denies that it is landing orders at unfairly low prices and says that the main reason for the problems is the fall of the *won* against the US dollar.

Japanese ship builders have maintained relatively high levels of order bookings, but fierce competition has driven prices down. Japan will need to monitor Korean financial assistance policies for conformance to the WTO

Agreement on Subsidies and Countervailing Measures.

AGRICULTURE

The Agriculture Agreement in principle provides for reductions in trade-distorting policies and measures in this area. Japan should monitor implementation of this Agreement closely.

1. UNITED STATES

Export Promotion of Agricultural Products

In the 1980s, the European Union, faced with a serious glut of agricultural products, increased its subsidized exports. During this period, the United States saw its share of export markets rapidly diminish as its competitiveness was sapped by the strong dollar and domestic price supports. To counter the export slump and revive prices, the United States has developed the following export promotion programmes. The Agriculture Act of 1996 (enacted in April) maintains these export policies, though it brings them into conformance with the WTO Agreement.

(a) *Export Enhancement Plan (EEP).* The EEP specifies markets and pays exporters bonuses equivalent to the discounts they provide their customers. The major items eligible for EEP bonuses are wheat, wheat flour, and barley.

(b) *Dairy Export Incentive Programme (DEIP).* The DEIP is an export subsidy system similar to EEP, and its application is limited to such dairy products as dry milk, butter, and cheese.

(c) *Marketing Loans*. Marketing loan provisions provide a repayment rate for short-term CCC loans repaid by farmers who have sold their crop during the term of the loan at prices below the loan rate. The system increases the government contribution, but it also holds down prices for US agricultural products, thereby increasing their export competitiveness. The marketing loans apply to products such as rice, upland cotton, soybean, wheat, and feed grain.

(d) *Export Credit Guarantee Programme.* The Export Credit Guarantee

Programme seeks to promote exports of US agricultural products by having the CCC provide debt guarantees to banks issuing letters of credit for borrowing used to finance imports of US agricultural products imported on a commercial basis by developing countries. The Agriculture Act of 1996 provides for: a short term credit guarantee programme (GSM-102) for short-term export credits involving loans of 90 days to three years; a medium-term credit guarantee programme (GSM-103) for medium-term export credits involving loans of three to 10 years; and a suppliers export credit guarantee programme (SCGP) that guarantees a part of account receivables by exporters of US agricultural products from importers. GSM-102 and GSM-103 apply both to 100-percent US agricultural products and value-added products with at least 90 percent US content (by weight). Emphasis in the SCGP is on high value-added products and promising future markets, and it defines specific products covered. The OECD is currently studying disciplines on public export credits for agricultural products.

For export subsidies like the EEP and DEIP, the Uruguay Round Agriculture Agreement allows arbitrary subsidization of exports to specific countries as long as countries fulfill agreements to cut the total amount and volume provided. These subsidies still, however, have an impact on international prices for agricultural products and they still distort trade.

In the US, agricultural products can also make use of export credit guarantee programmes that given them a competitive advantage compared to products from other exporters, and this too distorts trade. The programme instructs the CCC to collect debts should they not be repaid, but by nature this programme is extraordinarily similar to a circumvention of export subsidies.

Emergency Agricultural Relief Program

Congress enacted three emergency agricultural relief packages to alleviate the economic impact on farmers from slumping grain prices, droughts and other natural disasters. These packages affected fiscal 1999 (1 October 1998 – 30 September 1999) and fiscal 2000 (1 October 1999 – 30 September 2000). They are described below.

(a) Support under the Omnibus Spending Act of 1999 (passed October 1998). Total value: $6 billion. Main provisions: 1) payment of market losses (approximately $2.9 billion), and 2) payment of crop losses due to natural disasters and other calamities (approximately $2.4 billion).

(b) Support under the Agricultural Spending Law of 2000 (passed October 1999). Total value: $8.7 billion. Main provisions: 1) payment of market losses (approximately $5.5 billion); 2) payment of crop losses due to natural disaster etc. (approximately $1.2 billion); and 3) payments to producers of oil seeds (approximately $500 million).

(c) Support under the Agricultural Risk Protection Act (past June 2000)
Total value: $7.1 billion (farmer economic support portion). Main provisions: 1) payment of market losses (approximately $5.5 billion, and 2) payments to producers of oil seeds (approximately $500 million).

In addition to the $7.1 billion in farmer economic support, this law also contains an increase in government subsidization of insurance premiums and costs for improvements in farm insurance to enable better management of insurance operations (preventing fraudulent reports and other measures) worth $8.2 billion (over the next five years).

Parts of the package are noticed as “green” though they will need to be studied in detail to confirm that they really are. Even if they were “yellow” one could not necessarily conclude that they were inconsistent with obligations under the WTO Agreement as long as they were within the scope of promised AMS cuts. Still, the introduction of direct payments is hardly in line with the Agriculture Act of 1996 and its orientation towards market-driven agriculture.

2. EUROPEAN UNION

Export Subsidies and Export Tax

In the past, the EU imposed import levies on agricultural products as a cross-border measure and paid the difference between prices within the Union and international market prices as subsidies when exporting EU agricultural products to third countries. All of the import levies were changed into tariffs and the export subsidies will be reduced in accordance with the Uruguay Round Agreement.

The tightening of the world market in cereals has caused international prices for some products—wheat, for example—to exceed EU prices since the summer of 1995. To stabilize the international market for cereals the EU suspended export subsidies on wheat in July 1995 and amended EC regulations so as to impose export taxes on common wheat in November 1995 and barley in

December 1995. In September 1996, the imposition of export taxes was suspended and the grant of export subsidies was resumed because of the reduction of international prices for cereals. In response to a drought in May and June of 1997, which raised the potential of tight supplies and the depreciation of the German mark against the dollar in August, the EU imposed export taxes again on ordinary wheat and other products.

Developments in this regard need to be monitored closely because of the EU's position in world cereals trade. Because the EU accounts for about 20 percent of the world's wheat exports and about 40 percent of the world's barley exports in recent years, the imposition of export taxes by the EU could have significant influence on the world market in cereals. As already noted (see above, "United States; Export Promotion of Agricultural Products"), export subsidies have a strongly distortive effect on trade. The CAP reforms in "Agenda 2000", which articulates the EU expansion into Central and Eastern Europe and policies for fiscal spending restraint and other issues, provide for the use of export taxes only in extremely limited and exceptional cases—extremely tight domestic markets, for example. However, as long as the priority is on assuring supplies and stabilizing prices within the EU, these programmes call into question the balance of rights and obligations between exporters and importers.

Export Subsidies for Processed Cheese

The EU has an internal processing regime called "IPR" that enables producers to import raw materials for processing tax-free within the community and export processed products to other areas. In February 1997, it modified this system to add to the list of IPR-eligible items cheese processed within the EU and exported to provide export subsidies for processed cheese in proportion to the percentage of the contents of EU non-fat dry milk and butter used as raw materials (conditional upon at least five percent imported content in the final product).

During the Uruguay Round, the EU committed to limit and to reduce the quantity and budgetary outlay of export subsidies for four items: cheese, butter, non-fat dry milk, and miscellaneous dairy products. This system tries to use the allowance for butter and non-fat dry milk to subsidize processed cheese, and many countries suspect that it is an attempt to circumvent the commitments made for export subsidies.

In October 1997, the United States requested consultations under GATT Article XXII, arguing that the EU measure violated Articles 8, 9, 10, and 11 of the Agriculture Agreement and Article 3 of the Subsidies Agreement. Japan is participating as a third party since, as the largest export market for EU processed cheese, it has a substantial trade interest in the case. It will be necessary to monitor developments in the Article XXII consultations.

3. AUSTRALIA

Centralized Management of Wheat Exports by Government Trade Companies

Australia does not have any specific regulations on the export of agricultural products, but its public corporations and boards continue to have sole management of wheat, rice, and sugar exports. These government export companies tend not to disclose information in an adequate manner, ostensibly for "commercial reasons". The Australia Wheat Board (AWB), which had central control of all wheat exports, was privatized in July 1999 as "AWB Ltd.", but it continues to enjoy a federally granted monopoly on wheat exports; functionally it is no different from a government export company. Their monopolistic position enables government export companies to manipulate export prices and volumes, to impose unfair burdens on importers, and to compete unfairly with other countries. They are therefore by nature trade-distortive. While it cannot be necessarily concluded that these companies are inconsistent with the WTO Agreement, they do function essentially as a disguised export subsidy and call into question the balance of rights and obligations between exporters and importers.

4. CANADA

Export Subsidy Programs

In the Uruguay Round Agreement on Agriculture, Canada provided concessions on the amount and volume of export subsidies for specific items. In actual practice, the country paid a small subsidy for butter and non-fat dry milk during fiscal year 1996/1997, and no export subsidies during fiscal year 1997/1998. Canadian export subsidies, like those of the US and the EU, have the potential to influence international prices for agricultural products and to distort world trade.

Measures Similar to Export Subsidies for Dairy Products

An agreement between the Canadian federal and provincial governments resulted in the “National Marketing Plan”, under which the country regulates the supply of raw milk. The purpose of the programme is to use market-sharing quotas (MSQs) to balance the supply and demand for milk to be used in processing. The system allocates quotas to individual dairy farms and provincial producers groups in response to domestic demand.

However, Canada has an excessive supply of milk products (in particular, non-fat dry milk) because of demand and supply imbalances. For this reason, prior to the Uruguay Round negotiations, producers whose shipments exceeded their quotas were subject to stiff levies, and these levies in turn funded subsidies to exporters, thereby encouraging the surplus to be exported. As a result of the Uruguay Round, these levies were defined as export subsidies by the WTO and were therefore abolished by Canada in August 1995. At that time, however, Canada overhauled its price classifications for “milk for processing” and established a “Special Milk Class”. Prices for the Special Milk Class are set with reference to US market prices, but at levels lower than the domestic consumer price. This enables processors to export dairy products at prices below those of the domestic market.

This system was referred to the WTO by the United States and New Zealand as an export subsidy and a measure to circumvent the prohibition on export subsidies. Japan participated as a third party. In its May 1999 report, the panel found that subsidies under the programme constituted export subsidies as defined in Article 9 of the Agreement on Agriculture and were inconsistent with Article 10 of that Agreement. Canada appealed the decision, but the report of the Appellate Body in October 1999 did not overturn the final conclusions reached by the panel. During a meeting of the Disputes Settlement Body that month, both the panel and the appellate reports were adopted.

In line with these reports, federal government finally completed the necessary procedures for a new system in December 2000, and at the DSB meeting in February 2001, Canadian official reported that Canada had completely reformed the old policy in accordance with the recommendation. The core principle of the new policy is that processor or exporters with foreign customers will negotiate directly with dairy farmers in each province for milk price without control of government.

On the other hand, the United States and New Zealand insisted that the new policy has been still providing export subsidies because the Canadian government is substantially maintaining the system that low milk price is provided only for export. They requested to establish the panel based on the article 21.5 of DSU.

Grain Exports by the Canadian Wheat Board

The Canadian Wheat Board (CWB) has a monopoly on the shipment and export of the wheat and barley produced in the western plains provinces. The CWB shares the same problems as other government export companies (see above, “Australia; Centralized Management of Wheat Exports by the Government Trade Companies”.)