Chapter 7

SUBSIDIES

The subsidies may take a number of forms viz. direct financial assistance, tax remissions or tax reimbursements, foreign exchange retention schemes, multiple exchange rates etc. The General Agreement distinguishes between subsidies which result in the sale of a product abroad at a price lower than the domestic price and other subsidies which are designed to increase exports or to decrease imports. The former are generally known as the export subsidies and the latter as the domestic subsidies.

The Contracting Parties recognise that export subsidies may be harmful for the exporting as well as the importing countries. Subsidies adversely affect the trading interests of other countries and may impair the benefits which these countries expect from GATT. These adversely affect a country not only in foreign markets but also in its domestic market. Subsidies compel the adversely affected countries to institute trade and exchange restrictions which are against the fundamental objectives of the General Agreement. The financially strong countries can drive the poor countries out of the world market by the payment of liberal subsidies. Subsidies divert trade into artificial channels. Unfair competition through subsidies tends to embitter international trade relations.

Subsidies as an instrument of protection have got several advantages over other instruments of protection and, therefore, should be less objectionable. Subsidies are superior to import
restrictions in case of industries the products of which enter into
other export industries. Tariffs and quotas raise the prices of
the products of such industries and thereby adversely affect the
export industries. Similarly, subsidies are superior in case of
industries the demand for whose products is very elastic; any rise
in price caused by the institution of import restrictions might
shrink the market to such an extent that it becomes unprofitable
for the domestic entrepreneurs to enter that industry. The burden
of quantitative restrictions is concealed while that of subsidies
is known to the tax-payers and the public at large. The likelihood
of a misuse of quantitative restrictions, therefore, is more than
that of subsidies. Any misuse of subsidies is likely to arouse
strong protests from the tax-payers and thus will be immediately
checked. The distribution of the burden of the rise in the
prices of imported goods caused by import restrictions is not
equitable. The funds for paying subsidies come out of the general
revenue, the burden of which is likely to be distributed more
equitably over various classes of society (this argument is based
on the assumption that the taxation system of the country fulfills
the cannon of equity to a considerable extent). Import restrictions,
generally, raise the prices of imported goods and thus cause
inflationary pressures. Subsidies do not raise prices and thus
have no inflationary effects (the argument is based on the
assumption that funds for paying subsidies are raised in a non-
inflationary manner). Subsidies promote world consumption.

Any contracting party granting or maintaining any subsidy,
including any form of income or price support, which directly or
indirectly increases exports or decreases imports, is under the
obligation to inform the Contracting Parties in writing as to the extent and the nature of the subsidy, its estimated effect on exports or imports and the circumstances making the subsidisation necessary. (1) The Panel on subsidies, appointed by the Contracting Parties, was of the view that it is not sufficient to consider increased exports or reduced imports only in an historical sense. (2) In this connection, they drew attention to the following interpretation of the Contracting Parties: (3)

The phrase 'increased exports' in line 3 of Article XVI or the General Agreement was intended to include the concept of maintaining exports at a level higher than would otherwise exist in the absence of the subsidy, as made clear in line 3 of Article 25 of the Havana Charter.

mutatis mutandis this interpretation must apply to the effect on imports. The criterion is, therefore, what would happen in the absence of a subsidy. While the Panel agreed that in most cases such a judgment cannot be reached only by reference to statistics, it, nevertheless, held that a statistical analysis helps to discern the trends of imports and exports and may assist in determining the effects of a subsidy. The Panel considered it fair to assume that a subsidy which provides an incentive to increased production will, in the absence of offsetting measures, either increase exports or reduce imports.

At the Fourth Session, the Contracting Parties established

(1) Article XVI, 1.

(2) GATT, Basic Instruments and Selected Documents, Ninth Supplement (Geneva, 1961) 191.

(3) GATT, Basic Instruments and Selected Documents (Geneva, 1952) 11, 44.
arrangements for the notification of subsidies and at the ninth Session a questionnaire was adopted to facilitate this. At their sixteenth Session, the Contracting Parties approved a recommendation by the Panel for a revised questionnaire. In recent years the notifications have improved, both in respect of the number of countries submitting notifications and the information contained in them. In latter respect, there has been significant improvement since the revision of the questionnaire. Many countries maintaining subsidies, however, are not submitting notifications. A number of notifications do not contain the required information.

If the subsidy causes or threatens to cause an injury to the interests of any contracting party, the contracting party granting the subsidy undertakes, upon request, to enter into discussion with the contracting party concerned or the Contracting Parties as to the possibility of limiting the subsidization. At the review Session, it was made clear that such consultations can be initiated by a contracting party without necessity for prior action by the Contracting Parties. (4) Though some cases of complaint or consultation regarding subsidies have taken place, many countries have been reluctant to initiate consultations because they themselves apply similar measures.

A distinction is made between primary products and other products for the application of provisions relating to export subsidies. The contracting parties will try to avoid subsidies on the export of primary products. (5) If any contracting party

(4) GATT, Basic Instruments and Selected Documents, Third Supplement (Geneva, 1955) 226.

(5) Article XVI, 3.
grants directly or indirectly any form of subsidy which increases the export of a primary product, the subsidy will not be applied in a manner which results in that contracting party having more than an equitable share of world export in that product. The equitable share of the contracting parties will be determined in reference to a past representative period taking into account any change, which might have occurred since then, affecting trade in the product. Any subsidy resulting from stabilisation programme for primary products will not fall within the purview of this clause if the Contracting Parties determine that: 1) the programme has also resulted, or is so designed as to result, in the sale of the product for export at a price higher than the comparable price charged for the like product to buyers in the domestic market; 2) the programme is so operated, or is designed to operate, either because of the effective regulation of production or otherwise, as not to stimulate exports unduly or otherwise seriously to prejudice the interests of other contracting parties. In case the stabilisation programme is financed wholly or partly out of government funds in addition to the funds collected from producers, the subsidies under the programme will fall within the purview of para 3 of this Article. Stated below is a case of the violation of the above mentioned provisions of the General Agreement.

**French Assistance to Exporters of Wheat and Wheat Flour.**

The Government of Australia lodged a complaint against France regarding the subsidization of wheat, and more particularly of wheat flour, through the operation of the French Wheat monopoly which was causing adverse effects on Australian trade. A panel was appointed to examine the complaint. At the recommendations of
the panel, the Contracting Parties recommended that the French Government consider measures to avoid subsidization in a manner which causes adverse effects on normal Australian exports of flour to Southeast Asia and, more generally, on markets of wheat and wheat flour. (6) Such measures might consist of a revision of methods applied for financing of French exports of wheat more particularly of wheat flour, or of an agreement by the French Government to enter into consultations with the Australian Government before French exporters enter into new contracts for exports of flour to Southeast Asian markets in order to minimize the impact of such contracts on normal Australian trade channels.

While the industrialised countries have made extensive use of subsidies on primary products, particularly for supporting farm incomes, most of them have since adopted a standstill prohibition on the use of subsidies in respect of manufactured products. The Contracting Parties at their seventeenth Session drew up a Declaration giving effect to the provisions of Article XVI:4 which became effective between the countries which accepted it on 14 November 1962 after it had been accepted by fourteen "key" countries, as specified in the Declaration. (7) The sixteen countries participating in the Declaration cannot now apply direct or indirect export subsidy which results in the sale of non-primary

(6) GATT, Basic Instruments and Selected Documents, Seventh Supplement (Geneva, 1959) 22-3 and 46-60.

(7) The "key" countries are: Australia, Belgium, Canada, Denmark, France, the Federal Republic of Germany, Italy, Luxembourg, Netherlands, Norway, Sweden, Switzerland, the United Kingdom and the United States. New Zealand and the Federation of Rhodesia and Nyasaland have also accepted the Declaration.
products at prices lower those charged for the like product in the domestic market.

Under another declaration providing for a standstill on export subsidies on non-primary products which also became effective on 14 November 1962, seventeen countries including three countries which have not accepted the Declaration mentioned above have committed themselves not to introduce new subsidies or increase existing ones.

while recognizing the importance of avoiding competitive subsidization of their exports, most of the developing countries have expressed their inability to accept either the standstill or the prohibition on the use of subsidies on manufactured products on the ground that a judicious application of subsidies is essential for stimulating the development of their industries and encouraging exports.

The Panel on subsidies, appointed by the Contracting Parties, has pointed out that the progressive elimination of quantitative restrictions and reduction of tariffs has led to an increasing realization "of the importance of subsidies as measures influencing international trade and of the fact that they often closely resemble quantitative restrictions and tariffs in their purpose and effect," and has noted that the use of subsidies as a whole had increased during the last few years. (8) The commodities which are mostly granted subsidies are cereals, dairy products, meat, sugar and vegetable oilseeds and oils. Other important primary commodities

(8) GATT, Basic Instruments and Selected Documents, Tenth Supplement (Geneva, 1962) 201.
subject to subsidies in several countries include cotton, eggs, potatoes and tobacco. In a declaration on 19 November 1960, the Contracting Parties stated that it is highly desirable that the provisions of paragraph 4 of Article XVI should enter into force without further delay by the largest number of contracting parties possible. (9)

It has been suggested that the subsidies should also be a subject of negotiation at the tariff conferences. At the Review Session, the Working Party on Other Barriers to Trade urged that "there was nothing to prevent contracting parties, when they negotiate for the binding or reduction of tariffs, from negotiating on matters such as subsidies which might affect the practical effects of tariffs and for incorporating in the appropriate schedule annexed to the Agreement, the results of such negotiations." (10) The rules and procedures for the 1960-61 Tariff Conference provided that "participating countries may . . . enter into negotiations . . . in respect of . . . the level of a subsidy which operates directly or indirectly to reduce imports." At the Review Session the contracting Parties recorded that "so far as domestic subsidies are concerned it was agreed that a contracting party which has negotiated a concession under Article II may be assumed for the purpose of Article XXIII to have a reasonable expectation, failing evidence to the contrary, that the value of the concession will not be nullified or impaired by the contracting party which granted the concession by the subsequent introduction or increase of domestic subsidy on the product concerned."

(9) GATT, n. 2, 32-3.
(10) GATT, n. 4, 225.
The provisions relating to subsidies are, on the whole, weak and ineffective. (11) It has been proposed that the subsidies should be prohibited in principle and permitted only in specially defined cases with the prior approval of the Contracting Parties. (12) In such cases the Contracting Parties should lay down both the form which subsidies will take and the period for which these should be permitted.

The Contracting Parties shall review the working of the provisions of the Article from time to time in order to examine its effectiveness, in the light of the actual experience, to promote the objectives of the Agreement and to prevent subsidization injurious to the trade or interests of the contracting parties. (13)

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(11) GATT Document No. Sec. 140/53, Address by Mr. W. White, delivered on 24 November 1953 at the Handels - Hochschule, St. Gallen, 10.


(13) Article XVI, 6.