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Bolstering International Cooperation on Subsidy Policies

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A central source of current trade tensions are national subsidy policies. Prior to the re-emergence of tariff nationalism, subsidies were becoming the new tariffs. While tariffs continue to be an issue of importance in some countries, and in some sectors, the use of subsidies by national and sub-national governments is on the rise. This is not simply a 'China issue'. Subsidies of one type or another constitute the great majority of trade interventions imposed since 2009. Data on non-tariff policies are notoriously patchy, as WTO notification requirements generally are only partially complied with, if at all. An independent initiative that compiles data on trade policies, the Global Trade Alert, has documented over 20,000 measures affecting

trade taken since 2009 by G20 members, with subsidies accounting for more than 50 percent of all measures.

A subsidy policy aimed at some specific policy goal will have spillover effects on other sectors and on other countries. Some of these spillovers may be positive, but many will be negative. It is therefore necessary to recognize that if the goal is to discipline policies that give rise to negative international spillovers, the focus of attention must be on effects as opposed to narrowly defined policy instruments. A broad notion of actionable subsidies is used: measures that impose a direct burden on the government budget (including fiscal transfers through tax

¹ This note summarizes the main arguments of recent papers by the authors: (i) Subsidies, Spillovers and Multilateral Cooperation; (ii) Rethinking International Subsidy Rules; and (iii) Yours is Bigger than Mine! How an Index like the PSE Helps in Understanding the Comparative Incidence of Subsidies. Papers available at <https://qed-project.de/allgemein-en/wto-reform-industrial-subsidies/>.

expenditures). To be actionable a subsidy must be specific (as opposed to benefitting economic activity more generally), and convey a benefit to the recipients. Financial support for exports and local content requirements are prohibited. The focus of WTO subsidy rules is on potential adverse effects of national measures on foreign products.

Historically, the center of attention of WTO members on subsidies has been agriculture, reflecting the extensive trade-distorting support provided by European countries in particular to this sector in the 1980s and 1990s. The main WTO instrument for non-agricultural subsidy-related policies, the Agreement on Subsidies and Countervailing Measures, prohibits export subsidies and regulates the use of countervailing duties to offset injurious effects of foreign subsidies on domestic producers. The agreement applies only to trade in goods.

WTO disciplines were crafted in the 1980s, before the rise of global value chains, the emergence of China as a major trading nation, and the growth in trade in services and the digital economy. They are outdated. They do not cover investment incentives or services activities. They leave unclear how to treat the activities of state-owned enterprises and whether such entities are a 'public body' or whether input subsidies or differential taxes that lower domestic prices of inputs are covered.

Unlike tariffs, subsidies are appropriate instruments for many policy goals, but like tariffs they will generally have spillovers via effects on trade. To be successful, any revision of the international subsidy regime must rest on a clear understanding that the economics and politics of subsidies differ across polities; consider the goals that motivate their use; and the nature of cross-border spillovers they create. Virtually any significant policy action by a large trading economy will affect trade, often but not always unintended. The optimal response to spillovers will vary depending on the objective functions of both (all) national policymakers.

WTO rules pay no attention to the objectives of governments using subsidies. There is no notion

in the WTO of what constitutes a "good" subsidy. This contrasts with the EU and some recent trade agreements that recognize the legitimate role of certain types of subsidies and establish a presumption these are not objectionable. In this paper, we describe an economic approach that can be used to assess whether a subsidy effectively addresses a market failure or objectives of common interest, balanced against associated negative effects on competition in the relevant market. An important feature is a shift away from rigid 'hard law' rules to focusing on the effectiveness of subsidies in attaining economic and noneconomic objectives and their effects on markets.

The international subsidy regime can move in this direction through application of relatively simple, robust rules of thumb derived from the theory of economic policy. These recognize the right of nation states to engage in a wide range of domestically warranted subsidy policies, but also that conflicts will emerge over modalities and levels of acceptable competitiveness spillovers. Making such conflicts the subject of technical discourses focused on establishing the goal of a subsidy, whether it addresses a market failure, or pursues a legitimate domestic goal in a plausible way, and whether trade spillover effects are necessary to achieve the goal may deflect much of the political heat associated with conflicts over inherently domestic issues.

A revamped subsidy regime requires participation of the United States, the European Union, and the People's Republic of China – the three global trade powers. The rules must be seen as supporting the generalized gains from open trade and global production, not an attempt to isolate or 'reform' China. At the same time, China should accept that it has a leading role to play in the regime. The three majors should recognize that their political economies are consistent with a broadly liberal international regime even though they are, and will remain, profoundly different from one another.

Accommodating system differences will be facilitated by distinguishing between competitive spillovers arising from policies to address global collective action problems and market failures

and those stemming from national industrial policies. The former should be treated differently from the latter. A corollary is that governments must elucidate their policy goals. A rule of thumb creating a presumption in favor of national treatment can narrow the range of conflict, as nondiscrimination will be more efficient in attaining noneconomic objectives. Conversely, if a subsidy does not address a collective action/market failure problem, countries should be able to use CVDs or bring disputes alleging adverse effects.

This is not new ground for the WTO. An initial, time-limited effort was made to include a category of nonactionable subsidies in the WTO, but this expired in 1999. It was too narrow, and did not distinguish subsidies that address (global) market failures from those that do not. It is past time that WTO members revisit what was started over 20 years ago. Preparing the ground requires a collective effort to measure and analyze the prevalence and effects of subsidies, using robust, transparent methodologies. A cooperative rather than adversarial approach is called for, centered on deliberation informed by a concerted data collection program and analysis.

Governments can see distortions that look like they were caused by industrial subsidies offered by other countries, but they lack the data to illuminate that state support. In the early 1980s countries knew that some of the problems in farm trade were caused by subsidies, but fingers were pointed in all directions. The OECD was tasked with the analytic work that became instrumental in supporting the Uruguay Round of trade negotiations in the GATT, launched in 1986. In the course of that work the OECD developed an index that helped countries to see the overall incidence of agricultural subsidies, now called Producer Support Estimate (PSE). The PSE helped show that any negotiation framework would need to be comprehensive and encompass domestic agricultural policies in all the leading exporters and importers. The OECD has developed a matrix decomposing common types of support measures along two dimensions: the transfer mechanism (how a transfer is created) and its statutory or formal incidence—to whom or what a transfer is first

given. Recent work by the OECD on industrial subsidies in the aluminium and semiconductor industries using this matrix approach illustrates its usefulness in identifying the types of support that are most significant in different industries, and that this may differ importantly depending on the sector.

A similar approach is called for today. A first step can be taken by launching a work program to compile information and analyze existing subsidy programs in systemically important economies, bringing together the epistemic community with expertise and interest in subsidies. At this point in time, no international platform exists that brings together national Finance and Economy ministries, national competition authorities and international organizations concerned with the governance of subsidies. Building bridges across these groups can help provide a basis for mutually beneficial cooperation in this area.

Development of a body of professionally competent, peer reviewable, internationally balanced work will generate common ways of talking about and thinking about the issue of subsidies. For all the differences in national regimes, this may support agreement over time on good practice norms and standards. As those become more widely accepted, national governments can legitimate subsidy policy internationally by adopting those standards. The more this is treated as a technical, not a political, endeavor, the greater the likelihood of an epistemic community on subsidy issues taking root.

Disciplines on subsidies must begin with information, and this public good is under-supplied. Formal notifications may not be the best way to enhance understanding of policies that might be affecting the health of the trading system. Countries need to understand the incidence of subsidies before they can analyse the potential trade distortions, which is the prelude to agreement on additional disciplines. In the case of agriculture in the 1980s, Finance ministers wanted the work done to identify and quantify agricultural support and said so repeatedly in the annual meetings of the OECD

Council. Neither the OECD Council nor the G20 has offered the same impetus now.

Delegation of both measurement and analysis to a trusted, neutral and technically capable body is critical to support the needed deliberation by states. The OECD has played this role for decades in producing comparable analyses of subsidy regimes in agriculture. This work illustrates the importance of going beyond documenting policies to measure the magnitude of interventions using well-defined indicators. Producer support estimates played such a role in agriculture – analogous measures should be developed that are not sector-specific and permit monitoring and assessments of the economic incidence and effects of the policies of interest. Many international organizations collect information on and monitor the use of subsidy instruments. A joint initiative that spans the OECD and specialized international financial and development organizations in which the major emerging economies are members can provide the needed technical and analytical support. The G20 Trade and Investment Working Group is an existing mechanism that includes the major international agencies.

The WTO should provide a platform to members willing to invest resources into the proposed work program. This could include organizing regular thematic sessions of the WTO Committee dealing with subsidies; creating a dedicated Working Party spanning different WTO bodies concerned with subsidy matters, including those where no rules exist presently (e.g., services); or launching a new plurilateral effort along the lines of the ‘joint statement initiatives’ launched in 2017 at the 11th WTO Ministerial Conference.

In the short term, agreement on binding rules is unlikely to be possible. Work on developing more informal discipline on subsidies based on information, dialogue and peer review may be more feasible. Countries always want to believe that somebody else’s subsidies are bigger than their own: this is not a competition that anybody wants to be seen to be winning. But by not creating robust comparisons of subsidies, everybody is losing.

Calling for a work program on subsidies may be criticized as kicking the can down the road. It is not. WTO members simply do not have enough information to develop a common understanding of where new rules are needed and the form they should take. Calling a time out on the current focus on bilateral/trilateral talks and unilateral threats to establish such an understanding is a necessary condition for keeping the WTO relevant in the 21st century.

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