

SYNTHESIS OF THE POLICY OPTIONS

No.

18

**RETHINKING SUBSIDY
DISCIPLINES FOR THE FUTURE**

Rethinking Subsidy Disciplines for the Future

Synthesis of the Policy Options*

January 2016

* Horlick, Gary, and Peggy A. Clarke. *Rethinking Subsidy Disciplines for the Future*. E15 Task Force on Rethinking International Disciplines - Policy Options Paper. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

NOTE

The policy options presented in this synthesis are the result of a collective process involving all members of the E15 Task Force on Rethinking International Subsidies Disciplines. It draws on the active engagement of these eminent experts in discussions over multiple meetings as well as think pieces commissioned by the E15Initiative and authored by group members. Gary Horlick and Peggy Clarke were the authors of the report. While a serious attempt has been made on the part of the authors to take the perspectives of all group members into account, it has not been possible to do justice to the variety of views. The policy recommendations should therefore not be considered to represent full consensus and remain the responsibility of the authors. The list of group members and E15 papers are referenced.

The full volume of policy options papers covering all topics examined by the E15Initiative, jointly published by ICTSD and the World Economic Forum, and launched at the Forum's Annual Meeting at Davos-Klosters in 2016, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade.

E15 INITIATIVE

Jointly implemented by the International Centre for Trade and Sustainable Development (ICTSD) and the World Economic Forum, the E15Initiative was established to convene world-class experts and institutions to generate a credible and comprehensive set of policy options for the evolution of the global trade and investment system to 2025. In collaboration with 16 knowledge partners, the E15Initiative brought together more than 375 leading international experts in over 80 interactive dialogues grouped into 18 themes between 2012–2015. Over 130 overview papers and think pieces were commissioned and published in the process. In a fast-changing international environment in which the ability of the global trade and investment system to respond to new dynamics and emerging challenges is being tested, the E15Initiative was designed to stimulate a fresh and strategic look at the opportunities to improve its effectiveness and advance sustainable development. The second phase of the E15Initiative in 2016–17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

For more information on the E15Initiative:
www.e15initiative.org

ACKNOWLEDGEMENTS

WITH THE SUPPORT OF



Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

Federal Department of Economic Affairs,
Education and Research EAER
State Secretariat for Economic Affairs SECO



And ICTSD's Core and Thematic Donors:



Government of the Netherlands



Norwegian Ministry
of Foreign Affairs

PUBLISHED BY

International Centre for Trade and Sustainable Development
(ICTSD)

7 Chemin de Balexert, 1219 Geneva, Switzerland

Tel: +41 22 917 8492 • E-mail: ictsd@ictsd.ch

Website: www.ictsd.org

Publisher and Chief Executive: Ricardo Meléndez-Ortiz

World Economic Forum

91-93 route de la Capite, 1223 Cologny/Geneva, Switzerland

Tel: +41 22 869 1212 • E-mail: contact@weforum.org

Website: www.weforum.org

Co-Publisher and Managing Director: Richard Samans

CITATION

ICTSD and World Economic Forum. 2016. *Rethinking Subsidy Disciplines for the Future. Synthesis of the Policy Options.*

E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

COPYRIGHT

©ICTSD and World Economic Forum, 2016. Readers are encouraged to quote this material for educational and non-profit purposes, provided the source is acknowledged. This work is licensed under the Creative Commons Attribution-Non-commercial-No-Derivative Works 3.0 License. To view a copy of this license, visit: <http://creativecommons.org/licenses/by-nc-nd/3.0/> or send a letter to Creative Commons, 171 Second Street, Suite 300, San Francisco, California, 94105, USA. ISSN 2313-3805

The E15Initiative is managed by Marie Chamay, E15 Senior Manager at ICTSD, in collaboration with Sean Doherty, Head, International Trade & Investment at the World Economic Forum. The E15 Editor is Fabrice Lehmann.

OBJECTIVES AND OUTPUT

The E15 Task Force on Rethinking International Subsidies Disciplines had three objectives

- In light of the changes in the global economy and emerging social and environmental concerns, examine government practices in the area of subsidies.
- Assess the adequacy of existing international subsidy disciplines in this new context.
- Provide a solid analytical legal and economic basis to identify possible improvements and reform of subsidies disciplines.

Overarching questions and issues the Task Force was tasked to consider

- Assess the adequacy of the approach and structure of international disciplines on subsidies to address trade and sustainable development concerns, for example in areas such as clean energy, economic development, and natural resources.
- Investigate whether and under which conditions subsidies should be treated as non-actionable when achieving certain specified public policy goals, for example environmental protection, R&D, and regional development.
- Evaluate whether stronger multilateral disciplines (prohibitions and/or restraints) should be applied under the WTO Agreement on Subsidies and Countervailing Measures (ASCM) for certain subsidies or trade remedies.

Task Force analysis and policy proposals were submitted in two forms

1. Critical issues studied through think pieces commissioned for the E15 Initiative. These papers are referenced on page 12 and can be accessed at <http://e15initiative.org/publications/>.
2. Policy options presented in this synthesis and compiled in the summary table. The options fall under two categories:
 - Revisiting international disciplines
 - Establishing, monitoring, and resolving disputes

TABLE OF CONTENTS

FOREWORD	2
RETHINKING SUBSIDY DISCIPLINES FOR THE FUTURE	4
SHOULD SUBSIDIES BE DISCIPLINED	4
POLICY OPTIONS: REVISITING INTERNATIONAL DISCIPLINES	5
Non-Actionable Subsidies	6
Subsidies Subject to Prohibition	6
Actionable Subsidies	7
Subsidies Not Covered by the ASCM	7
MONITORING, DISPUTE RESOLUTION, AND NEXT STEPS	7
TABLE SUMMARY OF MAIN POLICY OPTIONS	10
TASK FORCE PAPERS AND THINK PIECES	12
MEMBERS OF THE TASK FORCE	13



FOREWORD

Subsidies in their different forms have traditionally been an important instrument for governments to influence the allocation of resources and ultimately consumption and production patterns. Critics often point to the economic distortions they create, their perverse distributive consequences, and the negative impact they can have on the environment. At the same time, subsidies can play a key role in correcting market failures and delivering essential social or public goods.

The WTO Agreement on Subsidies and Countervailing Measures represents the first attempt at crafting multilateral disciplines on subsidies, backed by a binding dispute settlement mechanism. Since its entry into force, however, the world has evolved, as have government practices, prompting calls for reassessing its disciplines — largely drafted in the late 1980s and early 1990s — in the light of new global challenges and future needs.

Since the 2008 financial crisis, attempts at reviving industrial policies in a number of developed and emerging economies, notably through the use of subsidies, have created new international tensions. Inspired by China's success or pressed by domestic demands to reinvigorate manufacturing and create jobs, several governments have re-established policy measures such as local content requirements or

government support for domestic industries. Beyond such bailout packages, in a global context marked by the fragmentation of production networks along complex supply chains, new dynamics are emerging, affecting how trade and investment flows operate but also how innovation and R&D are conducted. In a world of global value chains, assessing the effects of subsidies or the need for new types of policy interventions has become considerably more complex and remains largely uncharted territory.

On the environmental front, critics point to the aggressive use of trade remedies in the clean energy sectors — e.g. on solar panels or wind turbines — a trend that has become apparent in the last five years among major producers like the EU, US, India, and China. Environmentalists have been particularly concerned by the resulting higher prices in a sector struggling to establish itself as a viable low carbon source of energy. In the light of high potential for abuse or biased applications of existing rules, some have called for deep reform of trade remedy disciplines while others have pushed to resuscitate the notion of non-actionable subsidies to prevent WTO action against those programmes. Finally, some have raised concerns around various forms of subsidies affecting natural resources, including fish and fish products to minerals and extractive industries, including



fossil fuel, in a world increasingly confronted with resource scarcity. Here, environmentalists point to significant market failures and the tragedy of the commons, as government interventions affect production decisions without addressing environmental externalities.

In light of these growing tensions between current disciplines and government practices, the E15 Initiative initiated a comprehensive rethinking exercise of possible approaches to subsidies. Given the cross-cutting nature of the topic and its close intersection with other E15 groups (e.g. agriculture, services, global value chains, ocean fisheries, clean energy, and extractive industries), the E15 opted for the creation of a Task Force made of both subsidies experts including former negotiators, lawyers, economists, and practitioners; and experts from other E15 groups dealing with related topics. To undertake such a review, the group, led by Gary Horlick, met through a series of iterative meetings over the course of 2014 and 2015, supported by targeted analytical inputs generated by the group to inform and structure the discussion. The policy options and the different think pieces that support them are the result of this ground-breaking exercise.

As conveners of the E15 Initiative, we are convinced of the need to provide organized and structured input into the

policy and governance debate on international subsidies disciplines. The options that have resulted from these thought and dialogue processes are offered to policy-makers and stakeholders alike, in the hope that they provide paths to effectively address the most pressing challenges and respond to policy imperatives of societies the world over. In a second phase of this Initiative, we intend to engage policy-makers in advancing these options.

A handwritten signature in black ink, appearing to read 'R. Meléndez-Ortiz'.

Ricardo Meléndez-Ortiz
Chief Executive, ICTSD

A handwritten signature in black ink, appearing to read 'R. Samans'.

Richard Samans
Managing Director and Member of the Managing Board,
World Economic Forum

RETHINKING SUBSIDY DISCIPLINES FOR THE FUTURE

SUBSIDIES ARE A CRITICAL INSTRUMENT IN THE TOOLBOX THAT GOVERNMENTS USE TO ACHIEVE A VARIETY OF POLICY GOALS. THEY CAN PLAY A KEY ROLE IN FACILITATING SOCIOECONOMIC ADJUSTMENTS AND ADDRESSING MARKET FAILURES. AT THE SAME TIME, CRITICS POINT TO THE INEFFICIENCIES AND DISTORTIONS THEY CAN CREATE, THEIR PERVERSE DISTRIBUTIVE CONSEQUENCES AND THE NEGATIVE IMPACT THEY CAN HAVE ON THE ENVIRONMENT.

In an increasingly interdependent world, addressing the negative externalities and beggar-thy-neighbour effects of subsidies, while maintaining their market correcting function, the policy space for development, and their role in delivering essential public goods, is an imperative from a sustainable development perspective.

In an interdependent world, addressing the negative externalities and beggar-thy-neighbour effects of subsidies, while maintaining their role in delivering essential public goods, is an imperative from a sustainable development perspective.

The international community has long attempted to address the concept of subsidies discipline, currently through the WTO Agreement on Subsidies and Countervailing Measures (ASCM). However, a fresh look at the issue is necessary, as the world economy, government practices, developmental approaches, and environmental challenges have evolved since multilateral rules and disciplines on

subsidies were framed two to three decades ago. To this end, ICTSD, in partnership with the World Economic Forum, convened a Task Force of leading experts, as part of the E15 Initiative, to analyse the role of subsidies and international disciplines. While recognizing that this is a much examined field in which different conclusions can be reached, the recommendations resulting from the process aim to suggest new directions for discussion and future policy implementation.

SHOULD SUBSIDIES BE DISCIPLINED

For the purpose of this examination, the concept of subsidies is broadly defined as a subset of government intervention (or inaction) in the marketplace. So far, grants of monopoly rights have not been defined as possible subsidies, nor have industry-specific protective tariffs, safeguards, export taxes, input quotas, and trade remedy tariffs. All would seem quantifiable but are not addressed here. More broadly, the subsidy-like effects of regulatory action have not been treated as a subsidy and their discipline is best left to another study. While the ASCM provides some discipline on the use of subsidies to goods, there are almost no multilateral disciplines in services and the agricultural sector receives different treatment.¹ The policy options are based on the

perspective that subsidies for agriculture and services should be subject to the same (or similar) discipline as goods, even if remedies for services may need to be different.

ARGUMENTS FOR DISCIPLINING SUBSIDIES

The proposals herein stem from an assessment that the arguments for some disciplines on the use of subsidies are, on balance, stronger than the counterarguments. Subsidies can distort trade, competition, and investment decisions. Some encourage behaviours proven to be destructive of the environment — e.g. overfishing and the emission of greenhouse gases. They can also lead to an inefficient use of resources and even subsidy wars in certain instances. The use of subsidies may also increase the development gap between rich and poor nations, while unrestrained competition to attract investment can induce a race to the bottom. Moreover, as discussed below, there are already a variety of subsidy disciplines in place, which implies an international consensus that certain disciplines are beneficial. Some form of discipline is thus desirable (or likely), even though the type and extent of that discipline may vary depending on the type or purpose of the subsidy — e.g. measures that target subsidies that have a negative impact on the global commons as against subsidies that are distortive of trade.

ARGUMENTS AGAINST SUBSIDY DISCIPLINES

There are good arguments against the implementation of disciplines on subsidies, which are widely viewed by governments as effective policy instruments. The essence of the economic case against discipline has been succinctly described by Alan Sykes: “Subsidies *may* create negative international externalities and distort global resource allocation. But they may also represent sensible policy responses to a range of market failures or play a useful role in addressing income inequality. The task of distinguishing the good from the bad is extremely complex as a practical matter. Existing subsidies disciplines do a poor job in this regard, and simple fixes are not apparent. Subsidies disciplines also invariably ignore the other side of the ledger (taxation and regulation), so that the *net* impact of government on competitiveness is unobserved and likely unobservable in practice.”²

EVALUATING THE CROSS-BORDER IMPACT OF SUBSIDIES

The underlying issue is how to evaluate (and perhaps measure) the impact of subsidies outside the border of the subsidizing government and on global public goods. Subsidies can have positive effects, domestically and across the border, and any discipline must recognize the positive as well as the negative. If one starts with the proposition

that governments should have the policy space to provide subsidies as long as it does not cause adverse impact outside their territory or on the commons, then the question becomes how to determine whether there is impact and to what extent. Much greater use of current methods of economic analysis for subsidies (as is increasingly the case for other WTO disputes) should be tried.

However, the task of distinguishing the good from the bad is extremely complex as a practical matter, and existing subsidies disciplines do a poor job in this regard.

POLICY OPTIONS: REVISITING INTERNATIONAL DISCIPLINES

In recommending reform and improvements in subsidies disciplines, a three-tiered approach such as that found in the existing ASCM is considered appropriate.

- a. Establish a category of narrowly defined non-actionable subsidies (i.e. not subject to discipline, as envisaged in the expired ASCM, Article 8) with clear boundaries. This would include subsidies that usefully address market failures or other externalities.
- b. Expand the category of subsidies that could be subject to absolute prohibition or a presumption of prohibition (such as in the now defunct ASCM, Article 6.1). This would include subsidies that generate such negative externalities (environmental damage, economic injury) that they should be phased-out or banned.
- c. Third, all other measures should fall within the category that the ASCM calls actionable, as long as a negative impact outside the country (or to the commons) is demonstrated. These would be subject to disciplines similar to the existing ASCM, with some adjustments to make multilateral disciplines more effective and unilateral disciplines (i.e. countervailing duties) less prone to protectionist leanings.

A key concern in the above categorization is that of establishing clear definitions and strict criteria for inclusion, as well as effective procedures for monitoring and dispute resolution (see below). In addition, the more systematic collection of better data on subsidies using common standards, definitions, and measurement methodologies needs to be developed.

NON-ACTIONABLE SUBSIDIES

POLICY OPTION 1 - Establish a category of non-actionable subsidies

- *Subsidies to address climate change and similar environmental issues:* There is mounting evidence and consensus on the need to support and scale up efforts towards climate change adaptation and mitigation as well as addressing other environmental concerns such as conservation. Any safe harbour, however, should not be used to enable a country to gain commercial advantage over another — e.g. clean energy subsidies promoting consumption or directed at aiding local manufacture should be differentiated. A mix of hard and soft law could handle these boundary issues, for example through the role originally envisaged for the WTO Permanent Group of Experts (see below).

Any carve-out for subsidies that address climate change and similar environmental issues should not be used to enable a country to gain commercial advantage over another.

- *Regional development subsidies:* Many countries, especially developing countries, experience high disparities in the cost of investment in different regions and extreme variations in employment opportunities across these regions. A safe harbour should be considered for regional development subsidies that offset the additional cost of investment in a disadvantaged region. An objective baseline would need to be established to measure these costs. Another possibility would be to give preference to the poorest countries.
- *Research and development (R&D) subsidies:* A safe harbour should be established for subsidies targeted at certain R&D activities that would not occur (at a cost to social and economic development) without support due to insufficient commercial incentives. As the public would be funding such R&D, the safe harbour could require that the results be made publicly available to any agent, including foreign investors, who may seek to use them. This sub-category of non-actionable subsidies may be a particularly good area for mandatory periodic review.³
- *Natural and man-made disasters:* Currently there is no explicit carve-out for natural or man-made (post-conflict) disaster recovery envisaged under the ASCM (the Agreement on Agriculture provides for payments for relief from natural disasters). Any safe harbour for subsidies provided to allow an economy to return to its pre-disaster

state would need to be time restricted, with metrics to determine when the recovery period has ended. It would also need to be specific on the magnitude of the natural disaster that would qualify for such treatment.

SUBSIDIES SUBJECT TO PROHIBITION

POLICY OPTION 2 - Expand the category of subsidies subject to prohibition

The ASCM reflects a consensus that there exist certain forms of subsidies the results of which are so harmful to external partners or economically undesirable that they should be banned. This is apparent in the prohibition of export-contingent and domestic content subsidies. There are other subsidies that have the potential to generate negative externalities or to create such harm to global welfare that they should be banned. The following additional areas should be considered for prohibition purposes; and the definition of subsidy in these areas may need to be expanded from that found in the ASCM to include other forms of government intervention in the market that have similar economic effects as subsidies — e.g. waivers of environmental or labour regulations.

- *Locational subsidies designed to attract investment* (in goods and services): Locational subsidization is pervasive in many countries (e.g. the United States at the sub-federal level) and sporadic attempts to discipline the practice have failed. Moreover, the emergence of global value chains could exacerbate this trend among nations via the competition to attract investment worldwide. There is a strong rationale for international cooperation to discipline such subsidies, which may encourage a race to the bottom through predatory practices.⁴ The difficulty arises in defining locational subsidy with enough specificity to be identifiable but also sufficient generalization to capture a range of investment incentives as well as permissible regional development subsidies. One possible definition could be subsidies dependent on a specified company building a new or expanded facility, or a target company staying in an existing facility over a period of time.
- *Fossil fuel subsidies:* This group consists of subsidies that encourage the exploration, production, or use of fossil fuels. Under current rules, these subsidies cannot be challenged based on the environmental externalities they generate — i.e. greenhouse gas emissions. In addition, WTO reporting vastly understates the extent of the subsidization that occurs. A first step could include better notification and peer review (within the OECD or G20 for example). Meanwhile, an immediate stand-alone phase-out of production subsidies should be pursued, leading to an eventual ban on all fossil fuel subsidies while taking into account in the reform process the impact of consumption subsidies on the poor.

- *Other resource-depleting subsidies:* At issue (as with fossil fuels) is the tragedy of the commons; including fish stocks, forests, water, and biodiversity. The recommendation here is to combine a prohibition of the most egregious types of subsidies that encourage environmentally harmful activity (e.g. subsidies to capital costs, variable costs, and price supports) while leaving others as actionable — i.e. subject to disciplines if adverse impact on a WTO member's economic interests or on the sustainability of shared natural resources can be demonstrated. These hard law approaches should be accompanied by soft law disciplines (such as sectoral initiatives on sustainable fisheries and forestry), and agreements should be pursued along multilateral, regional, and plurilateral avenues.⁵

ACTIONABLE SUBSIDIES

Subsidies that do not fall into either the non-actionable or prohibited boxes are subsidies that consensus indicates may be permissible yet actionable. If it is demonstrated that others (or the public good) are harmed by their use, recourse to remedy should be possible. The most likely type of process to be acceptable in this instance is one similar to that currently provided for in the ASCM, as discussed below.

SUBSIDIES NOT COVERED BY THE ASCM

POLICY OPTION 3 - Explore the scope for services disciplines

- Some disciplines on services subsidies should be established; especially in light of the increasingly prominent role of services in international trade. To date, negotiations under the General Agreement on Trade in Services (GATS) have failed to reach consensus on whether disciplines should be established and what form they should take. As

with goods, there are arguments for and against disciplines: e.g. developing countries are concerned that rich country subsidies may hinder their ability to enter service sectors; trade distortions may be generated; most countries wish to maintain policy space to nurture domestic providers; services subsidies can be applied to correcting market imperfections and the delivery of public goods. In exploring the scope for services subsidies disciplines, the definition of subsidy and potential remedy would have to be adjusted to account for the different nature of services trade and the diverse modes of delivery (as established for example in the GATS commitments). The first step in this examination is the need for far better data allowing for a more informed mapping of the nature and sectoral incidence of subsidy practices and their use across country groupings.

There are subsidies that have the potential to generate negative externalities or to create such harm to global welfare and the commons that they should be banned.

MONITORING, DISPUTE RESOLUTION, AND NEXT STEPS

The procedures for establishing, monitoring, and resolving disputes for the different types of subsidies categorized above would not necessarily be identical although there would be certain commonalities.

BOX 1 Revisiting the Concept of Specificity

Specificity arose in the context of US countervailing duty law. It was viewed as necessary on at least two grounds. First, broadly distributed subsidies were thought not to favour a specific industry. Second, in practice, it was necessary to filter out subsidy allegations that would affect virtually all products, including normal government functions such as infrastructure, education, and security. The concept of specificity has several problems that may be worth re-examining as part of a wholesale reassessment of subsidies:

- There is no obvious bright line test for specificity, which leaves open the possibility of biased application;

- Most problematically, politicians, business people, and lawyers facing the specificity doctrine for the first time intuitively reject it;
- There is a significant big economy vs. small economy problem, as the latter will inevitably be less diversified and thus appear more specific;
- Many resource-depleting energy subsidies could well be non-specific (e.g. supporting cheap fossil fuel to a wide variety of industries) but so could clean energy subsidies.

BOX 2 Big and Rich vs. Small and Poor Country Issues

In general, wealthy countries can give more subsidies than poor nations. What is sometimes less appreciated is that only large markets have the ability to do much about other countries' subsidies. While any WTO member can utilize the dispute settlement process against another members' subsidies, in practice relatively few countries have done so and they tend to be the overwhelmingly large and relatively well off. More importantly, only large markets have the retaliatory capacity to force meaningful action after winning a

WTO case against subsidies. This situation is even more pronounced with respect to countervailing duties. In practice, the calculation of a large WTO member (or recipient company of a large member) is to take the subsidy when the only threat is to pay back a tiny share in a countervailing duty imposed by a small member. Further, on the supply side, a small member is likely to have a narrower range of industries and is thus more likely to be found providing specific subsidies that are potentially actionable.

WHO DECIDES?

The ASCM takes a mixed approach. The multilateral dispute resolution process provided for in the WTO reflects the goal of having a neutral decision-maker determine whether members' interests have been harmed through the use of subsidies. The ASCM also allows for national decision-making in the form of countervailing duty actions. Experience suggests that when the unilateral approach is taken there is an inherent tendency towards favouring local protectionist interests. Moreover, only large market economies can use countervailing duties effectively for many products. The following options should thus be considered.

The multilateral dispute resolution process reflects the goal of having a neutral decision-maker determine whether members' interests have been harmed through the use of subsidies.

POLICY OPTION 4 - Strengthen neutral decision-making

- The role of a neutral decision-maker in the resolution of subsidies disputes should be strengthened. The advantage of a neutral decision-maker is that one can apply a broader definition of subsidy (coupled with high standards of proof) to adjudicate on inevitable boundary issues and thus discipline more effectively. One possibility would be to establish a multinational group of experts (e.g. the Permanent Group of Experts, as identified under ASCM, Article 24). Another would be to use expedited arbitration procedures to complement the existing WTO dispute settlement mechanism, with some disputes subject to binding arbitration (on prohibited subsidies for example).

POLICY OPTION 5 - Eliminate or restrict unilateral options

- The option for unilateral action should be eliminated or at least restricted. The ASCM provides for unilateral subsidy discipline actions and outlines rules for how they should be undertaken. The current system should (at a minimum) be adjusted to apply to only the narrowest definition of subsidy and it may be appropriate to redefine how the notion of benefit is determined. Countervailing duties should be limited to offsetting only the effect of subsidies in excess of the support received by competitors in the importing country. In addition, national decisions must be subject to binding dispute resolution that is much faster than the current WTO system — beginning with initiation of a case when the commercial damage begins and restoring the status quo *ante* for the exporter if it wins.

As part of a re-examination of international subsidies disciplines, questions of proof, benefit, remedies, specificity (Box 1) and the impact of cross-border subsidies should be reviewed.

With regards to remedies, the WTO system does not seem to have been able, to date, to ensure repayment of subsidies. Moreover, the possibility in the system to provide compensation instead of complying with an unfavourable decision confers an advantage to wealthier countries able to buy their way out of rulings that have negative domestic political consequences, an option not available to poorer countries (Box 2).

In addition, in a world of expanding global value chains, analysis should be undertaken of the impact of cross-border subsidies and consider whether and how they should be disciplined. Thought should go into assessing whether national countervailing duty regulations and WTO rules are adapted to the contemporary business dynamics of transnational production and investment.

HOW TO GET THERE?

It may seem surprising to be thinking about changes in current subsidies disciplines given the general stagnation in WTO rules negotiations and the relative lack of interest in making major amendments to the ASCM in the ongoing Doha Round. Nevertheless, the issue deserves renewed attention and effort.

Interpretation of the ASCM by the Appellate Body would appear unlikely to bring about major change, as the Appellate Body in the best of cases is (mostly) trapped by the existing text. Are there approaches outside the WTO that could work? At first sight, there does not seem to be any other organization covering most countries likely to tackle the issue. But this is misleading: it is probable that changes will be made in subsidy disciplines in the course of high-level negotiations over climate change for example.

While improving the ASCM in line with the recommendations presented above, processes for reform should thus also be pursued in multilateral, regional, and plurilateral fora outside the WTO through soft law disciplines to address specific concerns on subsidies. This could include decisive action on fossil fuel subsidies under climate change action or a sectoral initiative on sustainable fisheries for example. Greater transparency would help. However, even widely publicized lists of subsidies and recipients have at best a mixed record in obtaining reform.

POLICY OPTION 6 - Generate better data

A key consideration in the subsidies discipline debate is that of obtaining better data. The formal intergovernmental notification process has not produced the necessary breadth or depth of information about subsidies for a consistent set of data that would permit more informed policy discussions and decisions.

While the ASCM encompasses some subsidies within its transparency and notification requirements, experience has found that WTO reporting vastly understates the full extent of subsidization. The work produced by the OECD is possibly as good a multilateral government effort as is currently possible. “Reverse” notification (by competitors or public interest groups) may achieve good results but not in a systematic manner. Extending beyond government-based notifications may be necessary.

- An option is thus to establish an international consortium of universities and independent think tanks, supported by funding, that could develop a platform for data collection using common standards, definitions, and measurement methodologies. Graduate students and researchers could be enrolled in the initiative.

CONCLUSION

Reaching consensus on an agenda of the type presented in this paper could firmly position the issue of international subsidies disciplines as an important vector for the improved effectiveness of the international trade system for sustainable development. Policy-makers interested in advancing reform are encouraged to consider these options for discussion and early implementation.

The formal intergovernmental notification process has not produced the necessary breadth or depth of information about subsidies for a consistent set of data that would permit more informed policy discussions and decisions.

ENDNOTES

1. For deeper analysis, see the policy options of the E15 Expert Group on Agriculture, Trade and Food Security Challenges, which include recommendations on the amendment of Green Box rules.
2. Sykes, Alan. 2010. “The Questionable Case for Subsidies Regulation: A Comparative Perspective.” *Journal of Legal Analysis* 2(2): 473–523
3. See the options put forward by the E15 Expert Group on Trade and Innovation, which call for greater clarification on the relationship between public research grants and permissible subsidies under the ASCM.
4. The E15 Task Force on Investment Policy recommends that empirical research and firm-level data gathering be undertaken on the incidence and effectiveness of FDI incentives.
5. The Expert Group on Oceans, Fisheries and the Trade System has put forward a comprehensive work package to discipline capacity-enhancing fisheries subsidies.

TABLE SUMMARY OF MAIN POLICY OPTIONS

POLICY OPTION	CURRENT STATUS	GAP	STEPS	PARTIES INVOLVED
Revisiting International Disciplines				
1. Create a category of narrowly defined non-actionable subsidies with clear boundaries and covering the following types of subsidies				
<ul style="list-style-type: none"> Subsidies to address climate change and similar environmental issues 	<p>Subsidies are actionable.</p> <p>Relatively narrowly defined exceptions for environmental subsidies, envisioned under ASCM, Art. 8.2, expired after the 1999 Seattle Ministerial Conference.</p>	<p>Need to scale up deployment of clean energy, support efforts towards climate change adaptation and address negative environmental externalities.</p>	<p>Difficult "boundary issues" to be handled by a mix of "hard" and "soft" law (e.g. the originally envisioned Permanent Group of Experts in the ASCM).</p> <p>Need to differentiate, for example, between subsidies promoting the use of clean energy from those targeting the manufacture of clean energy.</p>	<p>Policy-makers interested in advancing reform</p> <p>Relevant IGOs and stakeholders (e.g. WTO, UNEP, environmental NGOs, think tanks)</p> <p>Private sector leaders</p>
<ul style="list-style-type: none"> Regional development subsidies offsetting the additional cost of investment in a particular region compared to the rest of the country 	<p>Subsidies are actionable.</p> <p>Relatively narrowly defined exceptions for regional development subsidies, envisioned under ASCM, Art. 8.2, expired after the 1999 Seattle Ministerial Conference.</p>	<p>Many countries, especially developing countries, experience extreme disparities in the cost of investment in different regions and high variations in income and employment opportunities in those same areas. Some financial redistribution may be logical, as well as politically inevitable.</p>	<p>To prevent abuse, such subsidies should be limited to offsetting the additional cost of investment in a region.</p> <p>Another option is to give preference to the poorest countries.</p> <p>Use the type of provisions found in ASCM, Art. 27, to define inclusion and graduation as opposed to self-selection.</p>	<p>Policy-makers interested in advancing reform</p> <p>Relevant IGOs and stakeholders (e.g. World Bank, development think tanks)</p>
<ul style="list-style-type: none"> R&D subsidies for R&D which would not occur without support and the result of which is publicly available 	<p>Subsidies are actionable.</p> <p>Relatively narrowly defined exceptions for R&D subsidies, envisioned under ASCM, Art. 8.2, expired after 1999.</p>	<p>With some R&D, a company cannot expect to capture the full benefits. As a result, companies invest less in R&D than is desirable for society as a whole.</p>	<p>Since the public would be funding such R&D (through subsidies), the safe harbour could require that the results of the R&D be publicly available to any who seek to use it.</p>	<p>Policy-makers interested in advancing reform</p> <p>Relevant IGOs and stakeholders</p>
<ul style="list-style-type: none"> Natural - or other - disaster recovery (time-limited and not exceeding pre-disaster state) 	<p>Subsidies are actionable.</p> <p>Currently no explicit carve out for natural or man-made disaster recovery envisaged under the ASCM.</p>	<p>In recent years, the world has experienced natural disasters of such magnitude that recovery from them requires extraordinary investment.</p> <p>A similar rationale applies to time-limited use of subsidies to allow an economy to recover after certain man-made disasters.</p>	<p>Would need to be time restricted, with metrics established to determine when the recovery period has ended.</p> <p>The safe harbour would need to be very specific on the magnitude of the natural disaster that would qualify for such treatment.</p>	<p>Policy-makers interested in advancing reform</p> <p>Relevant IGOs and stakeholders (e.g. United Nations Office for Disaster Reduction)</p>
2. Expand the category of subsidies that could be subject to absolute prohibition or a presumption of prohibition (such as in the now-defunct ASCM, Article 6.1)				
<ul style="list-style-type: none"> Locational subsidies to attract investment (in goods and services) 	<p>Subsidies currently considered as actionable.</p> <p>Pervasive in the US, in particular at the state and local levels. The emergence of GVCs will exacerbate this trend worldwide. Sporadic attempts to discipline them have proven unsuccessful.</p>	<p>The competition to attract investment can lead to a race to the bottom. While politically difficult, there is a strong rationale for international cooperation to discipline such subsidies.</p>	<p>Focus on subsidies dependent on a specified/target company building a new or expanded facility; or subsidies dependent on a target company staying in an existing facility for a period of time (or indefinitely).</p> <p>May be desirable to use a broader definition than the ASCM to include other government actions, such as regulatory waivers, that have a similar effect.</p>	<p>Policy-makers interested in advancing reform</p> <p>Relevant IGOs and stakeholders (e.g. UNCTAD, civil society organizations)</p>
<ul style="list-style-type: none"> Subsidies for the exploration, production or use of fossil fuels, taking into account the importance of consumption subsidies for poor people 	<p>Subsidies currently considered as actionable.</p> <p>Limited transparency and subsidy reporting. WTO reporting vastly understates the extent of the subsidization that occurs.</p>	<p>Encourage the depletion of a non-renewable natural resource and lead to greater emissions of greenhouse gases. Yet, under current rules, cannot be challenged based on the environmental externalities they generate.</p>	<p>First steps could include better notification and peer review (e.g. within the OECD or G20).</p> <p>Pursue immediate stand-alone phase out of fossil fuel production subsidies, leading to an eventual ban on all fossil fuel subsidies.</p>	<p>Policy-makers interested in advancing reform (e.g. G20)</p> <p>Relevant IGOs and stakeholders (e.g. OECD)</p> <p>Private sector leaders</p>

POLICY OPTION	CURRENT STATUS	GAP	STEPS	PARTIES INVOLVED
<ul style="list-style-type: none"> Other natural resource-depleting subsidies such as fisheries subsidies combining a prohibition of the most egregious ones (capital cost, variable costs, price support) and leaving others as actionable 	Same as above	<p>As above, typical illustration of the tragedy of the commons.</p> <p>Need to define hard law prohibition of specific types of subsidies that are most likely to increase resource-depleting activities, combined with a recognition that most other subsidies would be actionable.</p>	Pursue multilateral, regional, or plurilateral avenues, including through a mix of soft and hard law disciplines, to address specific concerns on subsidies (e.g. sectoral initiative on sustainable fisheries).	<p>Policy-makers interested in advancing reform (e.g. G20, SDG)</p> <p>Relevant IGOs and stakeholders (e.g. OECD, UNEP, FAO)</p>
3. Establish disciplines on certain subsidies currently not covered by the ASCM				
<ul style="list-style-type: none"> Establish some form of services subsidies discipline 	<p>GATS negotiations on the appropriateness of subsidy discipline have been unable to reach consensus on whether or what form subsidy discipline for services should take.</p> <p>Significant lack of data and transparency on services subsidies.</p>	As with trade in goods, services subsidies can generate trade distortions but may also be used to correct market imperfections and ensure the delivery of certain public goods.	<p>Start with collection of better data.</p> <p>Definition of subsidy and potential remedy would have to be adjusted to account for the different nature of services trade and the different modes of delivery.</p>	<p>Policy-makers interested in advancing reform</p> <p>Relevant IGOs and stakeholders (e.g. OECD, World Bank, Global Trade Alert)</p>
Establishing, Monitoring, and Resolving Disputes				
4. Strengthen the role of a neutral decision-maker in the resolution of subsidies related disputes	ASCM takes a mixed approach involving both a neutral decision maker (e.g. WTO Panel) and national decision maker (e.g. countervailing duties).	When a unilateral approach is taken, there is an inherent tendency in the decision-maker towards a protectionist leaning. Moreover, only large market economies can use countervailing duties effectively.	<p>Establish a multinational group of experts as neutral decision-makers (e.g. Permanent Group of Experts in ASCM, Art. 24).</p> <p>Use expedited arbitration procedures with some disputes (perhaps concerning prohibited subsidies) subject to binding arbitration.</p> <p>Re-examine the question of proof, benefit, remedies, specificity and the impact of cross-border subsidies in a world of global value chains.</p>	<p>Policy-makers interested in advancing reform</p> <p>WTO members</p>
5. Eliminate the option for unilateral action (e.g. countervailing duties) or at least constrain and make it more restrictive	The ASCM provides for unilateral actions in the form of countervailing duties and provides rules for how such actions are to be undertaken.	Same as above	<p>Redefine how the notion of benefit is determined.</p> <p>Limit countervailing duties to offsetting only the effect of subsidies in excess of the subsidies received by competitors in the importing country.</p>	<p>Policy-makers interested in advancing reform</p> <p>WTO members</p>
6. Generate better data on subsidies through a consortium of universities/independent think tanks	Data on subsidies and subsidy notification sparse, ad hoc, incomplete, and unreliable.	<p>The intergovernmental notification process has not produced the necessary breadth or depth of information about subsidies, and is unlikely to due to lack of resources and incentives.</p> <p>"Reverse" notification (e.g. by competitors or public interest groups) does better, but not in a systematic manner.</p>	Establish a loose university consortium including a variety of institutions around the world using common standards and definition with graduate students seeking out the data.	Consortium of universities and independent think tanks, supported by funding

TASK FORCE PAPERS AND THINK PIECES

The papers commissioned for the E15 Task Force on Rethinking International Subsidies Disciplines can be accessed at <http://e15initiative.org/publications/>.

Clarke, Peggy A. 2015. *Rethinking Countervailing Duties*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Clarke, Peggy A., and Gary Horlick. 2015. *New Directions – and Old – in Subsidies*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Espa, Ilaria, and Sonia E. Rolland. 2015. *Subsidies, Clean Energy, and Climate Change*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Hoekman, Bernard. 2015. *Subsidies and Spillovers in a Value Chain World: New Rules Required?* E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Horlick, Gary, and Peggy A. Clarke. 2016. *Rethinking Subsidy Disciplines for the Future*. E15 Task Force on Rethinking International Disciplines – Policy Options Paper. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Josling, Timothy. 2015. *Rethinking the Rules for Agricultural Subsidies*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Maskus, Keith E. 2015. *Research and Development Subsidies: A Need for WTO Disciplines?* E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Rubini, Luca. 2015. *Rethinking International Subsidy Disciplines: Analytical Paper on Rationale and Possible Avenues of Reform*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Sauvé, Pierre, and Marta Soprana. 2015. *Learning by Not Doing: Subsidies Disciplines in Services Trade*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Schaffer, Gregory, Robert Wolfe, and Vinhcent Le. 2015. *Informal Law's Discipline of Subsidies: Variations in Definitions, Obligations, Transparency and Organizations*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Sykes, Alan. 2015. *The Limited Economic Case for Subsidies Regulation*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

Tipping, Alice. 2015. *A 'Clean Sheet' Approach to Fisheries Subsidies Disciplines*. E15Initiative. Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum.

MEMBERS OF THE TASK FORCE

Gary HORLICK – *Theme Leader*

Attorney, Law Offices of Gary N. Horlick

Ricardo MELÉNDEZ-ORTIZ – *Convener*

Chief Executive, International Centre for Trade and Sustainable Development (ICTSD)

Sadeq BIGDELI

Senior Lecturer, University of Waikato

Peggy A. CLARKE

Principal, Law Offices of Peggy A. Clarke

Terry COLLINS-WILLIAMS

Co-Director, Institute on Trade Policy, Queen's University (Canada)

Gérard DEPAYRE

Consultant in international trade

Ilaria ESPA

Marie Curie (COFIT) Senior Research Fellow, World Trade Institute (WTI)

Bernard HOEKMAN

Professor, Robert Schuman Centre for Advanced Studies, European University Institute

Veena JHA

Director, Maguru Consultants Ltd.

Timothy JOSLING

Professor Emeritus, Stanford University

Tsuyoshi KAWASE

Professor of Law, Sophia University

Matthew KENNEDY

Professor of Law, University of International Business and Economics (UIBE)

Keith MASKUS

Professor of Distinction, University of Colorado Boulder

Sonia E. ROLLAND

Professor of Law, Northeastern University School of Law

Luca RUBINI

Reader in International Economic Law, University of Birmingham

Pierre SAUVÉ

Director of External Programmes and Academic Partnerships, World Trade Institute (WTI)

Gregory SHAFFER

Chancellor's Professor of Law, University of California, Irvine School of Law

Ronald STEENBLIK

Senior Trade Policy Analyst, Organisation for Economic Co-operation and Development (OECD)

Alan O. SYKES

Robert A. Kindler Professor of Law, New York University Law School

Alice TIPPING

Senior Programme Officer, ICTSD

Robert WOLFE

Professor, Queen's University (Canada)

Jan WOZNOWSKI

Former Director of the Rules Division, World Trade Organization (WTO)

Mark WU

Assistant Professor, Harvard University

Alan YANOVICH

Senior Counsel, Akin Gump Strauss Hauer & Feld

Christophe BELLMANN – *Group Manager*

Senior Research Fellow, ICTSD

The experts participated in their personal capacity. The analysis and policy recommendations are not attributable to any institution with which members of the E15 Task Force are associated.

E15 INITIATIVE: EXPERT GROUPS AND TASK FORCES

In the quest for effective responses to the challenges faced by the global economy at this time, foremost experts were invited to contribute to 15 thematic groups as well as three task forces addressing horizontal issues. The groups met regularly between 2012 and 2015 with the goal of delivering a set of policy options on the occasion of the WTO's 20th anniversary. These options are intended to animate discussions and feed the present and future international trade and investment policy agenda for sustainable development. The full volume of policy options papers, jointly published by ICTSD and the World Economic Forum, and launched at the Forum's Annual Meeting in Davos-Klosters in 2016, is complemented with a monograph that consolidates the options into overarching recommendations for the international trade and investment system for the next decade. The second phase of the E15 Initiative in 2016–17 will see direct engagement with policy-makers and other stakeholders to consider the implementation of E15 policy recommendations.

E15 INITIATIVE THEMES

- 1 – Agriculture and Food Security
- 2 – Clean Energy Technologies
- 3 – Climate Change
- 4 – Competition Policy
- 5 – Digital Economy
- 6 – Extractive Industries
- 7 – Finance and Development
- 8 – Fisheries and Oceans
- 9 – Functioning of the WTO
- 10 – Global Trade and Investment Architecture*
- 11 – Global Value Chains
- 12 – Industrial Policy
- 13 – Innovation
- 14 – Investment Policy
- 15 – Regional Trade Agreements
- 16 – Regulatory Coherence
- 17 – Services
- 18 – Subsidies

* Policy options to be released in late 2016

Implemented jointly by ICTSD and the World Economic Forum, the E15Initiative convenes world-class experts and institutions to generate strategic analysis and recommendations for government, business and civil society geared towards strengthening the global trade and investment system for sustainable development.



International Centre for Trade
and Sustainable Development



COMMITTED TO
IMPROVING THE STATE
OF THE WORLD