



POLICY BRIEF
**INDUSTRIAL SUBSIDIES AS A
MAJOR POLICY RESPONSE
SINCE THE GLOBAL FINANCIAL
CRISES: CONSEQUENCES AND
REMEDIES**



Task Force 1
TRADE, INVESTMENT AND GROWTH

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موجز السياسة الإعانات الصناعية بصفقتها استجابةً رئيسية للسياسات منذ الأزمات المالية العالمية: العواقب والعلاجات

فريق العمل الأول
التجارة والاستثمار والنمو



المؤلفون
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ABSTRACT

The World Trade Organization (WTO) is at an impasse regarding the resolution of tensions surrounding the issue of subsidies. The weak implementation and surveillance of WTO disciplines is attributable to the lack of notifications by WTO members. Currently, major members are developing plurilateral initiatives to deal with the perceived unfair application of subsidies, which leads to market distortions, overcapacity, and unfair competition. Are these steps an attempt at broad reform or a self-serving agenda aimed at certain other members? This policy brief explores the major issues around subsidies, and identifies a plurilateral path forward if a broad—than member-targeted—reform agenda is to be followed. It proposes procedural steps that the Group of Twenty (G20) members can follow to address the subsidies problem and, thus, provides a set of substantive options to guide the proposed deliberations.

كما هو الحال مع قضايا أخرى، وصلت منظمة التجارة العالمية إلى طريق مسدود في ما يتعلّق بحل التوتر الذي يحيط قضية الإعانات. هذا وإنه لا توجد إخطارات من جانب الأعضاء في الغالب، وذلك يضعف عمليات تنفيذ ضوابط منظمة التجارة العالمية ومراقبتها. يحرز أعضاء منظمة التجارة العالمية الرئيسيون حاليًا تقدمًا في المبادرات الجماعية للتعامل مع التطبيق غير العادل للملغوس للإعانات، والذي يؤدي إلى انحرافات في السوق، وقدرة إنتاجية مفرطة، ومنافسة غير عادلة. ولكن هل تُعد هذه محاولة إصلاح واسعة النطاق، أم جدول أعمال يخدم مصالح ذاتية ويستهدف بعض الأعضاء الآخرين؟ يكشف موجز السياسة هذا القضايا الرئيسية المتعلقة بالإعانات، ويحدد المسار متعدد الأطراف، للمضي قُدّمًا في حال اتباع أجندة إصلاح واسعة النطاق، بدلًا من أجندة إصلاح تستهدف أعضاء بعينهم. ويقترح كذلك خطوات إجرائية يُبَّعها أعضاء مجموعة العشرين لمعالجة مشكلة الإعانات بجدية، كما يوفر مجموعة من الخيارات الموضوعية لتوجيه المداولات المقترحة.



CHALLENGE

There has been a well-documented global resurgence in protectionist policy measures since the 2008 Global Financial Crisis¹. The Group of Twenty (G20) has proven to be no exception, despite the organization explicitly articulating a longstanding commitment to fight protectionism between 2009 and 2020 (Hook and Politi 2018)². Since the G20 first communicated an explicit commitment to “anti-protectionism” in November 2008, member governments have introduced over 14,000 policy interventions favoring domestic firms over foreign rivals, but less than 5,200 liberalizing measures (Tamura et al. 2018). Thus, the G20’s anti-protectionism pledge has mostly been breached. However, this trend is not unique to the G20, but evidenced across the global economy since 2009. Importantly, while the US–Sino trade war has dominated global news on international trade since 2017, it only accounts for a small proportion of recent protectionist measures introduced by G20 members—to be precise, 21% since the first investigation into Chinese practices by the United States Trade Representative was launched in August 2017 (Evenett and Fritz 2019, 12).

The 24th Global Trade Alert observes a dramatic visualization of growth in unilateral trade-distorting measures by G20 members. It provides a series of “heat maps” every three years, from 2009 to 2020. It highlights growth in domestic interventions that tilt the playing field against imports. Figures 1 and 2 illustrate the first and last available maps for 2009 and 2020, respectively (Evenett and Fritz 2019, 36–37):

1. The post-2008 trend toward renewed protectionism is documented in detail in the Global Trade Alert reports since 2009; see <https://www.globaltradealert.org>.
2. The G20 dropped its anti-protectionism pledge in 2018.

CHALLENGE



Figure 1: Incidence of G20 Members' Trade Measures, 2009

CHALLENGE



Figure 2: Incidence of G20 Members' Trade Measures, 2020

Notably, only Japan, Mexico, and, to a lesser extent, South Korea have abstained from unilateral trade measures that discriminate against foreign commercial interests. Most of the new measures implemented are different forms of subsidies. As per Global Trade Alert data, at the time of writing this paper, of the 6,332 subsidies implemented by the G20, 3,173 were financial grants, 1,141 were state loans, and 575 involved tax and insurance relief. The G20 governments have awarded 13 different forms of state aid benefiting domestic firms on grounds other than their export status. The failures identified in multilateral processes have undoubtedly compounded the growth of trade-distorting subsidies, including:

- Fall in subsidy notification rates by World Trade Organization (WTO) members, and
- Slow and difficult subsidy litigation within the WTO Dispute Settlement Understanding framework (Wang et al. 2019; Hu 2019).

Evidently, the fall in subsidy notification rates by members is related to, and compounded by, difficulties in identifying subsidies—that which cannot be measured is difficult to control. Contrariwise, during the Uruguay Round, agriculture subsidies were subject to intense scrutiny and measurement to bring appropriate metrics to negotiations. This resulted in the Agreement on Agriculture, wherein subsidies were (imperfectly) disciplined (see box below). In addition, the multilateral resolution framework under the Dispute Settlement Understanding is sluggish; cases are difficult to prosecute, which risks the framework itself becoming obsolete³. Although recent developments within China—especially initiatives to build Communist Party cells in Chinese firms—have made it easier to fulfil the public body requirement in WTO litigation⁴, the Appellate Body crisis makes countries reluctant to use litigation to address such a systemic problem.

3. For example, it has taken the WTO 15 years to rule on the US complaint against Airbus subsidies by certain EU members; it ruled in favor of the complainant in October 2019.

4. For a detailed analysis on how these developments can build a successful WTO case against China, see Zhou, Gao, and Bai (2019).

The Agreement on Agriculture and Special and Differential Treatment

The complexity of the Special and Differential Treatment (SDT) issue should not be underestimated, as it cuts to the heart of current contestations in Geneva over relative “burden-sharing” in relation to trade liberalization commitments and agreements negotiated under the auspices of the WTO. On the one hand, as countries move up the development ladder, they should eschew access to the more generous concessions afforded to countries on the lower rungs. On the other hand, countries have always “self-defined their development status,” and obtaining agreement on quantitative criteria to determine graduation is seriously challenging. Nonetheless, in some respects, SDT is built into the architecture of the Agreement on Agriculture, with its colored boxes and graduated access to subsidies entitlements. However, as the Cairns Group proposal on January 23, 2020 to the WTO’s General Council notes, the Agreement does not cap subsidies entitlements in relation to levels of development and/or economic size. That is, they could, in principle, continue to grow well beyond developed country levels, as long as the developing country providing them chooses to do so. The challenge is to identify agreed-upon “graduation criteria.” If such criteria could be established, then it would be possible to peg industrial subsidies to pre-defined thresholds with respect to the levels of subsidization and phase-out periods, with sectoral application to be governed by a revised Agreement on Subsidies and Countervailing Measures and the principles set out in the Proposal below.

These issues undermine multilateral solutions to trade distortions caused by subsidies and further entrench the current drive toward protectionism. The data above, as well as the associated issues, were evident before the sudden advent of the COVID-19 pandemic. This pandemic has resulted in serious fiscal and monetary interventions by G20 members as well as other states in order to alleviate the severe crisis-induced economic impacts. These outlays will undoubtedly result in a host of subsidy-related issues that add to the stock already presented here, and, thus, substantially complicate international trade relations.

In this context, this policy brief tackles the challenge of identifying possible paths for reforming and disciplining the use of subsidies by WTO members in a manner consistent with a multilateral framework, but initially driven by a lead group of G20 members, given the current WTO gridlock. This challenge was already difficult prior to the COVID-19 crisis for the reasons outlined above; it is now more difficult, as governments worldwide look to boost national growth using subsidies, even as they engage in increasing levels of protectionist policies. The desired outcome of engaging with this challenge is enabling the transition to a positive trend of trade liberalization.



PROPOSAL

A number of G20 governments of larger economies have recently laid out reform agendas designed to address what they perceive as key sources of friction in the current trade environment. One agenda, which is focused on industrial subsidies reform, has been articulated by the US, European Union (EU), and Japan in three successive Trilateral Joint Statements since January 2019 (Office of the United States Trade Representative 2019a, 2019b, 2010). A second broader agenda for WTO reforms was outlined by China in a 2019 document circulated at the WTO General Council (Communication from China 2019). The Appendix sets out the core elements of these diametrically opposing proposals by major players in relation to subsidies reform.

It is evident that these core players are moving in different directions in relation to the key underlying matters that an industrial subsidies reform agenda would need to address, as well as related issues that might be included in a broader reform package, such as agriculture subsidies. Two implications arise here. First, a broader reform package is probably required in order to increase the scope for trade-offs, given the current lack of an immediately apparent landing zone. Simply put, there is insufficient internal convergence (on the industrial subsidies reform agenda) to enable a deal. Second, for any industrial subsidies reform proposal to meaningfully update WTO rules, more players need to be at the negotiating table. Given that the G20 represents the most systemically significant economies, it is sensible for this process to be incubated in the G20.

Thus, our broad proposal is that the G20 squarely address concerns regarding industrial subsidies by considering the underlying political economy logic, which suggests a broader reform package. Toward this end, **two process proposals** are proposed:

- The G20 should establish a subsidies reform sub-committee comprising senior trade and finance ministry officials. Both sets of officials are required to cover the trade and industrial policy as well as financial and broader economic policy dimensions of subsidies. The committee's scope should be sufficiently broad such that it can address issues beyond industrial subsidies per se; this would widen the scope for trade-offs. Its remit should be multi-year, that is, it must transcend the immediate G20 Presidency at hand—currently Saudi Arabia—since it will take years to work through the many complex and politically sensitive matters. Whether this committee should report only to trade ministers—given the broader economic policy considerations in play and the association of subsidies issues with the G20's finance track—requires serious consideration as well.

- The meetings of capital-based officials should be mirrored in Geneva, through regular meetings of officials from G20 members based in WTO delegations there. This will ensure that, first, there is a link to the broader WTO reform discussions taking place in Geneva. Second, that informal channels can be maintained with non-G20 WTO members, many of whom have an interest in subsidies reform negotiations. This is more likely to facilitate the establishment of a landing zone in Geneva—a necessity if any WTO rule changes are to be implemented. However, it is possible that this particular reform initiative may not succeed in Geneva; hence, the Geneva component should not be allowed to side-track or delay the G20 sub-committee process, which may be difficult.

Importantly, the last point highlights the centrality of a plurilateral approach incubated and negotiated in the G20. This may conceivably end in broadly simultaneous unilateral disarmaments via mutual agreement among the major subsidizers. For such an approach to work, our second proposal is that the sub-committee should establish **core principles** to guide negotiations. These will be required, since the process will be highly contested as well as rooted in divergent understandings of what the problems are, and, hence, what needs to be done. Some suggested organizing principles include:

- The focus should be on subsidies that have the potential to generate major negative cross-border spill-over effects on trading partners.
- Allowance should be made for subsidies designed to achieve legitimate social and policy objectives, particularly those with positive cross-border spill-over effects. An obvious example is research to combat infectious diseases such as global health pandemics or climate change mitigation technologies. Thus, research and development as well as environmental subsidization need to be considered global challenges.
- However, G20 governments should also agree to the principle of competitive neutrality, which requires that the application of subsidies payments has minimal distorting effects on market competition, particularly in relation to cross-border business.

- G20 governments should agree on the need for disciplined caps on the growth of subsidies, such as the entitlements governing agriculture subsidies. Within this limited framework, a range of principles would need to be established, such as capping the growth of subsidies entitlements as countries develop; ensuring periodic (e.g., every five years) reviews of entitlements; and/or automatic phase-outs for specific kinds of subsidies once they have been paid out. In other words, embed a core principle that permissible subsidies for specific kinds of economic activities and firms should be viewed as temporary; furthermore, they must be reduced, or phased out, according to predictable and enforceable schedules.
- Consensus on principles governing special and differential treatment or the access of countries at different stages of development to subsidies entitlements.
- The rules governing national defenses using trade remedies against negative cross-border spill-overs arising from subsidies need to be clarified to enable quick remedies when required as well as to prevent abuse.

Beyond an agreed set of principles, the negotiations would need to take practical form. Two connected **lines of negotiation** will need to be engaged:

- In which sectors are subsidies currently and, in future, most likely to result in significant negative cross-border spill-over effects? Here, the analysis in the Global Trade Alert's July 2019 report could be a useful basis for discussions. The report identifies the sectors where import surges (a possible source of cross-border spill-over created by subsidies) were more prevalent. Moreover, the willingness of governments to bring countervailing duties or safeguarding actions is revealing in terms of how concerned G20 governments are regarding cross-border spill-overs or their underlying causes.
- What kinds of subsidies are most problematic, and why? Furthermore, what needs to be done to discipline them? Finally, what are the implications for current WTO rules, as contained in the Agreement on Subsidies and Countervailing Measures?

Therefore, identifying, classifying, and **measuring the stock of subsidies** currently in use in G20 members require close attention, which, in turn, requires:

- First, an agreement on the definition of subsidy, that is, what constitutes a subsidy. The Organization for Economic Cooperation and Development (OECD) and EU via its State Aid rules and enforcement judgements could make significant contributions here. Decades of WTO jurisprudence via the Dispute Settlement Mechanism should be processed, although not as established precedents, given the political sensitivity of the issue.
- Assuming a consensus on definitions can be reached, a sustained measurement process needs to be instituted by major international institutions such as the World Bank and International Monetary Fund, with support from organizations such as the OECD and United Nations Conference on Trade and Development (UNCTAD). The composition of international institutions needs to be sensitive to the need to mobilize the best expertise, international networks, and access to data (International Monetary Fund and World Bank); practical experience with regulating subsidies recourse among member countries (OECD; EU); and focus on the concerns of developing countries (UNCTAD).

Finally, G20 members should commit to full transparency in publishing notifications to the WTO regarding the subsidies they pay to domestic producers. This would ensure a reliable flow of accurate data for measuring and calibrating ensuing actions. Where notifications are not forthcoming, appropriate procedures should be established—for example, via counter-notifications and reversal of the burden of proof; where reliability can be guaranteed, declarations in corporate financial statements; and well-regarded independent sources of information on subsidies. To avoid a descent into unilateralism, some procedures would need to be built to curtail arbitrary abuse. For developing countries with capacity constraints, technical assistance shall also be made available in order to help them identify, collate, and notify the subsidies.

Disclaimer

This policy brief was developed and written by the authors and has undergone a peer review process. The views and opinions expressed in this policy brief are those of the authors and do not necessarily reflect the official policy or position of the authors' organizations or the T20 Secretariat.



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APPENDIX

Table 1 below provides an overview of the key issues and policy recommendations of both the trilateral group and China, along with their reform agendas for the multilateral trading system.

Table 1. Key issues and comparison of the trilateral group's positions versus China's position.

| Trilateral Group | Key Issues | China |
|---|---|------------------------|
| Issue | Industrial subsidies | Non-issue |
| Non-issue | Misuse of AD and CVDs | Issue |
| Non-issue | Aggregate Measure of Support subsidies in agriculture | Issue |
| Issue | SOEs and National Champions | Non-issue ¹ |
| Key Policies Recommendations | | |
| Yes | Expand list of prohibited subsidies | No |
| Yes | Reverse ASCM burden of proof for very large subsidies | No |
| Yes | New clause of serious prejudice to interests of WTO members for subsidies that distort capacity | No |
| Yes | Stronger subsidy notification incentives | Yes |
| No | Expand list of non-actionable subsidies | Yes |
| No | Eliminate Developed Countries' AMS entitlements for agricultural subsidies | Yes |
| EU and Japan support China's position; US opposed | End the AB appointment blockage | Yes |
| No | Improve trade remedies rules | Yes |
| No | Improve rules on security exception to prevent misuse | Yes |
| No | Tightening rule on unilateral measures inconsistent with WTO rules | Yes |

Note. * Reform of state-owned enterprises is a non-issue for China on the condition, as stated in its WTO proposal, that “no special or discriminatory disciplines should be instituted on state-owned enterprises in the name of WTO reform.”

Evidently, the respective reform programs outlined in Table 1 are almost diametrically opposed to one another. The trilateral group’s policy recommendations could be viewed as constituting a “China-reform” agenda to the extent that they single out state-owned enterprises, non-market practices, and industrial subsidies (Lu 2019)⁵. An obvious question is—why would China agree to any or all of these reforms? On the other hand, why should the trilateral group engage with China’s demands, given that it fails to address any of the group’s concerns? Yet, these key players must be part of any substantive drive toward reform. In this context, we propose that any realistic path forward requires identifying possible trade-offs in order to reach consensus on a limited number of core reforms. The potential rules especially need to be neutral regarding the ownership structure of the firms that might constitute “public bodies” in order to not be perceived as China-specific. This is also in line with the evolution of WTO jurisprudence, where ownership is only one of the factors taken into consideration.

5. As Xiankun Lu argues, while China is open to WTO reform, it will not accept reform that specifically singles out its economic system.



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