



Task Force 3
Trade, Investment and Growth

Policy brief

RESTRUCTURING THE WTO REGULATORY FRAMEWORK ON INDUSTRIAL SUBSIDIES: SUSTAINABILITY, FREE TRADE AND PROSPERITY

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ABSTRACT

Industrial subsidies have long been a controversial topic for the World Trade Organization (WTO) and the G20. The debate was rekindled by the COVID-19 crisis, which compels countries to support their economies through subsidies. This policy brief will suggest reforming the notion of subsidy under the Agreement on Subsidies and Countervailing Measures (ASCM) in a broader sense, as well as the tripartite structure of prohibited, actionable and allowed subsidies, so as to promote sustainable development as a legitimate justification for state intervention. Finally, we will ponder how to enhance transparency and how plurilateral interim solutions may help in overcoming the current stalemate.



CHALLENGE

All countries are facing severe economic consequences from the COVID-19 pandemic. Every government is considering how to support enterprises and avoid the social impact of this crisis. The temptation of a return to protectionist policies is dangerous, especially in a phase of impasse for the multilateral trade system.

One of the most sensitive issues is the international framework for industrial subsidies. The topic was already debated at the G20 level before the COVID-19 pandemic, but it has become even more sensitive today as governments are called on to support their national economies. Therefore, we face the concrete risk that uncoordinated and unbalanced support to domestic economies may lead to socio-economic inequalities and restrictions on free trade. The search for a balance between free trade and other societal values is made more complicated by the lack of harmonized definitions and databases to gather data and assess the global impact of national policies.

COVID-19 is not the only challenge that the global trade community is facing. Only nine years separate us from 2030, the deadline we all set for the achievement of the seventeen UN Sustainable Development Goals (SDGs). Trade and sustainable development go hand in hand, so the G20 members, and all countries, should rise to the challenge and design their industrial and trade policies with due consideration for the SDGs.

Subsidies have long been an issue for the multilateral trade system. Now that they appear to be a common tool to promote green and innovative industries or to ease economic distress, it is time to find a balanced approach to their regulation and reform the Agreement on Subsidies and Countervailing Measures (ASCM) framework.

The regulatory framework provided by the ASCM reflects a view of economic development firmly entrenched in a static notion of trade efficiency. Therefore, long-term positive outcomes that subsidies may produce on environmental sustainability and socio-economic cohesion are, in principle, not taken into account.

In 2021, such an approach overlooks the diversified ensembles of economic law systems in place among members of the World Trade Organization (WTO). Today, such members include:

- i) democratic-liberal countries whose economic law systems aim at preserving static and/or dynamic market efficiency;
- ii) countries adopting a socialist market economy model whose economic law systems are strongly affected by public development policies and by policy-driven national interests; and
- iii) developing countries with fast-growing rates of industrialization adopting a state capitalist model of economic law, thus orienting rules on competition and state aid according to social and economic interests pursued by the state.



Each of these models attaches a different level of importance and scope to the usage of subsidies. We, therefore, propose to restructure the WTO framework for industrial subsidies in order to better deal with the stark differences among the development models, as well as to ensure coordination between international trade dynamics and the SDGs, in line with the objectives and actions of the United Nations.



PROPOSAL

1. THE NOTION OF SUBSIDY

The current notion of subsidy laid down in the ASCM is often deemed unsatisfactorily restrictive, and several challenges thereto can be found in the literature (Jung and Suh, 2016; Horlick and Clarke, 2017, pp. 690–6). Reportedly, Art. 1 ASCM deems a subsidy to be in place when, cumulatively:

- “a financial contribution by a government or any public body”, including any form of income or price support under the General Agreement on Tariffs and Trade (GATT) Art. XVI, is given; and
- “a benefit thereby conferred” is found to exist.

Furthermore, any subsidy so defined is only subject to the ASCM if it is “specific” within the meaning of Art. 2.

Each of these elements is held to raise distinct problems, detrimentally affecting the ASCM's scope of application. However, it should be noted that the requirement of specificity serves a purpose whose merits seem hard to deny, since, without its filter, basically any economic policy measure could be held, in the abstract, to satisfy the definition of subsidy. Accordingly, the specificity requirement should be retained. Moreover, the general notion that both a financial contribution and a benefit upon the recipient should be in place is also worth preserving. While amounting to an essential component of the political bargain underlying the ASCM (Lowenfeld, 2008, pp. 232–7),¹ this pair of concepts places minimal constraints upon the operation of a provision which, if left excessively open-ended, would be unmanageably unpredictable in its outcomes. In fact, the scope of application of the ASCM must be given with appropriate amplitude, but at the same time governments must be able to fully appraise which obligations are incumbent upon them.

Our proposal is to stick to the existing definition, while eliminating the exhaustive list at Art. 1.1, letter (a), which currently limits the scope of the financial contribution requirement. Leaving undefined the notions of financial contribution, benefit and specificity without renouncing them would leave the balanced lines along which the ASCM currently develops broadly unscathed, while avoiding its most striking shortcomings and preventing the rigidity which any positive list approach necessarily entails. At the same time, a detailed and comprehensive indicative list of measures qualifying as subsidies should also be annexed to the ASCM. The usefulness of an illustrative list providing guidance, so as to diminish interpretive uncertainty, has already been acknowledged by the WTO member states in Annex I to the ASCM, whose precedent might be built upon. An *ex ante* interpretive petition mechanism should be available for marginal cases not included in the list, to resolve doubts through an impartial procedure (Section 3).

The effect of such an amendment would be to preserve the conceptual boundaries currently delimiting the ASCM's scope of application,² while enabling the working of its provisions



in cases that are currently excluded, but still entail the conveyance of wealth from the public to the private caught by the financial contribution + benefit combination, such as the purchase of services by governments or public bodies.³ As a result, the ASCM's transparency and notification obligations would acquire a broader scope. These obligations should remain applicable to all subsidies, irrespective of the categories in which they are included for the purposes of their substantive legal discipline. This would benefit international economic relations at large, where commitments on subsidies often find their way into regional or bilateral bargains, which could thus rely upon an enhanced information network.⁴ Furthermore, the international discipline of subsidies outlined in Section 2 would also apply to a broader range of situations, enabling the more effective realization of the policy vision underlying the system.

2. THE INTERNATIONAL DISCIPLINE OF SUBSIDIES

The ASCM should be amended in a manner which is more sensitive to the establishment of sustainable development as a universal commitment by the international community (Drexhage and Murphy, 2010; Jolly, 2014; De Schutter, 2015, pp. 31–5).

The basic architecture of the ASCM should be retained. This is not only on grounds of political feasibility, but also because the formal categories established by the ASCM can provide a convenient framework to graduate the degree of intrusiveness of WTO law in as politically sensitive a sector of national economic policies as that of subsidies. The tripartite structure of prohibited, actionable and allowed subsidies should therefore find its way into a revised ASCM. It is the substantive content unfolding in those structures which should be refashioned.

2.1 Prohibited subsidies

At one end of the spectrum, certain subsidies should be prohibited per se, based on a presumption that they would cause detrimental effects. In other words, a *measure-based* prohibition should be laid down (Bäumler, 2017): certain types of subsidies can, based on experience, be deemed to affect the public goods protected by WTO law to such an extent that they should be prohibited irrespective of any inquiry into their actual impact in a given case. Reflecting the WTO+ approach advocated here, two sub-categories should be identified:⁵

- i) *Trade-distorting subsidies*: these are the subsidies which are currently prohibited by the ASCM, that is, export subsidies and import substitution subsidies.⁶ This baseline prohibition should be retained, subject to the possibility to benefit from the exemption accorded to allowed subsidies (see below).
- ii) *Subsidies detrimental to sustainable development*: there are plenty of subsidies supporting industrial activities which are detrimental to sustainable development goals. The importance of laying down an international regime restricting the use of such subsidies is increasingly acknowledged in the literature (Horlick and Clarke, 2017, pp. 678–88). This is in respect of both the environmental component of sustainable development (e.g. fossil fuel subsidies) and the social prong thereof (e.g. subsidies to production processes deploying forced labour).



2.2 Actionable subsidies

The ASCM currently condemns subsidies other than prohibited ones based on their *effect*: if and to the extent that they negatively affect the economy of another WTO member state, remedies against them can be triggered, both unilaterally and multilaterally.⁷ The core regulatory issue is striking a balance between the juxtaposed interests of subsidizing and importing states (Rubini, 2009, pp. 56–9).⁸

From this perspective, the scope of such a balancing exercise should be broadened and structured in a dual track, to reflect the broader range of values to which the “new” WTO should commit.

- i) *Trade-distorting subsidies*: again, the current ASCM’s framework should be retained, thus rendering actionable those subsidies which injure the domestic industry of another member state, nullify or impair its GATT benefits, or cause serious prejudice to its interests. Such a category should, however, be coupled with appropriate carve-outs, ensuring adequate recognition of the policy interests underlying the harmful subsidy (on which see below).
- ii) *Subsidies detrimental to sustainability*: if sustainability is to be an overarching goal of global economic relations, the possibility to dynamically target subsidies other than those identified *ex ante* (i.e. through the measure-based prohibition recommended here) as typologically detrimental thereto should not be radically excluded. Subsidies which, in reality, negatively impact on the environmental and social interests of the sustainable development agenda should also be amenable to confrontation under the ASCM’s remedies.

2.3 Allowed subsidies

The ASCM originally envisaged some narrowly defined exceptions to both actionable and prohibited subsidies. These, however, have become inapplicable in 2000, after the failure to arrive at a consensus to extend their inapplicability. Scholars have repeatedly urged policy-makers to reintroduce some form of exception in the ASCM, in particular to the benefit of environmental subsidies, which has started to be challenged before WTO dispute settlement bodies (Howse, 2010; Cosbey and Mavroidis, 2014).⁹ In a sustainable development-leaning amendment of the ASCM, the call should be heeded.

Subsidies which are beneficial to social and environmental sustainability should be allowed in principle, even when they would otherwise be prohibited or actionable as being trade-distorting. This would include, eminently, subsidies to the production of “green” goods, as well as subsidies meant to redress socio-economic imbalances affecting, for instance, depressed regions of a member state, by encouraging localization of production facilities therein.¹⁰ A provision modelled after GATT’s Art. XX, including its *chapeau*, should thus be included in the ASCM, listing environmental and social grounds for derogation. By so doing, states would retain policy space to use subsidies to further the Agenda 2030, without, however, being given *carte blanche* to use them instrumentally to pursue unrelated aims. The provision might be further qualified, for instance by requiring that the subsidy be contextualized within broader development programmes, in the service of the interests of rational allocation of resources and institutional transparency.



Furthermore, appropriate mechanisms to ensure the coordination of the social and the environmental components of the sustainable development model should be put in place. In particular, where the mechanical application of the ASCM would lead to unreasonable results (e.g. proscribing under the social prong an environmental subsidy that drives producers of an environmentally outdated good off the market, by making them unable to compete with subsidized producers of the “greener” version of the product), provisions should be laid down to properly balance conflicting interests (Draper et al., 2020).

3. THE GOVERNANCE OF THE ASCM

The increased complexity of the ASCM which would result from introducing sustainability considerations into the instrument would inevitably have repercussions on its organizational and institutional structure.

The current architecture of remedies should, in particular, be reconsidered.

- The multilateral dispute settlement track should be retained. It should be viewed as the privileged remedy to settle disputes concerning subsidies, based on adjudication by an impartial decision-maker dealing with complex balancing exercises.
- Unilateral countervailing duties should continue to play a role in respect of trade-distorting prohibited and actionable subsidies. They provide a prompt reactive mechanism against subsidies which governments would be unlikely to renounce.
- Unilateral remedies against “unsustainable” prohibited and actionable subsidies, however, should be carefully reflected upon. Countervailing duties reflect an eminently efficiency-based rationale: they offset an undue competitive advantage, ultimately aiming at preventing the economic harm caused by “boosted” imports of subsidized products. They thus seem unfit for countering subsidies which are undesirable because of sustainability concerns. Ideally, cross-sanctions (e.g. suspension of GATT concessions) would be the most effective way to induce elimination of such subsidies. Evidently, however, they can only be applied pursuant to a multilateral dispute settlement procedure capable of avoiding abuses.

Institutionally, the role of the WTO should be enhanced. Increased capacity to monitor the process of notification should be considered (see Section 4). Moreover, as already hinted (Section 1), the role of WTO bodies as providers of ex ante interpretive guidance should be enhanced. Member states should be able to preventatively ask, with no prejudice for possible subsequent dispute settlement proceedings, whether a measure not listed in the illustrative Annex qualifies as a subsidy.¹¹ Similarly, in the face of (alleged) actionable subsidies detrimental to sustainability or (alleged) allowed subsidies, it should be possible to ask for a preliminary opinion on whether the measure fulfils the requirements placed by the relevant norms.¹² The balancing exercise implicit in such qualification efforts should entail a careful crafting on the institutional side, to ensure the full impartiality of the delicate decisions which WTO bodies would be called upon to hand down.¹³



4. TRANSPARENCY OBLIGATIONS

At present, the notification procedure is highly ineffective. In 2020, out of 164 members, only forty-two provided notification on subsidies they had enacted, while eleven declared not having any measure qualifying as a subsidy in place; the remaining 113 members simply failed to comply with the notification obligations incumbent upon them (WTO, 2020).

In the proposed new framework for subsidies, the members should have an interest in complying with the notification obligations of both the ASCM (Art. 25) and the GATT (Art. XVI) (WTO, 2017). For instance, failure to comply may trigger a reduction of the terms of the Trade Policy Review or deeper scrutiny on that occasion.

The WTO and the G20 members should also facilitate the notification process, since certain countries bemoan their own lack of capacity to stay current with the reporting. The issue is relevant not only for industrial subsidies, but also for other sectors (e.g. fisheries subsidies: Formenti, 2019). On the one hand, the WTO should propose a baseline comprehensive list of measures qualifying as subsidies, as argued in Section 1. The members will then stop relying on their own nomenclature and the qualitative data will become more standardized and comparable. It will become easier for a member to report its measures and for the other countries to assess them. On the other hand, the WTO should provide clear statistical guidelines to assess subsidies also from a quantitative point of view. Indeed, the amount of some types of subsidies may be difficult for a member to estimate *ex ante* and to report. Further, this may help the other countries in assessing the effects on their own economies (Wolfe, 2013).

Yet transparency should not be considered narrowly, just as a form of accountability towards the other members. It could become a tool to empower stakeholders, who should be able to elaborate subsidies data on their own and lobby domestic and foreign governments accordingly. Businesses want to know if a domestic measure will effectively support their growth or if a foreign one will affect it adversely. Even more, for subsidies geared towards sustainable development goals, civil society may want to understand the concrete impact of these policy tools.

Qualitative and quantitative parameters for the evaluation of subsidies are needed, alongside technical assistance to countries which lack the capacity for reporting and assessing their own measures. Furthermore, the G20 should consider tasking the WTO, the Organisation for Economic Co-operation and Development (OECD) or other organizations (Draper et al., 2020) to gather data on industrial subsidies and then to develop methods of data-driven analysis and decision rule mining. These methods may help countries in designing their policies and stakeholders in navigating the complex scenario of state intervention. We will briefly outline these methods in the Appendix.



5. THE VIABILITY OF MULTILATERAL OR PLURILATERAL SOLUTIONS

Progress in the field of industrial subsidies goes hand in hand with overcoming the deadlock of the WTO and the Dispute Settlement Mechanism (DSM). The new US administration and the change at the helm of the WTO may give momentum to an effort to reform the organization, which should see its global status enhanced and its Director-General reinforced (Freytag, 2021).¹⁴

The optimal outcome of the current debate on industrial subsidies would be a multilateral solution. The proposed reform of the industrial subsidies framework should not meet any strong opposition from members, since it does not reduce their capacity to support their economies and growth. On the contrary, as examined, it provides clearer rules that may shelter subsidies (e.g. environmental ones) from litigation and countermeasures, both expanding governments' room for manoeuvre and tackling a long-lasting problem of the ASCM (Howse, 2010; Cosbey and Mavroidis, 2014). The sole new restriction imposed is on subsidies detrimental to sustainable development, and to refuse such a limitation would be untenable in an SDG-oriented international community.

Were it not possible to reach a multilateral solution, a plurilateral agreement could be viable. Plurilateral agreements can be an important tool in starting the necessary reform of the WTO – as several contributions of the T20 Saudi Arabia concluded (Berger et al., 2020; Sait Akman et al., 2020). The most apparent concern is that there might be a free-riding risk implicit in any plurilateral solution. The point can, however, be downscaled in the case of our proposal, since, as recalled above, an effect of such restructuring would actually be to broaden the leeway enjoyed by policy-makers in respect of subsidies. The G20 should thus encourage open plurilateral negotiations, if necessary. In order to make such agreements a viable alternative, all members need to agree on the core principles guiding negotiations among sub-groups of members, with multilateralization as the ultimate goal.



APPENDIX

Industrial subsidy decision processes through data mining technology

The prospect of a systematic collection and publication of reliable data on industrial subsidies, as seen in Section 4, makes it possible to implement data-driven analysis and decision rule mining thanks to a variety of algorithms developed in recent years.¹⁵ With this aim, the collection of notifications should occur in a standardized way, with state-of-the-art information technology systems, and should rely on a set of predetermined indicators set by the WTO or the OECD. Qualitative text inputs require higher complexity in processing; however, the application of text analytics in the data pre-processing stage could integrate the analysis of free text in the standardized processing. The scope of this further analysis is not to substitute the human decision process by automating the decision procedures, but rather to:

- i) *identify the most relevant variables*,¹⁶ that is, those variables that contribute the most to the final decision. For example, since the industrial sector plays a crucial role (some sectors are more sensitive than others to subsidies), we expect the variable “industrial sector” to play a key role in the decision process. This analysis can help create more transparency in the decision process since policy-makers and stakeholders can have a better understanding of which variables are most likely to influence the outcome;
- ii) *provide a coherent framework for the decision-making process*, since interpretable machine learning outcomes can deliver guidelines for the classification of new instances. In particular, outcomes of interpretable mining algorithms such as decision trees are easily interpretable even by laymen;
- iii) *increase accountability*: after being trained on an existing dataset, classification algorithms can predict the classification of a new measure. The classification of a new instance can occur by both a classification algorithm and human decision-makers: the information provided by the outcome of the algorithm can thus be integrated within the political and judicial decision processes.

Decision trees represent a particularly suitable rule mining algorithm given the problem, their consistency and their high interpretability by persons without a background in machine learning. The most popular decision tree algorithm, CART (Classification and Regression Tree), can help in the identification of the crucial variables in a classification task. CART algorithms require standardized labelled data as an input (e.g. a dataset containing information on previous subsidy notifications and the relative decision made by the committee) and, after a training stage, can classify new instances.

The application of other algorithms, such as Artificial Neural Networks (ANNs) or Support Vector Machines, could be suitable for this classification task. These two techniques could be even more precise in their prediction task; however, their low interpretability and their “black-box” nature are major drawbacks to their adoption in such sensitive tasks.



NOTES

¹ Reportedly, a heated debate was held prior to the ASCM between, in particular, the USA and the EU, which respectively held the existence of a benefit to be sufficient and maintained that the bearing of a financial burden by a public body should also be established. For a fairly detailed discussion in the case law of the *travaux préparatoires* of the ASCM, bearing traces of the confrontation, see the Panel's reasoning in *US – Measures Treating Exports Restraints as Subsidies* (2001) (WT/DS194/R), at paras. 8.65–8.74.

² For instance, phenomena such as generally applicable fiscal policies, which it seems inapposite to discipline, would continue to be excluded on account of the specificity requirement; a purely regulatory incentive, which should arguably be sheltered by an intrusive review at the international level, would not qualify as a subsidy as it would not entail a financial contribution; and so forth.

³ Currently not encompassed by Art. 1.1(a)(iii), which only refers to the provision of goods or services other than general infrastructure, but to the purchase of goods only. For a detailed analysis of the point in the case law, see the analysis carried out by the Panel in *US – Measures Affecting Trade in Large Civil Aircraft – Second Complaint* (2011) (WT/DS353/R), paras. 7.953–7.970.

⁴ See, for instance, Art. 8 of Section 3 of the recent draft EU–China Comprehensive Agreement on Investment.

⁵ Reference is made here to the EU's "GSP+" scheme, conditioning the granting of certain preferential trade tariffs upon compliance with sustainable development and good governance standards (see, by analogy, the notion of "trade-plus" employed in Claussen (2020) and in the literature referenced therein). For a different use of the expression (which is far from being a term of art), see, however, Horn, Mavroidis and Sapir (2009).

⁶ See Art. 3 ASCM.

⁷ See Arts. 5, 7 and 10 ASCM. For elaboration on the notion of effect-based measure, see Bäumler (2017, pp. 816–21).

⁸ See famously, in the case law, albeit from the slightly different perspective of the aim of reaching a balance between subsidizing states on the one hand, and importing states not as such, but rather *qua* states countervailing the subsidy, on the other hand, see *US – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMs) from Korea* (2005) (WT/DS296/AB/R), para. 115.

⁹ Remarkably, in *Canada – Renewable Energy* (2014) (WT/DS412/AB/R; WT/DS426/AB/R).

¹⁰ Whereas the former category was not satisfactorily included in Art. 8 ASCM, which only envisaged, as far as environmental interests are concerned, subsidies meant to provide "assistance to promote adaptation of existing facilities to new environmental requirements im-



posed by law and/or regulations” (Art. 8.2(c) ASCM), subsidies dealing with “assistance to disadvantaged regions within the territory of a Member” were contemplated by Art. 8.2(b) ASCM. This latter provision, however, in line with the rigorous approach underlying the whole of the agreement, placed severe constraints upon this category of non-actionable subsidies, which should not be replicated in an updated version of the Agreement.

¹¹ This should work both ways: a(n allegedly) subsidizing state should be able to preventatively ask whether its measure qualifies as a subsidy, should it entertain doubt in this respect, so as to be able to comply with the transparency obligations incumbent upon it; but at the same time, another state complaining about that state’s measure should be able to preventatively ask the Committee whether it actually amounts to a subsidy, with a view to assessing whether to resort to dispute settlement mechanisms and/or countervailing duties or other unilateral measures.

¹² Note that ASCM Art. 8.4 envisaged a similar mechanism in respect of non-actionable subsidies.

¹³ In particular, it would seem inappropriate to vest the SCM Committee with this task. The current intergovernmental approach underlying its composition does, indeed, seem hardly fit for the purpose of delimiting the scope of application of the ASCM (as regards the notion of subsidy), or deciding whether the circumstances required to legalize a prima facie prohibited or actionable subsidy prevail (as regards petitions on allowed subsidies). The politicization implicit in the working of any strictly intergovernmental body would be at odds with such decisions, which need to be as impartial as possible in view of the high economic policy stakes involved by questions concerning subsidies. To tackle the problem, inspiration could be drawn from the Permanent Group of Experts currently envisaged by ASCM Art. 24.3, where renowned experts appointed in a personal capacity sit (and which could now, in the abstract, issue an advisory opinion on the existence of a subsidy – albeit the general de facto ineffectiveness affecting the ASCM also leads to this aspect of the Agreement). As is currently the case with the Permanent Group itself, the body tasked with receiving preventative petitions could indeed be fashioned in such a way as to be additional to the Committee itself, whose intergovernmental structure is indeed valuable for other purposes (e.g. to provide a specialized forum for political engagement on furthering a multilateral agenda on subsidies).

¹⁴ In the words of Prof. Simon Evenett: “The next leader of the WTO must command respect in the corridors of power of the major players”. Available online at: <https://www.reuters.com/article/us-trade-wto-idUSKBN22Q191>.

¹⁵ We do not discuss technical details here. For a technical treatment of all the data mining methods presented here, reference can be made to Hastie et al. (2009).

¹⁶ The identification of these variables can happen through multiple methods: the most common is the percentage of variance explained by each variable, or game-theoretical approaches such as Shapley Additive Explanations (SHAP).



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