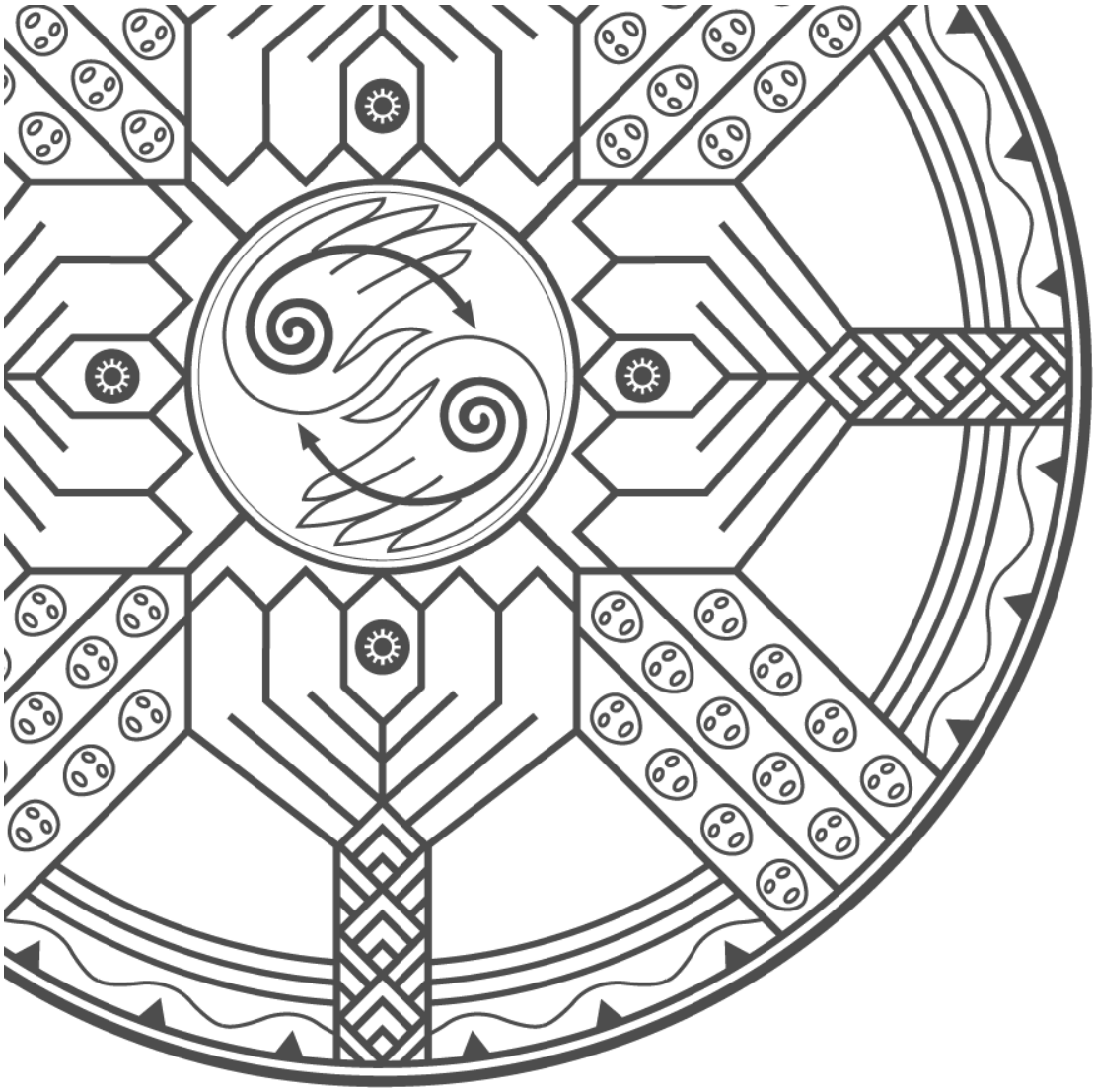

Negotiating Subsidy Reduction in the World Trade Organization

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"The problem of subsidies in international trade policy is perhaps the single most perplexing issue of the current world trading system, and one that is very complex."[1]

"To the United States, the [GATT Subsidies] Code is an instrument to control subsidies. To the rest of the world, it is an instrument to control US countervailing duties."[2]

Introduction

The literature on subsidies and their pernicious effects is large and growing.[3] In particular, in relation to trade in agricultural products there appears to be little doubt that subsidies in OECD countries are causing extensive damage to the economies of developing countries, which could consequently benefit dramatically by their removal. Indeed, there are a number of studies that place monetary values on the subsidies, on the damage and on the potential benefits. The figures involved are impressive.

Most analyses stop at the figures, assuming that the case has been made and all that remains is to find ways to remove the subsidies. Yet, understanding the rules that govern subsidies and their removal, as well as the likely impact of these rules on implementation, is even more important than calculating the damage done by these subsidies. It is unlikely that all the calculated benefits from the removal of subsidies can ever be achieved. More seriously, the benefits that are generated may be distributed very unevenly, leaving some countries no better off than before. The coffee market—undistorted by OECD production subsidies—shows that there are many issues that remain once subsidies are removed.

The experience with the Uruguay Round (UR) should provide additional cause for caution. Similar studies predicted large benefits from the UR. The deal that was ultimately struck, however, covered much more than the elements that could be modelled, so actual results were not as expected. In particular there continue

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1 John Jackson, "World Trade Rules and Environmental Policies: Congruence or Conflict?" John Jackson, *The Jurisprudence of GATT & the WTO*. Cambridge: Cambridge University Press, 2000, p. 433 (based on John Jackson, "World Trade Rules and Environmental Policies: Congruence or Conflict?" *Washington and Lee Law Review* 4.1992, pp. 1227–1278.

2 Messerlin as quoted in Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade*. London: Routledge, 2002 (2nd ed.), p. 190.

3 See Organization for Economic Cooperation and Development (OECD), OECD Workshop on Environmentally Harmful Subsidies, Paris, 7–8 November 2002.

to be no models for the agreements on intellectual property rights, services and non-tariff barriers to trade. The UR agreements presumably contributed to economic growth, yet their overall impact and, more importantly, their distributional effects remain impossible to quantify. Moreover the Agreement on Agriculture was carefully crafted to permit the continuation of a wide range of subsidies. The result may have been more a shifting of subsidies than their elimination. The assumption underlying the pre-Doha negotiations on "implementation issues," which are still continuing, is that the outcome of the UR did not meet expectations. The important lesson from this experience is that economic benefits no longer accrue automatically from trade agreements.[4] The precise wording of agreements that are negotiated is at least as important as the economic theory upon which they are based. It has also become necessary to monitor results to ensure that goals are actually being met. The traditional willingness of the GATT/WTO to leave implementation of multilateral rules largely to individual Members, a process that might be termed "multi-unilateral," may hide some highly undesirable outcomes from "trade" negotiations that increasingly cover many economic and other policy issues other than trade in goods that were at the origin of the GATT—or trade in services, for that matter.

This problem is reminiscent of one encountered in most international environmental agreements: it may be possible to identify a goal for an agreement and there may be consensus on the measures to be adopted in light of that goal, yet there is no assurance that the goal will actually be attained.[5] This is a dilemma that trade negotiators have not generally confronted. It should give particular pause to those who advocate the abolition of subsidies as a strategy for environmental improvement. Seeking environmental benefits through subsidy reduction adds yet another layer of uncertainty to what is already a frighteningly complex system of environmental management. An agreement may succeed in reducing or eliminating subsidies, yet that may not solve the environmental problems caused by those subsidies, or it may simply replace one set of environmental problems with another.

This system of uncertainty is one of the reasons that in the eighties, environmental interests in Europe shifted from opposition to the Common Agricultural Policy (CAP) to a more concerted effort to utilize the resources

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[4] The term "trade agreement" has come to encompass all the WTO Agreements, some of which are only marginally related to the original purpose of the trade regime, namely trade in goods. One of the paradoxes of the language of the WTO is that agreements that carry the term "trade-related" in their title are actually signalling that they address matters that are not trade-related.
[5] There exists an extensive literature on the effectiveness of international environmental agreements. See Oran Young, "The Effectiveness of International Environmental Regimes: A Mid-Term Report." *International Environmental Affairs* 10.4 (Fall 1998), pp. 267–289.

devoted to the CAP for purposes of conservation and environmental management. Removal of the CAP—an extremely unlikely eventuality—would presumably have removed certain incentives for over-production. But many other environmental impacts of agriculture would not have been eliminated. This logic is now also reflected in certain provisions of the AoA.

Subsidies in the WTO

While the evil of subsidies appears to be beyond discussion, their proper reduction and control poses significant dilemmas from the perspective of rule-making. Subsidies are covered in the General Agreement on Tariffs and Trade (GATT) Art. XVI as amended in the 1955 GATT review session. These rules were further elaborated in the Subsidies Code that was part of the Tokyo Round. Many developing countries did not sign either the 1955 amendments or the Subsidies Code in particular because they exempted "primary product(s)," not only agriculture, from their disciplines.

The UR included substantive provisions on subsidies in two areas. An Agreement on Subsidies and Countervailing Measures (SCM) was negotiated to replace the Subsidies Code from the Tokyo Round. The SCM is an integral part of the WTO and consequently applies to all Members. It removed the exception for primary goods but recognized that the Agreement on Agriculture (AoA) applied to subsidies for agriculture.[6] The UR also identified the issue of subsidies in relation to trade in services but provided no substantive rules.[7]

The Doha Declaration sets a modest agenda for the SCM Agreement,[8] an uncertain one for the GATS[9] and an ambitious one for the AoA.[10] Its aim for the SCM is "clarifying and improving disciplines…while preserving the basic concepts, principles and effectiveness of these Agreements and their instruments and objectives, and taking into account the needs of developing and least-developed participants." It leaves the determination of an actual agenda within this restrictive language to the initial phase of the negotiations. For the AoA, the

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[6] The definition of "agriculture" is contained in an Annex to the AoA.
[7] General Agreement on Trade in Services (GATS) Art. XV.
[8] Doha Ministerial Declaration paragraph 28.
[9] "The 'Guidelines' for the current services negotiations contain a 'best endeavour' deadline to develop multilateral disciplines for [subsidies in services] prior to the conclusion of the Doha Round 'single undertaking' negotiations in January 2005. Robert Prylinski and Dariusz Mongalo, "Towards a Definition of 'Subsidy' in the Services Trade." *BRIDGES Between Trade and Sustainable Development* 7.3 (April 2003, pp.11–12. Also available at http://www.ictsd.org
[10] Doha Ministerial Declaration paragraph 13.

objective is "reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support." This language was widely interpreted as embodying the most important concession by the European Union, namely the goal of phasing out export subsidies.

The Doha Declaration also states that participants "shall aim to clarify and improve WTO disciplines on fisheries subsidies, taking into account the importance of this sector to developing countries." Initial indications are that this could result in a new agreement on fisheries subsidies.

In light of the importance of subsidies in the trade regime and their potential importance for the Doha Round, it is remarkable that the WTO approach to the issue of subsidies has not received much analytical attention[11]—as opposed to the analysis of subsidies and their economic consequences. Yet the manner in which subsidies are reduced is no less important than whether they are reduced at all. Moreover the negotiating process at the WTO, based on a system of demand and offer, is singularly unsuited to dealing with matters that require technically precise measures or that have distributive consequences. Parties with an interest in ambiguity have the ability to introduce it to any agreement. Since the ability to appropriate rents and economic power are closely related, countries whose economic actors currently control rents generally have the power to protect their position or even—as in the case of TRIPS—to strengthen it.

Definition of Subsidies

The definition of a subsidy remains elusive.[12] In practice, economic researchers must define subsidies in ways that can be calculated. Negotiators may find calculations

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[11] John Jackson identifies the dilemma of subsidies but does not provide further analysis [see fn. 1]. Hoekman and Kostecki provide a brief account of the treatment of subsidies in the GATT/WTO system but do not develop it. Their index does not even contain the term "subsidies." [Bernard M. Hoekman and Michael M. Kostecki, *The Political Economy of the World Trading System*. The WTO and Beyond. Oxford: Oxford University Press, 2001 (2nd ed.)]. The most analytical discussion of subsidies is in: Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade*. London: Routledge, 2002 (2nd ed.), pp. 190–225. See also: Steven McGuire. "Between Pragmatism and Principle: Legalization, Political Economy, and the WTO's Subsidy Agreement." *The International Trade Journal* 16.3 (Fall 2002): 319–343.

[12] "Perhaps no testimonial has been more often quoted to summarize thee frustration researchers feel whenever they try to pin down the concept of a subsidy than that of Hendrik S. Houthakker: 'My own starting point was an attempt to define subsidies. But in the course of doing so, I came to the conclusion that the concept of a subsidy is just too elusive.' (JEC, 1972: 7). Houthakker, writing three decades ago, could have just as well described the situation today." Ronald Steenblik, "Subsidy Measurement and Classification: Developing a Common Framework." Paper for the OECD Workshop on Environmentally Harmful Subsidies, Paris 7–8 November 2002. Document SG/SD(2002)17.

useful but in practice they are seeking to develop language that can attract a consensus. Even though negotiations are informed by economic calculations, the final outcome may be literally incalculable since the focus is on the text, on the priorities that have been identified by individual participants in the negotiations and on the need to achieve consensus, not on broad systemic calculations.

The SCM includes the first definition of subsidies in the trade regime. It is "a financial contribution by a state where it: transfers funds or liabilities (e.g., loans or loan guarantees); forgoes revenue (e.g., tax credits); provides goods and services other than for general infrastructure; or entrusts a private body to conduct the above and in doing so confers a benefit."[13] This definition is not one employed in most studies on subsides. It also does not include policy failure as a subsidy, for example the failure to impose necessary environmental requirements.[14]

The SCM also includes a definition of "specificity," that is subsidies that are on their face limited to an enterprise or industry (or group of enterprises or industries), as well as subsidies that are *de facto* specific in terms of how they are implemented. This definition closely follows existing U.S. countervailing duty law.[15] It is generally problematic when an international text follows domestic law of a single country too closely, but the GATT/WTO has often been influenced by U.S. law and practice.[16] The country in question enjoys an immediate advantage in implementation. It enjoys a further advantage in interpretation by virtue of the fact that its experts are more familiar with the text. Such a practice also suggests to policy-makers of the country in question that all other countries should read the texts in the same manner as they implement them multi-unilaterally. Yet each country must adapt international legal texts into its own political, legal and administrative systems, with the result that there will be significant variations

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13 Summary from Steven McGuire, "Between Pragmatism and Principle: Legalization, Political Economy, and the WTO's Subsidy Agreement." *The International Trade Journal* 16.3 (Fall 2002), p. 326. Based on SCM Art. 1.1.

14 This question has indirectly been at issue in a long-running dispute between the United States and Canada on softwood lumber, with the United States alleging that low stumpage rates represent a subsidy. Stumpage, payments for the right to cut timber, can be seen as a tool to internalize environmental costs. Canada has consistently won all U.S. challenges to its practices with respect to stumpage.

15 Based on Trebilcock and Howse (see fn. 10).

16 See Robert O'Brien, *Subsidy Regulation and State Transformation in North America, the GATT and the EU*. London: Macmillan Press, Ltd., 1997.

from one country to the next.[17] The tendency to follow U.S. legal doctrine reflects both the dominance of U.S. economic concepts in international economic negotiations and the deep reluctance of U.S. policy-makers to accept any international legal text that does not conform to existing U.S. law.

The SCM does not ban subsidies, an approach that occasioned considerable resistance in the United States, which does not consider its relevant industrial programs to be subsidies but is convinced that other countries engage in extensive subsidization—at least in terms of U.S. law.[18] The SCM distinguishes between prohibited, actionable and permitted subsidies. "Non-specific" subsidies (i.e., subsidies not aimed at individual recipients or a particular economic activity) are permitted, as well as specific subsidies involving assistance to industrial research and pre-competitive development activity, assistance to disadvantaged regions or certain types of assistance for adapting

existing facilities to new environmental requirements imposed by law or regulations. These exceptions closely mirror existing practices in the United States and the European Union. Only export subsidies are prohibited. All other subsidies are "actionable," that is they are only subject to restraint if it can be shown that they are causing serious injury to other Members of the WTO, a fairly onerous requirement.

The AoA distinguishes between export subsidies and domestic measures of support. It approaches export subsidies much as the GATT dealt with tariffs: by forcing members to schedule their export subsidies and then subjecting them to a process of progressive reduction. Domestic measures of support are divided into three categories, generally termed the Green, Amber and Blue Boxes, which are respectively permitted, subject to reduction commitments, or prohibited.

This extraordinarily complex set of agreements is the result of negotiation, not of any economic calculation. In some respects it defies precise calculation, presumably that too, an intended effect of the negotiation process, representing a

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[17] Within the European Union this issue has been addressed by recognizing that identical terms can have different meaning in EU and national law and by giving the EU sole authority over the use of the languages of its member states in its legal texts. The use of the term "risk assessment" in the Agreement on Sanitary and Phytosanitary Standards (SPS) provides a text book example of the kind of confusion that can ensue when a term of legal art is transferred from U.S. law into international texts.

[18] See O'Brien (fn, 14), pp. 120–125.

"veil of ignorance."[19] Such uncertainty can promote desired consensus since none of the participants can be certain of the costs of agreement.

The definition of depletion of natural capital as a subsidy remains contested in the economic literature;[20] what is clear is that this does not fall within either the SCM or the AoA definition. From an environmental perspective, the WTO definitions of subsidies omit those subsidies whose elimination promises the greatest and most direct benefits.

Are There Good Subsidies?

It is generally recognized that subsidies are an essential tool of government policy, although the extent to which this may be acceptable can vary dramatically. They can serve to counteract market and policy failure and have played a critical role in the development process of many countries. Subsidies can be essential to counteract unexpected events. Subsidies played an important part in the construction of environmental infrastructure in OECD countries in the seventies and eighties, a fact that is recognized by a (temporary) exception in the SCM. Non-production related impacts of agriculture on biodiversity and the environment can often only be dealt with by subsidies. Indeed, as markets grow more efficient and fewer rents are available to market participants, it may become more important for governments to be able to provide payments to protect essential public goods, payments that are in practice indistinguishable from subsidies.

In this regard subsidies differ from tariffs. There are no good tariffs (including tariffs imposed as countervailing measures). That simplifies the process of negotiating a reduction of tariffs. When it comes to subsidies, the need to provide for necessary subsidies leads to the distinction between permitted subsidies and other subsidies. Yet this opens a door on efforts to continue subsidies that harm other countries.

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[19] The original theory behind the "veil of ignorance" was articulated by L. Rawls, *A Theory of Justice*, pp. 136–142, assuming that it would promote the development of optimal institutional arrangements. It has subsequently been applied to the desire to shroud certain impacts of international agreements so as to facilitate consensus.

[20] David Pearce, "Environmentally Harmful Subsidies: Barriers to Sustainable Development." Paper for the OECD Workshop on Environmentally Harmful Subsidies, Paris 7–8 November 2002. Document SG/SD(2002)14.

Export Subsidies and Domestic Support

From the time of the GATT, the trade regime has focused on export subsidies—those that require recipients to meet certain export targets or to use domestic instead of imported goods. These subsidies are more obviously trade-distorting than those provided to all production of a particular product. Yet the distinction makes less sense once markets are not subject to other forms of distortion. While it can be viewed as a pragmatic step in attempting to eliminate subsidies, the distinction between export subsidies and domestic subsidies creates incentives to shift rather than to eliminate subsidies. To counter this tendency, the AoA introduces the concept of Aggregate Measure of Support (AMS), which becomes an important tool to move countries towards reduction commitments on domestic support.

In general, the SCM regime deals with trade-distorting subsidies, a concept that introduces an additional level of complexity to the topic. Export subsidies are considered trade-distorting on the face of it but other actionable subsidies require proof of damage to the interests of other countries, a concept that involves several steps that are technically demanding. Subsidies can cause damage by hurting a domestic industry in an importing country; they can hurt rival exporters in third markets; and they can hurt exporters trying to compete in the subsidizing country's market. There is a lengthy process to determine whether subsidies are causing damage but if the Dispute Settlement Body rules that the subsidy does have an adverse effect, the subsidy must be withdrawn or its adverse effect removed. There is also the option of countervailing action.

The Boxes of the Agreement on Agriculture

The AoA introduces what are generally called "boxes," to classify domestic support, a modification of the distinction in the SCM Agreement between prohibited, actionable and non-actionable subsidies (the term "box" does not actually occur in the AoA). The Amber Box is the most restrictive and includes most domestic support measures considered to distort trade not only directly but also indirectly through distorted production. Amber Box subsidies are subject to negotiated reduction commitments. The Blue Box includes subsidies that would otherwise fall into the Amber Box, except that they also require farmers to limit production. The assumption is that these limits will counteract the distortions of production that would otherwise occur. The status of the Blue Box is an issue that is subject to negotiation, but for now the AoA imposes no limits on spending on Blue Box subsidies. Green Box subsidies are those that do not distort trade, or at most cause minimal distortion, but Annex 2 of the AoA lists a number of

subsidies that are considered non-distorting, even though it could be argued that this is not assuredly the case.

Reduction commitments are not tied to the AMS for individual products but to the Amber Box and the Total AMS, leaving countries with significant discretion as to the actual distribution of subsidies. Moreover the specified base period for calculation of the AMS (1986–1988) was chosen to maximize the flexibility of countries with high levels of support.

Once "boxes" are accepted as a modality, negotiations will focus on the definitions governing these boxes and the results are more likely to be conventional, in the sense that whatever is agreed counts, than strictly in accordance with enunciated criteria. The existence of the Blue Box has effectively put all subsidies listed in the Green Box out of reach of negotiations (other than reductions mandated by the Total AMS, should it be reduced to a level that actually constrains the use of Green Box subsidies—an eventuality in the distant future).

The use of "boxes" represents both an achievement and a limitation of the AoA. On the one hand, the boxes introduced a measure of flexibility into the negotiations that was presumably essential for their success. On the other, the definitions used tend to shield a number of subsidies that are in fact noticeably trade-distorting. Moreover the structure of the boxes permits countries a significant amount of flexibility, reducing at the same time the predictability of the outcome of implementation, including, critically, predictability concerning the likely distribution of benefits between countries.

Actionable Subsidies

Actionable subsidies are central to the functioning of the SCM Agreement since they represent its most dynamic part. To succeed with a complaint, a country must show that a subsidy in another country has an adverse effect on its interests. Sometimes that is possible, as the number of cases that have come to the dispute system attest. But in general, the burden of proof is heavy so that countries are liable to act only when vital interests are affected or the damage is gross. In practice, most subsidies will not be subject to action in the WTO.

The need to prove harm confronts the paradox that, not unlike in the case of tariffs, the country that engages in subsidy frequently suffers economic harm while some other countries may actually benefit. As in the case of tariffs, the calculation of harm differs strikingly, depending on whether one takes the point of view of a producer or of a consumer. By and large, consumers will benefit

from subsidies because prices will be lower than they would otherwise have been; taxpayers in the subsidizing country carry the financial burden of the subsidy; and producers in other countries are liable to be harmed. In some instances, consumers in other countries may benefit even as producers are harmed. Governments will generally focus on the interests of producers and their employees. Yet governments with large, potentially restless urban populations may find that it is more important to provide low cost products (food in particular) to their urban constituency than to protect the interests of producers (in particular when these are dispersed in the rural environment). A subsidy involves government expenses (and thus reduced prices, often in both the country of export and the country of import) while a tariff entails government revenues (and raised prices in the country of export).

Many trade disputes involve interpretations of general interest of trade agreements. Disputes concerning subsidies are highly specific since they revolve around the question whether payments have been made (or revenue forgone) and adverse effects have been caused. Because the interests are often time sensitive, and the process of determining adverse effects can be time consuming, followed by a dispute settlement procedure that takes more time, governments may be tempted to impose subsidies that they know to cause adverse effects in other countries. By the time the process has run its course, significant harm may have been caused.

The effect of the SCM Agreement is likely to be the elimination of prohibited subsidies, the limiting of subsidies that are manifestly damaging to other countries but not the limiting of subsidies in general, whether these are actionable or not. It can be argued that this is a significant achievement, that this is as much as can be expected, perhaps even that this is the only appropriate goal for international action. Yet from the perspective of the broader economic literature on subsidies, the WTO Agreements do little more than scratch the surface.

Special and Differential Treatment

Developing countries are generally too poor to indulge in economically counterproductive subsidies. Indeed, they are often too poor even to provide economically desirable subsidies. The subsidies provisions of the SCM and the AoA are largely directed at subsidies of wealthy countries, plus large developing countries under certain circumstances. They contain significant limits on the action expected from developing countries—which generally benefit from longer transition periods—and least developed countries—which are largely exempt from the restrictions imposed on other Members. Yet environmental damage does not correlate in a simple manner with wealth. Some of the most serious

environmentally damaging subsidies, for example for the harvesting of tropical timber or in the energy sector, are to be found in developing and least developed countries. These subsidies are unlikely to be affected by the WTO Agreements.

Countervailing Action

According to the SCM, prohibited subsidies are to be withdrawn immediately, actionable ones must be withdrawn once the Dispute Settlement Body has ruled or their adverse effect removed. In either case countervailing measures can be imposed if domestic producers are hurt by imports of subsidized products. Yet the use of such measures as a compliance tool is problematic.[21]

The paradox of countervailing action is that it contradicts the fundamental purpose of the GATT/WTO. Adam Smith first pointed out the hazards of blocking trade in order to promote it.[22] In protecting domestic producers, prices are raised for domestic consumers. At a theoretical level, countervailing action is unlikely to generate net welfare benefits, even though it may inflict pain on certain economic actors and have attractions from a political perspective. Most trade-restricting measures have political attractions. The core purpose of the GATT is to help governments accomplish what is economically desirable but politically difficult, to reduce tariffs. In the case of subsidies, countervailing action is somewhat less problematic since the benefits that are withdrawn from domestic consumers are lower prices caused by foreign subsidy. In principle, the net result should be the maintenance of proper market prices, provided the countervailing measures are appropriately chosen and dimensioned. In practice this is a difficult task, made more difficult by the fact that some subsidies correct market failures so that their removal would be undesirable.

As always, small and poor countries encounter difficulty using countervailing measures because their trade flows are insufficient, there are no suitable products from the country that is causing the harm against which to countervail and they are liable to be much more sensitive to the welfare implications of countervailing action. Since many of the subsidies of concern are OECD subsidies that damage smaller countries, the use of the right to "suspend concessions or other obligations" (SCOO) is not available to those countries that are most likely to be

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[21] Steve Charnovitz, "The WTO's Problematic 'Last Resort' Against Noncompliance." *Aussenwirtschaft. Schweizerische Zeitschrift für internationale Wirtschaftsbeziehungen*. 57.4 (Dec 2002), pp. 409–439.
[22] See Charnovitz (fn. 20) p. 433.

in need of effective remedies against harmful subsidies. In practice they must take their damage back to the negotiating table where they are liable to be asked for additional concessions just to obtain what they thought had previously been granted.[23]

At the very least, the use of countervailing measures is a blunt tool in a situation where finesse is called for. At its worst, "the case for countervailing duties… makes no sense."[24]

Government Procurement

Government procurement is one of the stranger issues on the trade agenda. In many markets, governments are powerful consumers on account of the volume of their purchases relative to the overall market and their ability to coordinate them. In most countries the government is the largest purchaser in the economy, yet these purchases are widely distributed. In some markets, governments are the dominant customers. Governments face deep conflicts of interest when dealing with government procurement. The role of governments in the WTO is to make rules governing the actions of governments in relation to industry and commerce. In government procurement, these roles are collapsed: governments are both rule-makers and those affected by the rules as purchasers of goods and services.

As "consumers" of goods and services, governments are further conflicted. On the one hand they strive for the best price/quality relationship as purchasers. On the other hand they view themselves as defenders of the interests of domestic producers and service providers when negotiating in the WTO. In practice it is hard to imagine governments purchasing uniforms for their armed forces from foreign providers when a domestic textile industry is struggling against foreign competition. Nor is a German Chancellor likely to be seen using a U.S.-made car, even one from DaimlerChrysler.

Government procurement is to subsidies what non-tariff barriers are to trade in goods. Governments can provide effective subsidies by purchasing goods from favoured suppliers under circumstances that do not accurately reflect market conditions. This can involve price but it can also extend to the abetting of market segmentation or financing conditions. It can include discounts for domestic

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[23] This dynamic can currently be observed with regard to both cotton subsidies and the Doha decision on public health and intellectual property rights.
[24] Trebilcock and Howse (see fn. 10), p. 222.

content of bids, selective sourcing policies that favor a domestic "champion" against which foreign suppliers cannot compete, set-asides of certain procurements—for example military ones—for domestic industries. Tendering procedures can be rendered opaque for foreign suppliers, or specified product standards can favour domestic suppliers.

The level of subsidy in the U.S. economy is generally accepted as being lower than in most other countries. Yet the States provide a panoply of incentives—in particular tax forgiveness—to investors. And by some accounts, U.S. defense spending can be viewed as raising average subsidy levels to those of most other OECD countries.[25]

The Agreement on Government Procurement (1994) (GPA) is third in a series of agreements in the GATT/WTO dealing with this issue. Over 20 years, these agreements have developed some ground rules for government procurement, based on three essential characteristics:

1. Like the GATT, the core principle of the GPA is non-discrimination, achieved by most favoured nation treatment, national treatment, transparency and dispute settlement, but there are some differences among the formulations of these principles.
2. Like the General Agreement on Services (GATS), but unlike the GATT, the GPA applies only to jurisdictions and products explicitly listed by each country in a series of Annexes. Countries can also specify thresholds below which the GPA does not apply, in addition to the thresholds contained in the GPA itself.
3. Unlike most WTO Agreements, the GPA is a "plurilateral" agreement. Members of the WTO do not automatically become Members of the GPA.

The GPA contains extensive provisions governing tendering procedures, selection procedures, submission, receipt and opening of tenders, and awarding of contracts, as well as negotiating procedures. In this manner it outlines a desirable system of government procurement.

The GPA has 28 members, with seven further applicants to join. A further category consists of observers (currently 24) that must meet certain requirements concerning transparency of procurement (Art. XVII). The GPA is overseen by a Committee on Government Procurement, which reports annually to the WTO General Council.

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[25] Bence and Smith, cited in Trebilcock and Howse (see fn 10), p. 191.

The GPA provides for negotiations to commence not later than three years after entry into force (1995), and periodically thereafter, "with a view to improving this Agreement and achieving the greatest possible extension of its coverage among all parties… ." This process was initiated in 1997.

Government procurement is one of four "Singapore Issues" that were considered for further negotiations at the First Ministerial Conference in 1996 without a clear decision being taken. A Working Group was established to "conduct a study on transparency in government procurement practices…" and "to develop elements for inclusion in an appropriate agreement." The effect of this decision was to create a forum that included the entire membership rather than the limited number of countries that had acceded to the GPA or were observers in the Committee on Government Procurement.

The Doha Declaration uses identical language when considering whether to open negotiations on the four "Singapore Issues." In the case of the GPA, the mandate is strictly limited to transparency in government procurement. It specifies that they "will not restrict the scope for countries to give preferences to domestic supplies and suppliers." Negotiations on government procurement have not reached the issue of indirect subsidization.

Dispute Settlement

Implementation of the SCM and the subsidy provisions of the AoA is multi-unilateral. In other words, each Member of the WTO is obligated to implement the agreements but each Member is also the initial judge of the appropriateness of implementation. There is no multilateral mechanism that can determine whether subsidies are prohibited, actionable or not, short of a formal dispute that requires the complaining Member to undertake the necessary assessment in advance of launching the dispute so as to be able to prove its case.

It is hard to overstate the significance of the dispute settlement system, in particular following the UR, which required all Members to adhere to all agreements and substantially raised the technical level of the agreements, creating additional scope for conflicting interpretations. The WTO dispute settlement system is unique, as has often been pointed out. It is also designed to supplement a set of agreements that are presumed to be largely self-executing. In other words, disputes are expected to be the exception rather than the norm. The norm is implementation of the WTO Agreements by the Members individually, each with a significant degree of flexibility based both on the text and the fact that dispute settlement is cumbersome. Self-executing (multi-unilateral)

agreements assume that the individual agreements, or at least the overall balance between agreements, were in the interests of all Members. This is an assumption originally rooted in the theory of comparative advantage, which postulates that (trade) liberalization agreements are in the interests of all parties, in their role either as producers or as consumers of the relevant goods. To the extent that some Members determine that the balance of advantages is seriously skewed, or that the WTO is infringing on vital interests of domestic policy, the WTO remains vulnerable since it possess no institutional means to address such a situation.

Dispute settlement is the only multilateral implementation tool. It is not a tool that is readily used since it requires a domestic process to determine adverse effects, followed by a demanding WTO process that will typically include both a panel and an Appellate Body phase.

There have been a significant number of disputes concerning the SCM. The AoA included a "peace clause" that provided that most disputes would not be initiated in a transition period.

Institutional Characteristics of the WTO

In approaching negotiations on subsidies in the WTO it is important to keep in mind, what the organization is designed to do and what it may find particularly difficult to undertake.

Purpose

The WTO has no clearly stated objective. It is not designed to promote good economic policy; it is not responsible for economic growth or development; and it does not seek to promote public health or human rights. According to the WTO Agreement, it is a forum for the negotiation of "reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations."[26] The assumption is that economic benefits will flow more or less automatically from such negotiations. This text is taken directly from the GATT and is augmented by "the desire to create an integrated, more viable and durable multilateral trading system," which is in turn defined as encompassing all the agreements that have been reached. Finally the WTO Agreement expresses a desire to "preserve the basic principles and to further the

[26] This is preambular text, not part of the binding provisions.

objectives underlying this multilateral trading system." In other words the WTO is the purpose of the WTO. The operative provisions of the WTO Agreement state this quite clearly. Article 1 declares the WTO open for business.

Article 2 states that "the WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments." In the WTO form is function: the WTO is whatever the parties agree to include in it, neither more nor less.

Institutions

The institutions[27] of the WTO are those of the GATT. The most important institutions ensure non-discrimination: most favoured nation treatment, national treatment, some transparency and dispute settlement. The management institutions are modest. The ultimate decision-making organ of the WTO is the Ministerial Conference, and once again whatever it decides is what the WTO is.

The principal institutions of the WTO are the numerous bodies and organs that are associated with the various agreements. While they are organized in a hierarchical manner, they are all in fact committees of the whole in the sense that their membership is identical (although many countries have specialized representatives who attend only certain meetings). Few of these bodies and organs have deliberative functions, most being constituted for the purpose of permanent negotiation. Bodies that have primarily deliberative functions—such as the Committee on Trade and Environment or the Committee on Development—rank below those with negotiating mandates. In practice the WTO remains a forum for negotiation while the implementation of the agreements that it develops lies almost entirely with the individual Member states. Disputes arise typically about the measures adopted or not adopted by individual countries in this multi-unilateral process. Strong dispute settlement is a critical institution in this system of implementation. It plays a much less central role in alternative approaches to implementation, such as those used by human rights regimes or environmental agreements.

It is sometimes said that the WTO is a small organization, but careful consideration of the resources at its disposal suggests that this is hardly the case. The WTO Secretariat is indeed relatively modest in size—although it has been growing, albeit not as fast as its workload. But most of the organization's work is undertaken in the bodies and organs rather than in the Secretariat, which provides

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[27] "Institutions" is used here in the technical sense of "rules of the game." In this sense, property is an institution but the WTO itself is an organization.

support for them. These bodies in turn are composed of representatives of the Member states, whose sole responsibility (if their government can afford that luxury) is to ensure the functioning of the organization in accordance with the interests and instructions of their government. While these persons are not employees of the WTO, they are an integral part of its institutional resources. In addition, many governments maintain a substantial trade bureaucracy both to ensure implementation of the agreements and to instruct and support their representatives in Geneva. Unlike the foreign service, where staff is moved around regularly, the staff assigned to the trade regime frequently moves only between Geneva and the home ministry, acquiring skills that are specific to the WTO. To understand the functioning of the trade regime and to properly assess the resources at its disposal it is appropriate to consider these persons as part of the regime, indeed to a certain extent as part of the organization. From this perspective the secretariat is but the tip of the iceberg, maybe not much more than one eighth of the entire resource. While the Secretariat is modest in size, the "trade regime" is probably among the largest international regimes, comparable in size to the World Bank or the United Nations. In this environment, the ability of governments to devote significant resources to the trade regime is a critical determinant of their ability to promote desirable outcomes. Larger delegations have greater impact than smaller ones. A significant number of developing country Members are unable to maintain a permanent delegation in Geneva. They are rule-takers in the trade regime.

Fit

It is possible to push the analysis of the institutional resources of the WTO somewhat further. The central function of the WTO is negotiation. Yet it is not designed to negotiate any kind of agreement. It would clearly be an inappropriate organization to consider issues of security, environment or human rights—as has been pointed out many times to those who believe that the WTO needs to be more sensitive to some of these concerns. It is designed to negotiate "trade agreements." Yet there is a remarkable absence of discussion about what constitutes a "trade agreement."

The WTO Agreement uses a circular argument to define a "trade agreement": it is any agreement included in the WTO. Yet the number and object of agreements included in the WTO is not fixed—which also entails the risk that the tasks assigned to the WTO will outstrip not just its organizational resources—staff, budget, facilities—but also its institutional capabilities.

In its original meaning, "trade" was "trade in goods." The Preamble and Article 2 of the WTO Agreement still contain an echo of this fact in that they speak of "the substantial reduction of tariffs and other barriers to trade" and "the elimination

of discriminatory treatment in international trade relations." Both phrases are taken verbatim from the original GATT and clearly mean trade in goods, although modern readers of the WTO Agreement tend to hear them more broadly. Article II.1 of the WTO Agreement has no equivalent in the GATT and serves to define the scope of the organization by the agreements that are included in it—a broad definition that is in no way limited to trade in goods.

Trade in goods is governed by the principle of comparative advantage. This principle has been questioned from a variety of perspectives. Yet its core hardly seems open to question since it is little more than a restatement of the principle of fair exchange that underlies any market. If one accepts markets as institutions one must also accept that the exchanges that occur on markets are mutually beneficial. In practice markets may be distorted. The removal of such distortions in international markets has become an integral part of the mission of the GATT/WTO and the pursuit of these distortions has led the GATT/WTO far beyond border measures into the heart of national economies. In doing so it has become party to some of the most complex political processes where (undesirable) rent seeking behaviour and the (legitimate) protection of public goods mesh almost seamlessly.

In many respects the GATT was the institutionalization of the principle of comparative advantage, and the WTO Agreement did nothing to change that. Several features of both agreements underline this observation.

- The absence of any agreed objectives for the GATT and subsequently for the WTO, other than negotiation, assumes that results would flow in a self-evident manner from such negotiations, without requiring further justification in terms of some broader objective;
- The assumption that "multi-unilateral" implementation would be effective without enforcement other than dispute settlement reflects the view that the agreements reached would be in the interests of every one of the countries involved;
- The emphasis on negotiation similarly assumes that any agreement will be better than no agreement, consequently the only problem that needed to be solved was to organize negotiations in a manner that would promote an outcome;
- Since everybody benefits from liberalization, the GATT was never troubled by the distributive effects of its agreements. There are no mechanisms in place in the WTO to seriously consider these effects, much less the strategies that may be needed to overcome them. This also goes some way to explain why discussions of "development" in the trade regime have a tendency to sound hollow;

- A pervasive attitude towards interest groups as being against the common interest in liberalization. This has united those in the trade regime in reluctance to increase avenues for the participation of such groups, even when they were not self-interested;
- The assumption that one of the principal obstacles to success in the negotiations was the need to help governments fight off their domestic protectionist interests led to a sharply limited willingness to meet even minimum standards of external transparency;
- The trade review process assumes that results can be achieved by simply pointing out to countries that it is in their own self-interest to adopt the liberalization measures that have been agreed;
- The definition of the WTO—as the sum of all agreements reached—is the ultimate expression of this institutional optimism.

Distributed Governance

The WTO agenda is overloaded. Some items on that must be handled in the WTO itself. But others require a careful distribution of roles between the WTO and other (international) organizations. In some areas this distribution is emerging, for example in relation to the Bretton Woods institutions or the World Intellectual Property Organization (WIPO) and the International Organization for Standardization (ISO). In others it remains to be seen whether the role required by the trade regime can be fulfilled by the organizations that are in place, for example the Codex Alimentarius Commission. In certain areas, the relationship is currently under consideration, most notably in those covered by multilateral environmental agreements. And in other areas again the debate has not yet been engaged, notably in relation to labour and human rights.

The emerging pattern of organizational relationships can be described as "distributed governance." Since there is no sovereign in international society, roles need to be assigned on a contractual basis—or at least they must emerge via interpretation in specific instances from the thicket of international law that has been created by the extraordinary treaty-making effort of the past decades. For the WTO, the attendant organizational challenges are significant. The unique character of the organization, its focus on negotiation and its practice of multi-unilateral implementation backed by dispute settlement, render the development of robust organizational relationships difficult.[28]

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[28] Konrad von Moltke. *International Environmental Management, Trade Regimes and Sustainability*. Winnipeg: International Institute for Sustainable Development, 1996. Also at http://www.iisd.org/publications/publication.asp?pno=274

The Effectiveness of the WTO

The modest institutional resources produced remarkable results during the GATT years. The distortions attributable to tariffs were large so their removal swamped any other economic consequences of the agreements: comparative advantage worked! Accumulating problems in commodity markets could either be ignored or papered over with subsidies.

In this phase, the GATT can best be described as a mutual assistance society for governments faced with the difficulty of removing tariffs because domestic interest groups were capable of mobilizing opposition while those liable to benefit—often consumers—were poorly organized and politically ineffectual. In essence the Contracting Parties of the GATT helped each other do what was economically desirable but politically difficult.

As globalization takes hold, single-minded adherence to the fiction that sovereign states are the subjects of the trade regime has become increasingly untenable. There are a number of interlocking problems that now need to be addressed:

- *The problem of market failures*. The messy business of correcting market failure requires skills that are focused on qualitative outcomes, rather than striking a deal, any deal.
- *The inexorable expansion of the agenda*. Whereas the GATT was highly focused on the liberalization of trade in goods, the WTO finds itself confronted with a much more complex agenda. Some parts of this agenda are the result of successes in tariff reduction—SPS and TBT, for example. Some confront potential conflicts between international regimes, the trade regime on the one hand and regimes for human rights, public health, and the environment on the other. Some arise from an inability to draw necessary boundaries around the trade regime—investment and competition. While these are clearly "related" to trade, the institutions and disciplines required are in truth entirely different.[29] And some are little more than an opportunistic attempt to use the trade regime to promote unrelated interests—intellectual property rights.[30]

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[29] See Konrad von Moltke, *An International Investment Regime? Implications for Sustainable Development*. Winnipeg: International Institute for Sustainable Development, 2000. Also at http://www.iisd.org/publications/publication.asp?pno=277.

[30] The term "trade-related," as in Trade-Related Aspects of Intellectual Property Rights, should in fact serve as a warning that the issue is in fact not trade-related.

- *The prevalence of deals that involve incommensurate elements and are consequently not calculable*. The Uruguay Round included traditional deals such as those on textiles. The Agreement on Agriculture contained some promise of future benefits even though it delivered few if any itself. But the Uruguay Round also included elements such as the GATS where there is a pervasive suspicion that benefits will be one-sided, or TRIPS where there is reasonable certainty that this will be the case. Ambiguity can be helpful to promote agreement. But it is vital that outcomes continue to be perceived as widely beneficial and equitable. That appears not to be the case, witness the discussions surrounding "implementation issues," which suggest that a large minority of countries have come to the conclusion that the outcome of the Uruguay Round was not to their advantage.
- *The institutional requirements of trade liberalization*. As markets become more open, countries with weak institutional infrastructure are at a disadvantage. These institutions range from the ability to make and implement sound economic policy to the basic institutions to manage imports and exports: airports, harbors, customs services, brokerage, banks and insurance. The benefits from trade liberalization no longer accrue "automatically."

Many of these pressures are attributable to the success of the trade regime. But the results are nonetheless threatening. Above all, the comfortable cover provided by the principle of comparative advantage is no longer available. The actions of the WTO are clearly distributive in nature, but it is institutionally incapable of dealing with this dimension of its actions. Indeed, it remains unclear whether any international organization is capable of undertaking such a task. "Development" ultimately implies "unequal development," namely that poorer countries must grow faster than richer ones.

Beginning with the Kennedy Round, and continuing with the Tokyo Round leading ultimately to the Uruguay Round, the GATT found itself drawn deeper and deeper into the details of economic policy within countries and further and further away from the comparatively secure world of trade relations between countries. Problems initially arose from the nature of markets and the unfortunate tendency of protectionist interests to seek other forms of cover as tariff protection was stripped away. This led, of necessity, to increased consideration of measures that governments adopted to ensure market discipline—initially "non-tariff barriers to trade," then standards and ultimately to issues such as the environment. At the same time, governments were loading new issues onto the trade regime, issues that may have been "trade-related" but that in truth needed a different international approach than that perfected by the trade negotiators in the GATT.

The first indicator of trouble has been the failure of the Uruguay Round to deliver the anticipated benefits to the projected number of countries. While the Uruguay Round has presumably contributed to economic growth and efficiency, there is a pervasive suspicion that benefits have not been evenly distributed.

The result has been an expansion of the agenda of the WTO and increasing dissatisfaction with the results of "trade" liberalization that dealt less with trade than with other matters. Yet there has been no corresponding adjustment of the WTO's institutional capabilities. In particular the negotiating processes, built on the assumptions of comparative advantage, are singularly unsuited to dealing with decisions that have significant distributive effects. The attendant risks are significant, above all a breakdown of discipline in the multi-unilateral structure of implementation as countries decide that the penalties do not really hurt while maintaining the infraction has few disadvantages.[31] The risk is real that any further loading of the agenda—in particular with investment, which has proven a major negotiating challenge in several other fora—entails the risk of bringing down the entire structure.

Negotiating Subsidies

The WTO is not an organization for grand bargains. It is an environment devoted to painstaking negotiation to develop consensus. The issue of subsidies will be tackled much the same way: over a period of years—possibly many years—in an incremental manner. Nevertheless the current situation calls for some carefully considered but far-reaching steps.

The issue of subsidies is growing out of hand. Not only are the relevant negotiations increasingly spread all over the organization—with significant elements in the Committee on Agriculture, the Committee on Rules and the Council on Trade in Services—there is also a negotiation on fisheries still located in the Committee on Rules but that is taking on a life of its own. The impacts of these negotiations are liable to be felt in a wide range of areas where the WTO has needed to show greater sensitivity, environment, labour and sustainable development in particular.

There appears to be no practical way to draw all of these negotiations together. Yet it is increasingly important to view the issue of subsidies in a more comprehensive manner, and in relation to legitimate policy goals of the countries

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[31] Both the beef-hormones case and the FTC case have this structure.

involved. It is vital to solve the problems of multi-unilateral implementation and to provide alternatives to countervailing action and dispute settlement as the primary institutions of implementation.

Find Mutually Advantageous Bargains

The trade regime has been most effective when it has identified measures that are in the interests of all parties—tariff reduction being the most important. It is necessary to seek such arrangements in relation to subsidies, even though this will be more difficult. The underlying assumption of the trade regime is that countries will respect its rules because it is in their interest to do so, yet it can no longer be assumed that any agreement will be in everybody's interest. Consequently identifying such self-executing arrangements is demanding even while it is vital to the success of negotiations on subsidies.

Develop the Mutual Assistance Dimension

Reducing subsidies is politically hard, no matter how economically desirable it may be—provided it is possible to ensure that only subsidies that are economically undesirable become the object of reduction. Countries can help each other with the political challenge that subsidy reduction entails, provided the resulting package is recognizably in all countries' interests.

Avoid False Bargains

Trade negotiations are increasingly about apples and oranges, that is about issues that do not have a logical linkage. To some extent this situation has arisen in an attempt to create complex package agreements that contain something for everybody. Yet the risk of false bargains has grown dramatically, in particular since unequal negotiating power can mean that some countries will be more successful at achieving their goals than others, in other words the packages are almost inevitably skewed towards the more powerful countries. The ultimate result can be false bargains in which some countries benefit while others do not. That is a risky situation.

Expand Implementation Capacity

The dispute settlement system is indubitably remarkable. Yet it cannot be the sole instrument of implementation. Moreover the requirement to demonstrate damage severely limits the applicability of dispute settlement for a differentiated reduction of subsidies. The most important alternative to dispute settlement is

transparency in all of its forms. The establishment of a subsidies review mechanism, based on robust analytical capability within the secretariat would have multiple benefits. It would ensure that impartial analytical information is available; it would promote transparency at country level; it would create useful pressure on recalcitrant governments and their constituencies; and it would reduce the divergence between the analysis of subsidies and the practical implementation of agreements that may be reached to reduce them.