

## TRADE BEYOND BORDERS: A PATH TO REFORMING WTO SUBSIDY REGULATIONS

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**Annotation:** This thesis is devoted to international trade, trade beyond borders and a path to reforming WTO subsidy regulations.

**Keywords:** WTO, SCM Agreement, Loopholes, Preamble.

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### INTRODUCTION

In the dynamic landscape of international trade, the regulation of subsidies has emerged as a critical issue at the heart of the World Trade Organization. Subsidies, both domestic and foreign, play a significant role in shaping the competitiveness of industries, fostering economic growth, and influencing global trade dynamics. However, the existing framework for subsidy regulation within the WTO has faced increasing scrutiny and calls for reform. The thesis outlines the shortcomings of the current subsidy regime, including unclear definitions, limited enforcement mechanisms, as well as opportunities associated with reforming the WTO's subsidy regulation regime.

The WTO, as the primary international organisation governing global trade, plays a crucial role in establishing rules and disciplines to ensure fair and predictable trade relations among its member countries<sup>1</sup>. The Agreement on Subsidies and Countervailing Measures is the key instrument within the WTO framework that addresses the regulation of subsidies. It sets out rules and procedures for identifying and remedying subsidies that are deemed to cause adverse effects on international trade. The primary objectives of the SCM Agreement are to ensure fair competition in international trade and prevent the use of subsidies as a trade-distorting tool that gives an unfair advantage to certain industries or countries. The SCM Agreement contains special rules for dispute resolution that set rigorous deadlines for implementing panel reports and providing remedies that, depending on the type of subsidy in question, call for the withdrawal of the subsidy or the reduction of the subsidy's negative consequences.

The significance of the legal framework for subsidy regulation under the WTO lies in its potential to balance the competing interests of promoting domestic industries and maintaining fair competition in the global marketplace. Excessive usage of subsidies can lead to the destabilisation of the functioning of international trade and the distortion of international competition.<sup>2</sup> By establishing clear rules and procedures, the WTO aims to prevent trade

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<sup>1</sup> Ingo, M. and J. Nash. *Agriculture and the WTO: Creating a Trading System for Development* (Washington, DC: Oxford University Press and the World Bank, 2004). Available at: <http://hdl.handle.net/10986/14930>.

<sup>2</sup> OECD and Global Forum on Competition, 'Subsidies, Competition, and Trade' (OECD Competition Policy Roundtable Background Note, 2022). Available at: <https://www.oecd.org/daf/competition/subsidies-competition-and-trade-2022.pdf>.

distortions arising from subsidies, thereby fostering a level playing field for all market participants<sup>3</sup>. A robust legal framework for subsidy regulation contributes to promoting market efficiency, preventing protectionist measures, and facilitating global economic growth.

## **Loopholes in the regulation of subsidies under the SCM Agreement**

While the SCM Agreement has brought significant improvements to subsidy rules, it has drawn criticism for being both weak and ineffective. Given how they have evolved over time, subsidy regulations require regular adjustments. So does the SCM Agreement. The SCM Agreement has been criticised for having loopholes and ambiguities that can be exploited by member countries. These gaps undermine the effectiveness of the regime and create a lack of clarity in identifying and regulating trade-distorting subsidies. Reforms can help address these regulatory gaps and strengthen the rules governing subsidies.

An effective notification system is a prerequisite to well-functioning disciplines. Despite the requirement that members report on and inform about subsidies, there are many states that continue to fall short of their reporting obligations, and the number has increased significantly. Statistics show that less than half of WTO Members fulfilled their notification obligation in 2019. Furthermore, due to the absence of a standardised information system, not all WTO members include the same information in their notifications, and it appears that not all of the subsidies they offer are disclosed in their reports<sup>4</sup>.

Another drawback of the SCM Agreement is the criteria used to compute benefits as well as the concept of a subsidy, which are also in need of improvement and further clarification. For example, the definition of a public entity and de facto specificity, are rather ambiguous and cause a lot of misunderstanding between the Members.

The agreement's scope being restricted to subsidies affecting exports in goods markets is another factor that has led to criticism of the SCM. Additionally, some types of government support might not be included in the SCM Agreement<sup>5</sup>. The regulation of subsidies needs to adapt to the changing global economic landscape and emerging subsidy practices. Rapid technological advancements, new forms of government support, and evolving business models pose challenges in effectively capturing and regulating subsidies that may have protectionist effects. There is a need to continuously assess and update the SCM Agreement to address these evolving issues.

The absence of rules on subsidies to service industries, creates a big gap in subsidy disciplines that needs to be corrected, thus limiting the ability of WTO members to effectively address protectionist practices and unfair competition arising from government support in the services sector. It also hampers efforts to promote transparency, predictability, and accountability in subsidy practices, which are essential for fostering a fair and competitive global trading system.

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<sup>3</sup> Gea M. Lee, 'Subsidies and Countervailing Duties, Handbook of Commercial Policy. 1B, 161-210. Research Collection School Of Economics (2016) Available at: [https://ink.library.smu.edu.sg/soe\\_research/1914](https://ink.library.smu.edu.sg/soe_research/1914).

<sup>4</sup> European Commission, Staff Working Document; Evaluation of the Commission Notice on the Definition of Relevant Market for the Purposes of Community Competition Law of December 9, 1997 (2021). Available at: <https://eur-lex.europa.eu/EN/legal-content/summary/definition-of-relevant-market.html>. Accessed on: February 23, 2023.

<sup>5</sup> OECD (2021), "Measuring distortions in international markets: Below-market finance".

## **The need for a Preamble to the SCM Agreement**

According to Article 31 of the Vienna Convention, object and purpose are one of the four elements of the single interpretative rule<sup>6</sup> and they also give a clearer explanation to others<sup>7</sup>. As per this article, the WTO adjudicating bodies should establish the ordinary meaning of the terms of each WTO treaty “in the light of its object and purpose.” However, this fundamental aspect of the interpretative rule is almost impossible to use while interpreting the SCM Agreement. The Appellate Body has admitted this when it stated: “considerations of object and purpose are of limited use . . . [w]e do not see that the object and purpose of the SCM Agreement provide clear indications as to the intentions of the drafters of the SCM Agreement.”<sup>8</sup> Similarly, in *Canada – Aircraft*, the Panel acknowledged that the SCM Agreement “does not contain any express statement of its object and purpose . . . [w]e therefore consider it unwise to attach undue importance to arguments concerning the object and purpose of the SCM Agreement.”<sup>9</sup>

The preambles of other WTO agreements typically accomplish one or more of the four purposes. Generally, they serve to clarify the following things: the goal or teleology of the agreement and/or the rationale behind specific provisions; the relationship between the agreement and the GATT 1994 or other agreements; the relationship between various parts of the agreement; and the general principles governing its interpretation and application. The SCM Agreement's lack of a preamble indicates that the Members have not reached consensus on these issues. These differences represent the underlying gaps in the SCM Agreement. It is the interaction of the forces opposed to each other across these fault lines that shape, in litigation, the development of the WTO subsidies law and will continue to do so.<sup>10</sup>

There is no explicit statement of the object and purpose of the SCM Agreement. According to Cartland et al., “the SCM Agreement does not contain any preamble or explicit/implicit indication of its object and purpose because the drafters specifically decided that reaching an agreement on these matters would be impossible.”<sup>11</sup> Although the SCM Agreement's object and purpose are described in a broad and ambiguous manner, panels and the Appellate Body have occasionally shared their opinions on what they believe the SCM Agreement's object and purpose to be. In *Brazil—Aircraft*, the Panel stated that “[t]he object and purpose of the SCM Agreement is to impose multilateral disciplines on subsidies that distort international trade.”<sup>12</sup>

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<sup>6</sup> Vienna Convention, title to Article 31: (“General rule of interpretation”).

<sup>7</sup> Vienna Convention, Article 31: (“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”)

<sup>8</sup> Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R, adopted 25 March 2011, paras. 302, 574.

<sup>9</sup> Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, adopted 20 August 1999, para. 9.119 [hereinafter *Canada – Aircraft*].

<sup>10</sup> James Flett, ‘Preserving the Balance between Trade and Non-Trade Interests through a Systematic Interpretation of WTO Subsidies Law’ (2016).

<sup>11</sup> M. Cartland, G. Depayre and J. Woznowski, ‘Is Something Going Wrong in the WTO Dispute Settlement?’, 46(5) (*Journal of World Trade*, 979-1016, at 992, 2012). Available at: doi:10.54648/TRAD2012031.

<sup>12</sup> Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, adopted 4 August 2000, para. 7.26.

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According to the Appellate Body's findings in US - Carbon Steel, "[t]aken as a whole, the main object and purpose of the SCM Agreement is to increase and improve GATT disciplines relating to the use of both subsidies and countervailing measures."<sup>13</sup>

Therefore, it can be concluded that the primary goals of the WTO subsidy discipline are to (1) prevent WTO Members from providing subsidies that distort international trade and (2) control unilateral responses to such subsidies by imposing CVDs, ensuring that they are justifiable and proportionate, thereby limiting their ability to distort international trade. Despite the fact that it is evident that the WTO's rules on subsidies are designed to prevent its Members from granting subsidies and imposing CVDs in a manner that might hurt another country, it is unclear what kind of harm these rules are meant to guard against. The ultimate goal of the WTO subsidy regime may be understood differently depending on how the word "harm" is interpreted.

Balancing economic efficiency and legality is crucial to striking a harmonious equilibrium in the regulation of subsidies. On the one hand, subsidy programmes should be designed and implemented in a manner that maximises their positive economic impact while minimising any negative effects on market competition and resource allocation. This requires careful consideration of the potential trade-offs and unintended consequences that subsidies may create.

On the other hand, adhering to the legal framework ensures that subsidy programmes are consistent with the principles and obligations of the WTO. Compliance with the rules promotes fair competition, avoids discrimination, and provides a predictable environment for businesses and trading partners.

The following wording for the SCM Agreement's Preamble is proposed in this article, adopting and drawing inspiration from the Preambles of the other WTO Agreements as models:

“Members,

**Having** in mind the overall objectives of the GATT 1994;

**Recognising** the need to clarify and reinforce rules for the application of the provisions of GATT 1994 that relate to subsidies and countervailing duties, in particular the provisions of Articles III:8(b), VI and XVI;

**Recognising** that Members should not use subsidies that distort competition and reduce economic efficiency in the markets of other Members;

**Acknowledging** the necessity to establish a robust framework that addresses the challenges posed by subsidies and their potential impact on market dynamics and international trade,

**Reaffirming** our commitment to the principles of non-discrimination, transparency, and legal certainty in the regulation of subsidies,

**Emphasising** the need to strike a balance between promoting economic growth, innovation, and competitiveness, and ensuring legal compliance with the existing international trade rules,

**Desiring** to ensure that countervailing duties and other legal actions to counteract subsidies themselves do not create distortions of competition; and

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<sup>13</sup> Appellate Body Report, United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany, WT/DS213/AB/R, adopted 19 December 2002, para. 73

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**Recognising** that Members should not be prevented from granting subsidies to domestic producers in order to pursue legitimate objectives, provided that they comply with the relevant provisions of the GATT 1994 and other applicable WTO agreements;

Hereby agree as follows:”

## **CONCLUSION**

Reforming the WTO subsidy regulation is a complex but necessary step to adapt to the evolving global trade environment. While challenges and opposition may arise, the potential benefits in terms of fairer trade, economic growth, and global cooperation make it a worthwhile pursuit. Moreover, due to the growth of global value chains, governments may now subsidise a company in their own country who may, by extension, subsequently use this subsidy for production in several other countries, this demonstrates the fact that the current subsidy regulation framework at the WTO is outdated and ill-equipped to address contemporary trade challenges, including the issue of transnational subsidies. Reform is necessary to ensure a fair and level playing field for all member countries. Furthermore, reforming the WTO subsidy regulation can lead to greater transparency, predictability, and fairness in global trade. Additionally, reform can promote economic development, reduce trade tensions, and enhance the multilateral trading system's credibility.

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General Agreement on Tariffs and Trade, 1994.

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