

IMPORTANCE OF THE SUBSIDY REGULATION UNDER THE WTO REGULATION

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Abstract. *This thesis aims to explore the legal basis of the regulation of subsidies within the WTO. The regulation of subsidies holds significant importance in the realm of international trade. Subsidies, defined as financial contributions made by governments to support domestic industries, can have far-reaching implications for market competition and trade flows.*

Key words: *regulation of subsidies, actionable subsidies, World Trade Organization (WTO), Agreement on Subsidies and Countervailing Measures (ASCM), protectionism, International trade, Agreement on Agriculture, GATT.*

Subsidies play a crucial role in promoting economic growth in several countries.¹ Regulating subsidies ensures that government intervention does not hinder trade and that the benefits of economic growth are spread equitably across all countries. Multilateral rules governing subsidies promote opportunities for competitive trading and help countries integrate into the global economy, making international trade an excellent tool for economic growth.

Subsidies in the agriculture sector have the potential to artificially protect recipients from market changes and distort² the global prices for agricultural products.³ This may constitute unfair trade, since it may violate the commitments importing countries have made to the WTO regarding

¹ For example, US high technology production and export are to a large extent due to substantial R&D subsidies to many industries through heavily subsidised university research sectors, subsidies to defence and space exploration sectors, as well as direct export subsidies provided by the Export-Import Bank of the United States to high technology industries, including aircraft production. See Brandner, supra note 33, at 64-65.

² The measurement of subsidies in the international trade field was studied by the OECD, which developed a set of measures for the purposes of comparing Member countries' levels of subsidies, types of subsidies, and reductions under the Uruguay Round Agreement on Agriculture. The Aggregate Measurement of Support [AMS] is now used to estimate the dubbed “trade distorting” agricultural support measures, which are the support policies slated for reduction under the AoA. Timothy Wise. “The Paradox of Agricultural Subsidies: Measurement Issues, Agricultural Dumping, and Policy Reform” Paper n. 04-02 from the Global Development and Environmental Institute, 2004 (Medford: Tufts University, 2004).

³ The World Bank predicts that removing trade barriers in agriculture could lift hundreds of millions of people out of poverty. There is an estimation that the removal of trade barriers in agriculture by industrial countries could reduce poverty worldwide by 8%, or about 200 million people. William R. Cline, Trade Policy and Global Policy, (Washington, DC: Institute for International Economics, 2004) [Cline, Trade Policy].

market access⁴ and may displace exports from other WTO Members. According to these considerations, agricultural subsidies violate fundamental principles of the WTO.⁵

Therefore, the regulation of subsidies ensures that all countries have a level playing field when it comes to trade. Without regulations, some countries may provide massive subsidies to their domestic industries, giving them an unfair advantage in the global market, both to industrial and agricultural products. Agriculture receives extensive and well-documented government support.⁶ Over the course of 2018–2021, public budgets supported agriculture with \$447 billion annually,⁷ of which almost three-fifths (\$268 billion) went to producers directly and the remainder to general services or consumers.⁸ Improper and excessive usage of subsidies can lead to the destabilisation of the functioning of international trade and the distortion of international competition.⁹ Regulations ensure that competition is fair and that smaller countries have a chance to participate meaningfully in the global economy.

By regulating subsidies, the WTO can promote sustainable development and ensure environmentally-friendly practices. Governments can offer less harmful subsidies that support green initiatives, such as promoting renewable energy and organic farming. Regulations ensure that subsidies do not cause harm to the environment but help protect natural habitats for future generations. Environmental degradation, poor food safety, resource waste, and labour disputes are examples of societal problems brought on by economic globalisation and progress.¹⁰

⁴ WTO market access conditions are the tariff and non-tariff measures agreed to by Members for the entry of specific goods into their markets. Each Member has a schedule of concessions associated with its tariff commitments.

⁵ Trade without discrimination, free trade, predictability and promoting fair competition (http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm).

⁶ The OECD measures support to agriculture for 54 economies through its Producer Support Estimate (PSE), covering around three quarters of the global agricultural value added, and support to fisheries through its Fisheries Support Estimate (FSE) databases. The International Organisations Consortium for Measuring the Policy Environment for Agriculture—a joint effort across the IDB, IFPRI, FAO, OECD and WBG—provides consistent information for 88 countries globally, representing over 90 percent of the global value of agricultural production.

⁷ Total support to the sector was \$720 billion a year, but this also includes \$272 billion in market price support (MPS), which is a measure of the actual transfers to agricultural producers through price policies. The OECD methodology to calculate support to agriculture differs from that used in the WTO.

⁸ OECD, “Measuring Distortions in International Markets: Below-market Finance.” OECD Trade Policy Papers, No. 247, OECD Publishing, Paris. (2021). Available at: doi:10.1787/a1a5aa8a-en.

⁹ 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>.

¹⁰ Khurshid A and others, “Technological Innovations for Environmental Protection: Role of Intellectual Property Rights in the Carbon Mitigation Efforts. Evidence from Western and Southern Europe - International Journal of Environmental Science and Technology” (2021). Available at: doi.org/10.1007/s13762-021-03491-z.

Furthermore, disputes relating to subsidy regulations are common in global trade.¹¹ Different countries employ varying levels of subsidies; some are excessively high, while some fiscally constrained developing countries use far less. Thus, sharp disagreements over subsidies are fuelling trade tensions worldwide, which are detrimental to growth and living standards.¹² A thorough understanding of the rules and regulations governing subsidies can help resolve these disputes efficiently. A clear understanding of the legal principles involved in regulating subsidies ensures that disputes are resolved through existing structures established in the WTO.

In recent years, there has been a steady rise in the quantity and size of subsidy measures taken around the world.¹³ Globally, states face a number of challenges, including recent events like the COVID-19 recovery¹⁴, climate change, fragile and disrupted global value chains¹⁵, and other challenges that have necessitated and will continue to require government intervention¹⁶ (see Figure 1).

State sovereignty and international regulation of subsidies will always clash¹⁷. On the one hand, governments are free to enact any laws they see fit as sovereign states, including those that depend on the use of subsidies to further their goals. International control of subsidies, however, poses certain difficulties because not all states are willing to restrain their own policy space¹⁸. The gains of the national and international economies are also constrained by subsidies because they

¹¹ The SCM Agreement was raised in WTO disputes more than 130 times during the period between 1995-2021. Available at: https://www.wto.org/english/tratop_e/dispu_e/disputstats_e.htm

¹² IMF, OECD, World Bank, and WTO report "Subsidies, Trade, and International Cooperation" (January 2022). Available at: <https://thedocs.worldbank.org/en/doc/0534eca53121c137d3766a02320d0310-0430012022/original/Subsidies-Trade-and-International-Cooperation-April-19-ci.pdf>

¹³ Though the exact understanding of the size and role of the subsidies is incomplete due to uneven and incomplete data because of the lack of transparency by governments about their support to companies.

¹⁴ Evenett, S. and J. Fritz, Subsidies and Market Access: Towards an Inventory of Corporate Subsidies by China, the European Union, and the United States (2021). Available at: www.globaltradealert.org/reports/gta-28-report.

In response to the pandemic, governments have provided businesses and whole industries with substantial support, particularly through subsidies. Such assistance programmes have yet to be loosened and finally terminated in many economies, and the various methods for doing so (speed, extent, etc.) may result in considerable trade conflicts and competition.

¹⁵ IMF et al., Subsidies, Trade, and International Cooperation, (OECD Publishing, Paris, 2022). Available at: <https://thedocs.worldbank.org/en/doc/0534eca53121c137d3766a02320d0310-0430012022/original/Subsidies-Trade-and-International-Cooperation-April-19-ci.pdf>

¹⁶ 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>.

¹⁷ Hugo Paemen, 'Forces that (may) Have Shaped Subsidy Regulation' in *What Shapes the Law? Reflections on the history, law, politics, and economics of international and European subsidy disciplines* (Luca Rubini and Jennifer Hawkins eds., 2016). Available at: <https://ssrn.com/abstract=2960046>.

¹⁸ Chikusa E, 'Surveillance and Litigation of the GATT/WTO Subsidy Disciplines' (2015) in *What shapes the law? Reflections on the history, law and politics and economics of international and European subsidy disciplines* (Luca Rubini and Jennifer Hawkins eds., 2016). Available at: <https://ssrn.com/abstract=2960046>.

imply distortions. As a result, governments "have a collective interest in cooperating to limit the adverse effects on trade, but they also have a legitimate interest in seeking to influence economic activity within their jurisdiction."¹⁹

On the other hand, from the governments' perspective, despite the fact that some subsidies pose challenges, they nonetheless possess a certain level of legitimacy that 'border instruments' like tariffs or quotas do not. The most common defence of subsidies is that they enable governments to address a variety of market failures.²⁰ By reducing negative externalities (such as those between jurisdictions and the environment) or by generating positive externalities (such as investment in research and development), subsidies can be used to alleviate market failures and attain specific policy goals.²¹ To increase the economic growth of a state, government subsidies can be used to circumvent the market system in the allocation of resources. Economically speaking, subsidies are similar to negative taxes in that they can be used to achieve significant social and political goals, frequently more effectively than other policies. For example, subsidies are used to stimulate innovation (e.g., through R&D tax credits), address regional inequalities (e.g., through European Commission Objective I initiatives), and enable social mobility (e.g., through funding student loans). Due to these factors, trade agreements, such as the GATT/WTO system, have attempted to strike a balance between limiting subsidies and state autonomy. As a result, agreements were reached to reduce or eliminate export subsidies as well as limit the detrimental effects they could have on trade flows.

Subsidies are often used as a tool to promote economic development and stimulate growth in certain industries or regions.²² Governments may provide financial assistance to industries such as aerospace, defence, renewable energy, or high-tech sectors to nurture domestic capabilities and maintain a competitive edge in the global market. By providing financial support to businesses, governments aim to encourage investment, innovation, and job creation. Subsidies can attract domestic and foreign investment, boost exports, and enhance competitiveness in strategic sectors. Governments may offer financial incentives, tax breaks, or grants to entice companies to establish

¹⁹ Terry Collins-Williams, 'A Negotiator's Perspective on Enhancing Subsidies' Discipline', in *What Shapes the Law? Reflections on the history, law, politics, and economics of international and European subsidy disciplines* (Luca Rubini and Jennifer Hawkins eds., 2016). Available at: <https://ssrn.com/abstract=2960046>.

²⁰ *Ibid.*

²¹ Krugman P. R., et al. 'International Economics Theory and Policy 226(27) (9th ed. 2012).

²² Zahariadis N., 'State Subsidies in the Global Economy' (2008). Available at: [doi:10.1057/9780230610514](https://doi.org/10.1057/9780230610514).

or expand operations within their jurisdiction. These subsidies aim to create jobs, boost local economies, and enhance competitiveness by providing advantages over other locations.²³

Subsidies, particularly export subsidies, expand trade volume; therefore, limiting export subsidies may result in a decline in world trade.²⁴ This has long troubled economic theorists: there is an economic equivalence between tariffs and export taxes, as both raise the relative price of local products, and export subsidies are equivalent to negative export taxes because both lower the price of local products. According to this reasoning, governments that want to increase tariffs should welcome foreign export subsidies, as both help a country's terms of trade.²⁵

From an economic perspective, subsidies, in comparison to tariffs, are more efficient at overcoming market failures²⁶ as well as bringing social and private costs and benefits into alignment.²⁷ In situations where the market does not adequately allocate resources, such as in the case of public goods or externalities, governments may provide subsidies to incentivize private investment or consumption. This can ensure the provision of essential services, promote research and development, or mitigate negative environmental impacts.

It is important to note that while subsidies can have positive effects, they can also lead to unintended consequences, such as market distortions, inefficient resource allocation, or trade disputes. Balancing the objectives of subsidies with the principles of fair competition and international trade rules is a complex challenge faced by governments worldwide.

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²³ IMF, World Bank, and WTO. 2017. "Making Trade an Engine of Growth for All: The Case for Trade and for Policies to Facilitate Adjustment." Prepared by staff of the IMF, World Bank, and WTO for discussion by G20 Sherpas, March.

²⁴ Mavroidis et al. (2010) argue that, as a result, the GATT/WTO subsidy agreement is 'one of the least economically informed agreements in the WTO.

²⁵ Bagwell, K. and R.W. Staiger, 'The Economics of the World Trading System' (Cambridge, MA: MIT Press, p 167, 2002). Available at: doi:10.1016/j.jinteco.2003.08.005.

²⁶ Market failure is when the prices of goods and services do not reflect the true costs of producing and consuming those goods and service

²⁷ World Trade Organization, 'The Economics of Subsidies' (World Trade Organization, 2006). Available at: <https://doi.org/10.30875/0ff6a90e-en>.

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