specific sectors such as the chemical or the automotive industry. As of the late 1980s, government subsidies to industry (excluding public services and agriculture) in OECD countries averaged about 2 per cent of the value of industrial output (OECD, 1993). Between two-fifths and three-fifths of these subsidies went to specific sectors, much of it for declining industries such as steel, shipbuilding and mining. Of the service sectors, available statistics showed that rail transport was often highly subsidized, with rates of support varying between 15 per cent and 180 per cent of total value added. The magnitude of subsidies varies greatly across countries, but a general rule of thumb is that the larger the share of government in GDP, the more prevalent are subsidy programmes, both direct financial grants and implicit subsidy schemes that operate through the tax system.

More recent data from reliable sources that allow for cross-country comparisons are available for only a limited number of sectors (agriculture, coal, fisheries). Data on subsidies in service industries are particularly limited. Using national statistical sources for 69 countries the WTO Secretariat documented that aggregate subsidies comprised some US$300 billion in 2003, of which developed countries accounted for over 80 per cent (WTO, 2006). The average ratio of national subsidies to GDP was in the range of 1.4 per cent for developed countries and about 0.6 per cent for developing countries. In the time period assessed there appeared to be a tendency to redirect subsidies towards 'horizontal objectives' and to reduce subsidies in the agricultural sector. For those countries reporting subsidies to the WTO, the report revealed significant omissions—and most WTO members do not report their subsidies (Table 5.4). This is an area where the principle of transparency appears to attract mostly lip service—with the exceptions of the EU, Brazil and Korea.

WTO rules on subsidies

The disciplines in the SCM agreement relating to subsidies have a twofold objective. First, to establish rules to avoid or reduce adverse effects on members, and, more specifically to prevent the use of subsidies to nullify or impair concessions. Second, to regulate the use of countervailing duties (CVDs) by members seeking to offset the injurious effects on their domestic firms of foreign subsidization of products. The latter dimension of WTO rules is discussed in Chapter 9. As discussed further in Chapter 7, there are no subsidy disciplines for services. Special rules apply to agriculture, where there is greater flexibility to use export subsidies and disciplines are imposed in the form of an Aggregate Measure of Support. These disciplines are discussed in Chapter 6.

The GATT 1947 was quite permissive regarding the use of subsidies. This continues to be the case under the WTO, with the difference that the WTO more clearly defines what is covered by multilateral disciplines: any measure that has a

Table 5.4. Subsidies in selected countries (US$ billion, 1998–2002 average)

Country	National Accounts Data	WTO Notifications
Canada	7.7	0.9
EU (15)	109.0	96.3
Australia	4.7	0.3
Japan	34.3	4.2
Norway	4.1	2.9
Switzerland	10.8	0.7
United States	43.5	16.3
Brazil	2.0	1.7
India	12.2	–
Republic of Korea	1.0	1.3
South Africa	0.9	–

Source: WTO, World Trade Report (2006).

cost to the government budget and is specific. The large measure of subsidy freedom makes the WTO quite different from deep regional integration agreements such as the EU, where strict disciplines are imposed on the use of subsidies and CVDs cannot be used by member states on imports from partner countries. Instead, subsidization is subject to explicit rules and EU competition disciplines. If these are violated, countries can be brought before the European Court of Justice.

The reason for the difference is that the objective of the WTO is not deep integration. The WTO subsidy rules attempt to strike a balance between the need to agree on minimum standards regarding the subsidies that may not be used because they distort trade, and ensuring that measures used by importing countries to offset the effects of foreign subsidy programmes are not abused. The SCM agreement distinguishes between three categories of subsidies: nonactionable, prohibited and actionable. Nonactionable subsidies are by definition permitted and cannot be contested. They span all nonspecific subsidies—those that do not primarily benefit a specific firm, industry or group of industries. Nonspecificity requires that allocation criteria are neutral, nondiscriminatory and horizontal (that is do not target or benefit some sectors more than others). Specific subsidies are either prohibited outright or are actionable.

Attempts under the auspices of GATT 1947 to deal with the subsidy issue suffered major difficulties. The term subsidy was not defined in the GATT 1947, and agreement on a definition proved elusive. It also proved difficult to determine what types of subsidies distorted trade. These difficulties led to many disputes and panels in the 1970s and 1980s (many of the cases involved agriculture). Progress was made on both fronts during the Uruguay Round. First, agreement was reached on a

definition. A subsidy is deemed to exist if there is a financial contribution by a government (or public body). This in turn may involve an actual or potential direct transfer of funds (such as grants, loans, equity infusions or loan guarantees), forgoing government revenue (tax concessions or credits), or the provision or purchase of products other than general infrastructure. Government funding of a private body to carry out a function that would normally be vested in the government and any form of income or price support is also covered by the definition. This definition is embodied in the SCM Agreement and applies to nonagricultural products (as mentioned, there are separate disciplines for agricultural production and trade—see Chapter 6).

A consequence of the way subsidies are defined in the SCM agreement is that de facto subsidization, resulting from, for example, differential taxation, regulatory policies or the imposition of import duties, is not considered a subsidy. Insofar as these instruments raise concerns they need to be—and often are—addressed by other WTO agreements. Duty drawback schemes and rebates of VAT on exports are not considered to be subsidies as long as the magnitude of the rebate does not exceed the level of taxes applying to products sold on the domestic market.

Subsidies that are contingent, formally or in effect on export performance or on the use of domestic over imported goods are prohibited (Article 3 SCM) (except for LDCs and certain developing countries—see below). Thus, export subsidies and local content incentives may not be used by WTO members. One justification for this strong form of constraint is that both types of measure by definition have a direct impact on trade. Other subsidies will have a more indirect impact on trade, if they have an effect at all.

An illustrative list of export subsidies, attached to the SCM agreement, mentions the provision of products or services (including transportation) for use in export production on terms more favourable than for domestically consumed goods. It also lists export credits and guarantees or insurance at a cost that does not cover long-term operating costs and losses of the insurer (except if a member applies the provisions of the OECD agreement on export credits). A case brought against the US in 1998 clarified that tax concessions on export income also constitute an export subsidy. A necessary condition is that the government, or an institution under its control, provides the subsidy. All export subsidies are deemed specific, whether targeted or not. If WTO members are found to be using export subsidies by a dispute settlement panel, the remedy will generally be a requirement that the measures be removed within a three-month period.

The third category, actionable subsidies, are specific measures that are permitted but may, if they create adverse effects on a WTO member, give rise to consultations, invocation of dispute settlement procedures, or the imposition of countervailing duties by an importing country. For SCM disciplines to kick in (to be actionable) a subsidy must be specific *and* confer a benefit to the recipient(s) *and* have adverse

effects on a trading partner. Criteria to determine specificity are laid out in Article 2 SCM. This article states that if a government establishes objective eligibility criteria or conditions that are neutral, do not favour certain enterprises, are economic in nature and horizontal in application (such as number of employees or size of enterprise), and are spelled out in legislation or regulations, a subsidy will not be deemed to be specific if eligibility is automatic and the criteria are strictly adhered to.

Part IV of the SCM agreement made several *specific* subsidies nonactionable if they satisfied certain criteria. These included research and development (R&D) subsidies, aid to disadvantaged regions, and subsidies to facilitate the adaptation of plants to new environmental regulations. However, this part of the agreement was of limited duration: it was to lapse after five years unless WTO members extended them (Article 31 SCM). They did not do so and thus these provisions expired in 2000. As a result there are at present only two types of specific subsidy categories distinguished by the SCM agreement: prohibited and actionable.

Adverse effects include injury to a domestic industry, nullification or impairment of tariff concessions, or serious prejudice or threat thereof to the country's interests. Serious prejudice is defined to exist if the total *ad valorem* subsidization of a product exceeds 5 per cent, the subsidies are used to cover operating losses of a firm or industry or debt relief is granted for government-held liabilities. Serious prejudice *may* arise if the subsidy reduces exports of WTO members, results in significant price undercutting or increases the world market share of the subsidizing country in a primary product. If actionable subsidies have an adverse effect, a government may request consultations with the subsidizing member and ask for a panel if the matter is not settled within 60 days. Article 31 SCM, which as mentioned earlier specified that certain specific subsidies were nonactionable for five years, also reversed the burden of proof on serious prejudice for a period of five years. This was a significant trade discipline—as it greatly facilitated bringing a case —but was allowed to lapse. As also reflected in the limited compliance with reporting of subsidies, the fall into abeyance of this dimension of Article 31 was symptomatic of the generally less than serious attitude towards dealing with subsidies that prevails in the WTO.

The focus of the WTO disciplines (and dispute settlement) in cases where there is prejudice is on the amount of the assistance given, not on the extent to which a subsidy harms trading partners (competitors). This makes little sense from an economic perspective, although it has the advantage of being straightforward to calculate. Subsidy case law developed under the WTO has moved somewhat towards more stringent remedies, in that instead of requiring simply the abolition of an illegal measure, some panels have required re-payment of the subsidy by the firms that benefitted. This is not necessarily a step in the right direction from an economic perspective, as it ignores the effect of the subsidy. In some cases a subsidy may have no injurious effect; in others the damage caused may be a multiple of the subsidy.

In the Doha round it was agreed that the negotiations would clarify and improve disciplines under the SCM Agreement 'while preserving the basic concepts, principles and effectiveness' of the agreement and its instruments and objectives, and taking into account the needs of developing countries and LDCs. Fishery subsidies emerged as a priority area of concern for many developing countries. Debate also focused on whether to extend the list of prohibited subsidies and on the type of payments that should be covered. The US argued that an extension of the prohibited subsidy list was an obvious next step in deepening subsidy disciplines. The EU preferred to put emphasis on strengthening rules prohibiting subsidies that are contingent on the use of domestic inputs (local content) (Article 3.1*b* SCM). The EU also aimed to loosen rules on export credits, driven primarily by its interest in the aircraft industry. Proposals from developing countries such as India and Brazil aimed at relaxing the disciplines on subsidies, reflecting a perception that government financing was an important means to achieve export growth and/or greater diversification. The overall gist of the SDT proposals in the SCM discussions was the extent to which developing WTO members should be allowed more room to use subsidies. One suggested option was to remove the time frame for seeking an extension to use export subsidies and raise the threshold for being forced to eliminate them (Chapter 12). An important decision taken at the 2005 ministerial meeting in Hong Kong was a conditional agreement to eliminate export subsidies for agricultural products by 2013 (see Chapter 6).

Developing countries and WTO subsidy disciplines

Under the GATT, developing countries were free to use export subsidies. World Trade Organization members are required to notify their subsidy programmes to the WTO Secretariat each year, giving information on the type of subsidy, the amounts involved, the policy objective and intended duration, as well as statistics allowing their trade effects to be determined. Any member may cross-notify alleged subsidies of other countries that the latter have not notified. A number of special provisions for developing and transition economies are included in Article 27 of the SCM agreement. Developing country members listed in an annex (all LDCs and 20 countries that had a GNP per capita below US$1,000) are exempted from the prohibition on export subsidies.[11] Once GNP per capita exceeds US$1,000, nonconforming subsidies must be eliminated within eight years. Developing country WTO members not listed in the annex were to phase out their export subsidies

[11] This spanned the following developing countries: Bolivia, Cameroon, Congo, Côte d'Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka and Zimbabwe. Market exchange rates are used, not purchasing power parities.

over an eight-year period, starting from January 1995 (Article 27:4 SCM). The prohibition on subsidies contingent on the use of domestic goods (local content) did not apply to developing countries for a period of five years (eight years for LDCs), and further extension could be requested. If granted, annual consultations with the SCM Committee must be held to determine the necessity of maintaining the subsidies. Developing countries that have become competitive in a product—defined as having a global market share of 3.25 per cent—must phase out any export subsidies over a two-year period.

Although the traditional difference in subsidy disciplines applying to industrialized and developing countries was narrowed substantially in the Uruguay Round, especially as regards export subsidies, it proved controversial to implement these provisions. In 2007, the SCM Committee issued a decision, subsequently endorsed by the General Council, extending the temporary exemption for export subsidy disciplines for a number of developing countries that should have abolished such subsidies in 2002. The 2007 General Council decision extends the exemption through the end of 2013, with a two-year phase-out period—the same end date agreed in Hong Kong for the elimination of agricultural export subsidies.[12] In practice this decision implies that other developing countries falling under the $1,000 per capita threshold will also have until 2015 before the export disciplines will bite. Thus, a total of 88 WTO developing country members will not be affected by export subsidy disciplines until 2015 at the earliest.

Many countries, both developing and developed, pursue export promotion programmes. These may involve assistance with penetrating new markets through organization of trade fairs, general advertising campaigns that aim at 'selling' the country and enhancing the visibility of export products, and maintenance of commercial attachés in embassies and consulates. During the 1990s, an increasing number of countries implemented so-called matching grant schemes that subsidize a proportion of the cost of improving production facilities, obtaining ISO 9000 certification of management systems, and exploring new export markets. Such schemes could be regarded as export subsidies if the provision of the grant element is made conditional upon exports.

By far the most important source of concern for developing countries was the prospect that WTO rules would constrain their ability to use export processing zones (EPZs) and similar special economic zones as an instrument to overcome investment disincentives caused by weak business environments. Virtually all developing countries have put in place such zones. Often part of the package of incentives offered to investors are tax exemptions and direct subsidies of varying types. Insofar as economic activity in the zone is directed at exports such support is

[12] The countries concerned are Antigua and Barbuda, Barbados, Belize, Costa Rica, Dominica, Dominican Republic, El Salvador, Fiji, Grenada, Guatemala, Jamaica, Jordan, Mauritius, Panama, Papua New Guinea, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, and Uruguay.

clearly linked to (conditional on) exports and could therefore fall foul of the ban on export subsidies. The extension of exemptions of export subsidy disciplines through 2015 was largely driven by such concerns.

Special and differential treatment proposals in the Doha Round aimed at allowing developing countries more room to use subsidies (especially in terms of SCM Articles 3 and 27). For example, a proposal to modify SCM Article 27.4 aimed to remove the time frame for seeking an extension to use export subsidies and to raise the threshold for having to eliminate the subsidy. Among developing countries, Brazil wished to focus the Doha Round negotiations on the treatment of export credit guarantees and the interpretation of de facto export subsidies. Some developing countries also supported the view that uniform disciplines on all subsidies would not address the specific problems associated with the fisheries industry. Work on developing specific rules for the latter sector progressed at a slow pace, even though there was a broad agreement that disciplines in the fisheries sector should be strengthened including through the prohibition of certain types of subsidies that resulted in overfishing and overcapacity.

Whether there is a good economic case for these subsidies is of the course the key question from a policy perspective. The answer depends on whether this instrument offsets distortions created by market failures or other government policies. There are possible economic rationales for a more lenient stance for developing countries. Subsidies may be beneficial in stimulating economic development if there are externalities to firms operating in export markets. These may arise through the beneficial effects of learning by doing. Marketing experts have argued that quality upgrading and export marketing of nontraditional products by firms has positive spillover effects on other potential exporters in a developing country, potentially justifying an export subsidy. Export subsidies may also be the appropriate instrument to offset an anti-export bias resulting from an overvalued exchange rate or high rates of protection in cases where first best policies are not available (devaluation or a market determined exchange rate and trade liberalization). Export subsidy programmes may also have an important political dimension as they can give credibility to a government's commitment to maintain an export-oriented strategy, thus encouraging investment of resources and entrepreneurial energies in the development of foreign markets (Bhagwati, 1988).

If the source of the problem is policy-induced, the case for a subsidy is very much a second-best one—the appropriate action is to target the source of the problem. More often than not subsidy policies are driven by rent-seeking interest groups, not by a clearly identified market failure. The stricter disciplines that were negotiated in the Uruguay Round are therefore likely to be beneficial. Even if export subsidies are optimal from a national perspective, they are likely to be distortionary for the world as a whole, can easily be captured by private interests seeking rents and are difficult to target at a well-defined distortion or market failure.

Summing up, the adoption of a 'green–orange–red light' approach towards subsidies in the Uruguay Round was important. The approach is both pragmatic and sensible from an economic perspective. Ensuring that subsidies that are not firm or sector-specific are in principle unconstrained is appropriate as such subsidies are most likely to be used in the pursuit of noneconomic objectives or in efforts to offset market failures. It ensures freedom for governments to use subsidy instruments in many of the cases where there may be a good rationale for it, and reduces the scope for other countries to second-guess the motivation underlying the use of such instruments. Production subsidies can be the most efficient way to offset externalities, but are more often used to redistribute income. If so, they are likely to distort the operation of markets, but in ways that are very difficult to address. Clearly such subsidies can have detrimental effects on foreign countries, and allowance is therefore made for actions to be taken against their trade effects. But the WTO makes no attempt to get involved in questioning government objectives or to determine whether the policy instrument is necessary or effective or appropriate. The focus is only on the effect of the subsidy. This greatly reduces the scope for disputes, as the focus of attention centres primarily on whether a contested measure is an export subsidy. Export subsidies clearly distort trade and will have direct negative effects on some WTO members. Although economists often remark upon the asymmetry in the WTO regarding the use of trade policies—outlawing export subsidies but permitting tariffs—this is simply a reflection of the mercantilist underpinnings of the institution.

Subsidy disputes under the WTO

There have been a number of major subsidy-related disputes in the WTO. Almost all involved export subsidies. Major cases included disputes between Brazil and Canada regarding export subsidies for civil aircraft production (Brazilian and Canadian firms are major producers of regional and corporate jets), a case brought by the EU against the US Foreign Sales Corporation (FSC) legislation (under which US firms could reduce taxes on export income by funnelling revenues through offshore tax shelters), a number of cases by the US alleging that certain provisions of the corporate tax law of a number of European countries constituted de facto export subsidies, two disputes brought by Brazil and other WTO members against the EU export subsidy regime on sugar and US export subsidies for cotton, and finally, two disputes between the EU and US regarding their respective subsidy programmes for civil aircraft (Boeing-Airbus). The agricultural disputes are discussed in Chapter 6.

In 1996, Canada brought a complaint against Brazil's export financing programme for aircraft (WT/DS46), claiming that subsidies granted under Brazil's

Programa de Financiamento às Exportações to foreign purchasers of Embraer aircraft were illegal export subsidies. A 1999 panel report found that Brazil's measures were prohibited export subsidies. On appeal, the AB mostly upheld the findings of the panel. Upon the initial request for consultations by Canada, Brazil responded by counterattacking. In March 1997 it contested what it perceived as illegal export subsidies granted to the Canadian civil aircraft industry with a request for consultations, followed by a request for a panel in July 1998. This panel also concluded that certain of Canada's measures were inconsistent with the SCM Agreement, but rejected Brazil's claim that the Canadian measures constituted an export subsidy. The DSB adopted both reports in August 1999. In both cases the complainants perceived that the losing party did not comply with the rulings and requested the DSB to reconvene the original panels to assess implementation.

The panel on Brazil found it had not complied. Canada requested authorization to retaliate on C$700 million of imports from Brazil. This reflected Canada's calculation of the value of the subsidy granted to Embraer. Canada noted that the damage to its industry was C$4.7 billion, but that it did not seek to use this as the basis of countermeasures. Indeed, both parties agreed that retaliation should be based on the amount of the subsidy, not damage incurred, a practice that has been followed subsequently. Brazil argued that C$700 million was a gross overestimate of the effective magnitude of the subsidy, which in its view should be based on the lost sales by Canada (number of aircraft) multiplied by the per unit (illegal) subsidy on each of these sales. Although the arbitrators rejected this argument, they concluded that the amount of the subsidy and thus the level of authorized countermeasures was C$344 million (WT/DS46/ARB).

In January 2001, Brazil brought another case, *Canada—Aircraft Credits and Guarantees* (WT/DS222), claiming that Canada was providing export credits and loan guarantees to support exports of aircraft and that these were illegal export subsidies. The panel rejected some of Brazil's claims but upheld the argument that financing provided to a number of airlines buying Canadian aircraft constituted prohibited export subsidies. In May 2002, on the grounds that Canada had failed to implement the recommendations of the DSB within the 90-day time period allocated, Brazil requested authorization to retaliate for an amount of US$3.36 billion. Canada objected to this, the DSB referred the matter to arbitration (under Article 22.6 DSU and Article 4.10 SCM), and the arbitrator determined that Brazil could suspend concessions equal to US$247.8 million. A noteworthy feature of the award was that although it was less than one-tenth of what Brazil had requested, it was 20 per cent higher than the amount of the subsidy calculated by the arbitrator. This was motivated on the basis that a punitive adjustment was justified by Canada's repeated assertions that it would not comply with the panel ruling. This was the first, and to date only, instance of punitive damages awarded in a WTO dispute (Mavroidis, 2007).

These bilateral tit-for-tat cases illustrate a phenomenon that was often hypothesized to exist by observers during the GATT years and used to explain the limited number of subsidy disputes—governments are wary of bringing cases because they worry about retaliation. This has been called the 'glass house' effect—if people live in glass houses, they will be concerned about throwing the first stone. As many governments engage in subsidy practices of one kind or another, the glass house effect can be quite strong. The Brazil–Canada disputes illustrate that it may not be a good idea to throw stones if you are living in a glass house! They also illustrate that if the parties to a dispute of this type do not use the WTO process as a way to negotiate a MAS, the outcome can easily be worse than the status quo ante.

This observation also applies to a follow-on case. In 2004, following the termination of a 1992 agreement with the EU on trade in large civil aircraft, the US brought a dispute against EU subsidization of Airbus Industrie—the immediate trigger being the provision of large-scale launch aid for the A380 double-decker jumbo jet. The EU immediately retaliated by bringing its own complaint against the US, alleging major indirect subsidization of Boeing through military contracts, as well as other forms of illegal support. The conflict between the two sides is discussed further in Chapter 11 in the context of the plurilateral Agreement on Trade in Civil Aircraft. This dispute is an example of a case that is both extremely complex factually and politically very sensitive, and that will most probably have to be resolved bilaterally—ideally through agreement that involves more specific disciplines on the future use of subsidies.

As noted earlier, tax systems often result in de facto subsidies. This was illustrated in a case brought by the EU against the US tax treatment of so-called Foreign Sales Corporations (FSC) in late 1997 (WT/DS108). Under the FSC system, any US firm whose exports have at least 50 per cent US content can set up a FSC, a shell company that is established in a tax haven. More than 90 per cent of FSCs are located in the Virgin Islands, Barbados and Guam (*Financial Times*, 25 February 2000: 7). The US firm 'sells' its exports to the FSC, which then 'exports' them, 'subcontracting' the actual transactions involved back to the US company. Up to 65 per cent of the FSC's profits are exempt from US tax, reducing the US firm's tax burden by anywhere from 15 to 30 per cent (ibid.).

The EU argued that provisions of the US tax code violated the SCM Agreement, as they were conditional on exports. In October 1999 a panel found that the FSC scheme was a prohibited subsidy. On appeal, the AB supported the findings of the panel, and rejected arguments by the US that the FSC was permitted under a 1981 understanding that related to a 1976 GATT dispute concerning the forerunner of the FSC, the so-called Domestic International Sales Corporation (DISC) provisions of the pre-1984 US tax code. The DISC allowed US firms to defer taxes on export income. The FSC was adopted in 1984 because the DISC had been found to be inconsistent with GATT subsidy rules. The FSC case was particularly noteworthy because it involved huge sums of money (some US$4 billion in revenue foregone by

the US Treasury) and required the US to revise its legislation. The US indicated it would do so and in late 2000 passed the FSC Repeal and Extraterritorial Income Exclusion Act.

In 2001, a compliance panel report concluded that the amended FSC legislation still constituted a prohibited subsidy (violated Article 3 SCM). Arbitration then determined that the EU was permitted to retaliate in the amount of US$4 billion. The EU proceeded to do so in a staggered fashion: it initially imposed an additional duty of 5 per cent on 1,608 US products, which was to rise automatically by one percentage point each month until it reached a ceiling of 17 per cent in March 2005.[13] In 2004 the US made another effort to bring its legislation in compliance by passing the American Jumpstart Our Business Strength (JOBS) Creation Act. The JOBS Act repealed the existing legislation with a complex set of tax provisions and exemptions that were aimed at assisting US-based manufacturing enterprises. The JOBS Act overall was expected to reduce federal tax revenues by approximately $8.5 billion over ten years—in other words it would result in US industry obtaining more in the way of support than the amount of the export subsidy determined by the arbitrator (Atkins, 2005). Thus, the no doubt unintended consequence of bringing the case was that overall US firms now get more 'assistance' (pay less tax), although this is no longer conditional on exports. In 2005 the EU asked for another Article 21:5 compliance panel, which again found that the US was not in compliance, largely as a result of certain transitional arrangements that were included in the legislation.

As in the Brazil–Canada aircraft disputes, after the EU brought the FSC case, the US retaliated by claiming that EU member states had very similar provisions in their tax codes, and brought cases against Belgium, France, Greece, Ireland and the Netherlands (it had done the same in the GATT-1947 era DISC case—see GATT 1994*b*). In each instance the US held that the income tax laws of these countries granted de facto export subsidies. The US claimed that France allowed firms to deduct certain start-up expenses of its foreign operations through a tax-deductible reserve account, Ireland granted certain trading entities special tax rates on income from export sales, Greece gave exporters special annual tax deductions calculated as a percentage of export income, the Netherlands allowed exporters to establish a special fund for export income, and Belgium granted corporations an index-linked income tax exemption for recruitment of export managers.

[13] Product categories affected included precious stones and metals, articles of jewellery, agricultural products (e.g. soybeans, linseed, sunflower seed, orange juice, horse meat), wood products, toys, sporting equipment, board games, textile and apparel products, refrigeration equipment, heavy machinery (engines, boilers, refrigerators), construction equipment and paper products. The choice of these products was based on two criteria: dependency on the US as a source was low (accounting for no more than 20 per cent of total EU imports), and the EU is an exporter of the items concerned (EU Delegation to the USA, Press Release 32/04, 2004).

A final noteworthy subsidy case concerned a 1998 US complaint regarding Australian subsidies granted to producers and exporters of automotive leather. These involved preferential government loans on noncommercial terms and grants. The panel found that the government loan to the firm was not a subsidy contingent upon export performance, but that the payments under the grant contract were illegal export subsidies, and should be withdrawn within 90 days. The report was adopted in June 1999. In September 1999, Australia informed the DSB that it had implemented the panel recommendations. The US contested this and requested that the original panel be reconvened. The parties reached an agreement that Australia would not raise any procedural objection to the reestablishment of the panel, and that the US would not request authorization to retaliate. This agreement was inspired by what had happened in *Bananas* (see Chapter 3). In January 2000, the review panel determined that Australia had failed to withdraw the prohibited subsidies within 90 days, and thus was not in compliance with the recommendations made by the DSB. The panel recommended not only that Australia cease applying this measure, but also that the beneficiary of the subsidy be required to reimburse the funds (the case involved about US$19 million). This was a first in the history of the WTO (although a number of unadopted panel reports had recommended reimbursement of illegal antidumping duties under GATT 1947—see Palmeter and Mavroidis, 2004). However, as discussed in Chapter 3, this has never been repeated.

5.6. State Trading Enterprises

State trading has been poorly attended to in the history of GATT, in part because it was considered a relatively minor aspect of policy among the original signatories of the GATT. It was also most prevalent in agriculture and services—sectors that remained largely outside the purview of multilateral discipline until the Uruguay Round. General Agreement on Tariffs and Trade provisions establishing rules of behaviour for state-trading enterprises (STEs) therefore played only a minor role. This situation changed with the introduction of services into the WTO, the prospective accession to the WTO of many economies in transition, and the conclusion of the Agreement on Agriculture. The prominence of state trading as a policy issue consequently increased. State trading also became a higher profile issue with the emergence of competition policy as a subject of discussion. In effect, state trading is part of a much bigger complex of policy questions to do with the conditions of competition in markets.

There are numerous reasons why governments might be concerned about the existence and behaviour of STEs when negotiating commitments to liberalize