

Module 3.

WTO Agreements and Rules on Trade in Goods: Analyzing Subsidies and Domestic Support

ECN 330

Analyzing Economic Integration and Multilateral Trade Liberalization

1. Subsidies and Domestic Support: Trade in Goods

1.1. Multilateral treatment of subsidies prior to UR-GATT

1.2. Subsidies under the GATT structure with the WTO

Basic principles	Goods	Services	Intellectual property	Trade disputes
Additional details	GATT	GATS	TRIPS	DSM
Specific sectors or issues	Agreements and Annexes			
Market access commitments	Subsidies and countervailing measures; Agriculture		Telecom Financial Transportation	
	Schedule of Commitments		Example of schedules: agri-cultural support	Limitations on market access, national treatment
Country-specific requirements				

Glossary of abbreviations

- AD – anti-dumping duties
- AMS – aggregate measure of support
- ACS – change in consumer surplus
- CSE – consumer subsidy equivalent
- CVM – countervailing measures
- AD – change in demand
- DS – domestic support
- DSM – dispute settlement mechanism
- DWL – dead-weight loss
- ED – excess demand, import demand
- ES – excess supply, export subsidy
- AED – change in excess demand
- GATS – general agreement on trade in services
- GATT – general agreement on trade and tariffs
- Eqbm – equilibrium
- MA – market access
- MFN – most favoured nation
- MSB – marginal social benefit
- MSC – marginal social cost
- P_B – border price
- P_D – domestic price
- P_W – world price
- PS – producer surplus
- APS – change in producer surplus
- PSE – producer subsidy equivalent
- Q – quantity
- Q_D – quantity demanded
- Q_M – quantity imported
- Q_S – quantity supplied
- Q_T – quantity traded
- Q_X – quantity exported
- S – supply
- ΔS – change in supply

Subsidies and Domestic Support, continued . . .

1.3. Subsidies and the basic WTO principles

- ✘ MFN
- ✘ National treatment
- ✘ Predictability
- ✘ Transparency
- ✘ Reciprocity
- ✘ Safeguards and exemptions

2. WTO Rules Governing Subsidies

2.1 Motive: MA restrictions versus subsidies

- ✱ MA restrictions have a tax-subsidy equivalent
- ✱ Tax-subsidy scheme as an alternative to MA restriction
 - ① tax-subsidy schemes can be desirable forms of intervention to overcome specific domestic economic problems;
 - ② tax-subsidy schemes are more transparent/direct than trade policy
- ✱ WTO rules: find a balance between minimum standards for subsidies (i.e., not distorting trade) and use of measures by importers to protect markets

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WTO Rules Governing Subsidies, continued ...

✱ Example of a subsidy dispute

- ◆ "The *US Foreign Sales Corporation Act* allows major exporters to shelter some overseas earnings from tax by funneling sales through offshore shell companies ..."
- ◆ "A WTO judgment ... Found that billions of dollars' worth of special tax breaks offered to *Microsoft Corp.*, *Boeing Co.*, and hundreds of other US exporters amounted to an illegal subsidy that discriminates in favor of US products."
- ◆ EU officials ... That the *US* has the responsibility of bringing its tax regime into line with world trade rules."
- ◆ "EU claims ... \$4-5 billion in damages."

Washington Post, 21 Aug 2001

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WTO Rules Governing Subsidies, continued ...

2.2 WTO definition of a subsidy

✱ Legal aspects of the definition: 3 elements

- ◆ Financial contribution
- ◆ Public body
- ◆ Confers a benefit

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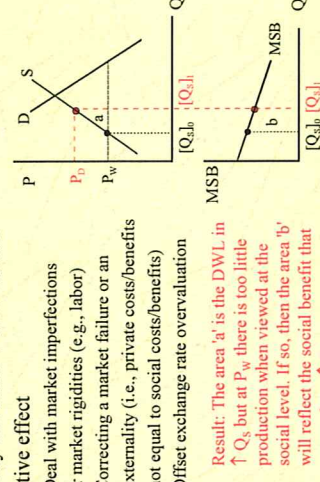
WTO Rules Governing Subsidies, continued ...

✱ Definition of a subsidy: economic aspects

- ◆ Subsidy can either ↑ or ↓ welfare

◆ Positive effect

- Deal with market imperfections or market rigidities (e.g., labor)
- Correcting a market failure or an externality (i.e., private costs/benefits not equal to social costs/benefits)
- Offset exchange rate overvaluation



Result: The area 'a' is the DWL in ↑ Q_s but at P_w there is too little production when viewed at the social level. If so, then the area 'b' will reflect the social benefit that comes from ↑ Q_s .

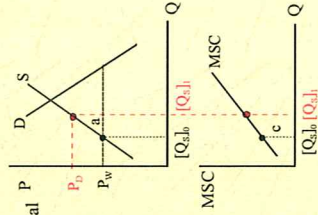
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WTO Rules Governing Subsidies, continued . . .

♦ Negative effect

- Distort allocation of resources within an economy
- Cost is greater than the benefit
- Increase welfare at the expense of a rival

Result: The area 'a' is the DWL from the $\uparrow Q_s$ because of a resource misallocation. The $\uparrow Q_s$, when viewed at the social level (e.g., including the environment), then the area 'c' will reflect the social cost of the environmental degradation that comes with $\uparrow Q_s$.



✖ Defining a subsidy: specificity

WTO Rules Governing Subsidies, continued . . .

2.3. Objectives of a subsidy

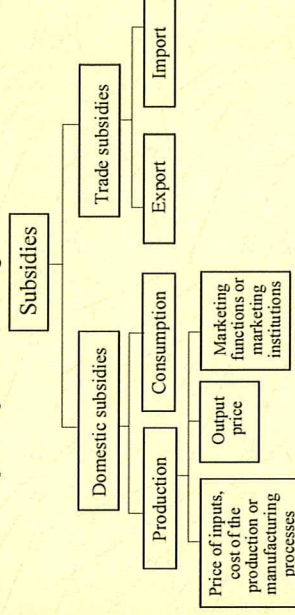
- ✖ Support production, processing, or manufacturing
- ✖ Support price, income, or revenue of producers
- ✖ Improve domestic or international market shares
- ✖ Promote input use, reduce unemployment
- ✖ Target level of consumption
- ✖ Target level of trade; promote and/or facilitate trade
- ✖ Improve long-term competitiveness
- ✖ Import substitution or decrease trade reliance
- ✖ Other social objective: environment, security, assistance
- ✖ Response to some other policy or other firm's behavior

WTO Rules Governing Subsidies, continued . . .

2.4. Types of subsidies

✖ Domestic versus trade subsidies

- ♦ On production, consumption or marketing
- ♦ On export, import or marketing



WTO Rules Governing Subsidies, continued . . .

2.5. Categories of subsidies

✖ Industrial goods

- ♦ **Red light**
 - Prohibited and actionable
 - Cause *adverse effects*:
 - ♦ "Injury to domestic industry"
 - ♦ "Serious prejudice"
 - ♦ "Nullification + impairment of benefits"
- ♦ **Amber light/box** – no longer a category
- ♦ **Green light/box**
 - Non-actionable
 - ♦ No adverse effects
 - ♦ Neutral in economic terms
 - Agricultural subsidies negotiated

WTO Rules Governing Subsidies, continued . . .

- ✧ Agricultural subsidies
 - ✧ Green light/box
 - ✧ Amber light/box
 - ✧ Blue box
 - ✧ Export subsidies

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Economics of a Subsidy, continued . . .

- ✧ Subsidy on input price: small, net importing country

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3. Economics of a Subsidy and Domestic Support

3.1. Economic effects of a production subsidy

- ✧ Effect of a production subsidy: specific or *ad valorem*

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Economics of a Subsidy, continued . . .

3.2. Economic effects of a price support

- ✧ Subsidy on output price, small country
 - ✧ Complementarity of price support and MA restrictions

Case 1. By exporter

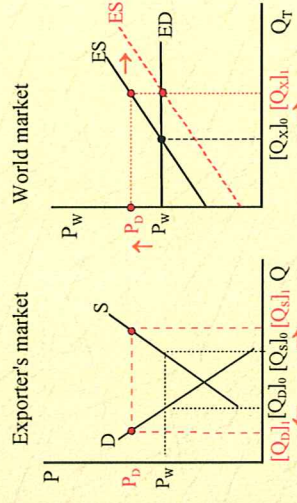
Case 2. By importer

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Economics of a Subsidy, continued ...

3.3. Economics of an export subsidy

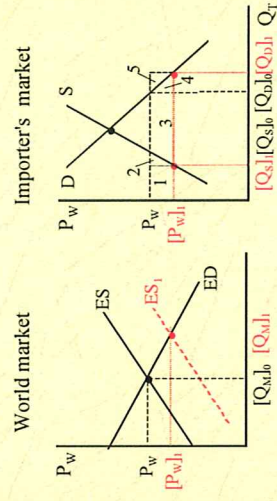
- ✱ Export subsidy, small country exporter
- ♦ Symmetry between export subsidy and price support



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Economics of a Subsidy, continued ...

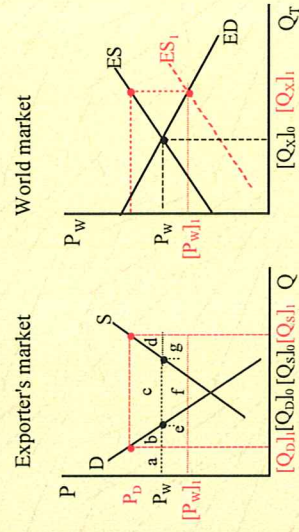
- ✱ Effects of an export subsidy on importer
- ♦ Trade and welfare effects



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Economics of a Subsidy, continued ...

- ✱ Export subsidy, large country
- ♦ Effect on prices and domestic market
- ♦ Trade and welfare effects



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