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Perspectives on Countervailing Duties

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PERSPECTIVES ON COUNTERVAILING DUTIES

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INTRODUCTION

The article by Professor Richard Diamond entitled "A Search for Economic and Financial Principles in the Administration of U.S. Countervailing Duty Law," is an intriguing presentation of certain economic principles applied to an area of international and national law that desperately needs such analysis. The subsidy rules of the General Agreement on Tariffs and Trade (GATT) system could substantially undermine the post-World War II Bretton Woods System as it applies to trade, unless these rules are refined and disciplined by current or future international trade negotiations. An expansive interpretation of subsidy and countervailing duty rules could result in the application of countervailing duties to almost any imported product. If this were to occur, the forty-year effort to liberalize border trade barriers could be largely nullified.

Thus far, the United States is the most extensive user of countervailing duties. Few other governments have applied countervailing duties, and have done so only in rare cases. Nevertheless, there is a fear that these other governments may follow the lead of the United States. In fact, it is thought, they may utilize principles of United States law and thereby not only disrupt trade, but disrupt exports from the United States. As a result, an attempt to develop a more rational international discipline for the use of countervailing duties, and for subsidized trade, became a priority item at the September 1986 GATT Ministerial meeting held at Punta del Este, Uruguay, which launched the GATT Uruguay Round of trade negotiations.

The article by Professor Diamond is one of relatively few attempts to rigorously apply the principles of economics to the law of countervailing duties and subsidies and thus is a substantial contribution to the literature. It is my role to comment on that article, with some emphasis on GATT and the Uruguay Round.

This comment primarily reflects its author's reactions to the principal article. However, to some extent it also addresses a 1989 work by the principal author,[1] and a paper by Goetz, Granet and Schwartz[2], to which Professor Diamond's 1989 paper replies. While this comment will raise some fundamental objections to the central thesis of the article, it also demonstrates an admiration for the analysis undertaken. That analysis, perhaps modified, can substantially contribute to the national and international debate on this subject.

The first issue this comment will discuss is the reasons underlying or justifying a nation's response to subsidized imports. It is important to explore that issue because, at least in theory, one possible response would be to do nothing except, as some economists have said, "send a thank you note."[3] In exploring why there should be a response to subsidized imports, we can begin to appreciate what some of the policy goals of the response system could be. These goals would shape the economic and other rules for disciplining that system.

A second problem that must be explored further, is whether or not the analysis of the author is "administrable." Although commendable in theoretical terms, the analysis may require a level of expertise and immunity from political or bureaucratic forces that is unattainable in the real world. The principal author's approach appears to require sophisticated economic analysis, and provides few of the clear, bright lines and categories that make a system administrable. On the other hand, the analysis might well provide a basis for evaluating certain bright lines, existing or proposed. This would be a considerable contribution.

In discussing this last point, this comment will briefly survey the current GATT system and suggest ways in which the principal author's analysis fits into the system. (As used in this comment, the phrase "GATT system" refers not only to the international treaties, including the GATT and the 1979 Subsidies Code of the Tokyo Round, but also to national legal systems that apply to subsidized imports, namely the countervailing duty laws of national systems.) The attached Appendix lists a number of practices that have been, or could be considered, subsidies. These demonstrate some of the conceptual problems of administering the current GATT system. Finally, this paper outlines several specific principles relating to the countervailing duty subsidy system, and discusses those in the light of the principal article and the previous parts of this comment.

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1. Diamond, *Economic Foundations of Countervailing Duty Law*, 29 VA. J. INT'L L. 767 (1989).

2. Goetz, Granet & Schwartz, *The Meaning of 'Subsidy' and 'Injury' in the Countervailing Duty Law*, 6 INT'L REV. L. & ECON. 17 (1986).

3. *See, e.g.*, Sykes, *Second-Best Countervailing Duty Policy: A Critique of the Entitlement Approach*, 21 LAW & POL'Y INT'L BUS. 699 (1990); Trebilcock, *Is the Game Worth the Candle?* 21 LAW & POL'Y INT'L BUS. 723 (1990).

The Policy Objectives of the GATT System Concerning Subsidized Products in International Trade

Professor Diamond refers to tension between a distortion deterrent model and an entitlement model.[4] Application of the entitlement model would lead to the use of countervailing duties to neutralize the effects in the importing market of the subsidies in the exporting market—an elaborate fine tuning. This author does not agree, however, that the entitlement model is necessarily the best one, or for that matter that it is always necessary to choose between models. In fact, the international community appears to have adopted the rationale that primarily supports a deterrent to distortion,[5] even though specific treaty language may be ambiguous in that regard. Experiences in the agricultural sector strongly suggest to governments the need to deter and inhibit the use of subsidies that affect international trade.[6]

Furthermore, a focus solely on Congressional intent behind the U.S. statutes is only partially adequate or revealing. Both the legislative history and the statutory language are often ambiguous. On the one hand, the reasonably clear legislative history for the 1979 Trade Agreements Act[7] (which established the current countervailing duty statute) indicates that Congress intended the Act to satisfy U.S. obligations arising from the Tokyo Round agreements.[8] On the other hand, references to the earlier countervailing duty statute and definitions could lead to contrary implications, particularly if one believes that the earlier statute was merely protectionist.

4. *See* Diamond, *A Search for Economic and Financial Principles in the Administration of U.S. Countervailing Duty Law*, 21 Law & Pol'y Int'l Bus. 507 (1990).

5. The 1979 Subsidies Code includes language "*[r]ecognizing* also that subsidies may have harmful effects on trade and production . . . ." Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade, *done* Apr. 12, 1979, 31 U.S.T. 513, 518, T.I.A.S. No. 9619, at 1, 1186 U.N.T.S. 204, 204 [hereinafter GATT Subsidies Code]. *See also* Rivers & Greenwald, *The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences*, 11 Law & Pol'y Int'l Bus. 1447, 1448-49 (1979); Baldwin, *Nontariff Distortions of International Trade*, in 1 United States International Economic Policy in an Interdependent World: Compendium of Papers 641, 646-47 (1971); H.R. Rep. No. 317, 96th Cong., 1st Sess., at 8 (1979).

6. *See* Winglee, *Agricultural Trade Policies of Industrial Countries*, Fin. & Dev., Mar. 1989, at 9; *The True Costs of Farm Support: Canada's Shame*, Economist, Mar. 31, 1990, at 67; *USDA Undersecretary: Export Bonus a Success*, J. Com., Aug. 1, 1989, at 7A; Boaden, *Abolish Farm Export Subsidy*, J. Com., July 20, 1989, at 8A.

7. 19 U.S.C. § 2501 (1982).

8. *See* J. Jackson, J. Louis & M. Matsushita, Implementing the Tokyo Round: National Constitutions and International Economic Rules 167 (1984) [hereinafter Implementing the Tokyo Round].

Fundamentally, however, it is necessary to ask, before endorsing an entitlement model, why should there be any entitlement? What gives a U.S. industry sector the right to demand that its government offset or neutralize the effects of foreign subsidies on its business? Professor Diamond's answer refers generally to unfair actions, but does not explain why subsidies are unfair.

This author has previously considered the question of the policy underpinnings of countervailing duties and international subsidies rules.[9] What follows is a brief review of part of that discussion, starting with the question of why the GATT system should provide for any sort of response to the international trade of subsidized products.

Many have argued that subsidized imports represent a benefit to the importing country, which substantially exceeds the potential detriments (on a welfare basis), and thus that the best response would be a "thank you note" sent to the subsidizing government that exported the goods. Further, it has been argued that levying a countervailing duty in response to such a subsidy would have the same welfare damaging effects as any tariff. These arguments, however, seem inadequate. Since economists demonstrate persuasively that subsidies can have a considerable distorting effect, it seems clear from a global perspective that many subsidies in international trade reduce overall world welfare.

On the other hand, it can be argued that the principal welfare reduction occurs in the economy of the subsidizing government, and that, therefore, no retaliatory or recompensating response need be levied by the importing countries. This argument also is inadequate. There are a number of market and political factors which illustrate why governments may choose to respond. The unfettered use of subsidies in international trade can lead to counter-subsidies, and counter-counter-subsidies in an escalating progression, all of which can seriously damage world welfare. This has already been demonstrated in the agricultural sector. In some cases, the countries whose welfare is damaged can ill afford the costs. Thus, it can be argued there is a reason for the international system to intervene and in some way try to inhibit the use of subsidies generally. Game theorists, such as Robert Axelrod, would suggest that a "tit for tat" policy of countermeasures can have desirable effects in circumstances such as these.[10]

9. J. Jackson, The World Trading System: Law and Policy of International Economic Relations (1989).

10. *See* R. Axelrod, The Evolution of Cooperation 27 (1984).

The GATT system provides two approaches for disciplining subsidies in international trade. The first, embodied in GATT Article VI[11] and in Track I of the 1979 Code,[12] is to permit countervailing duties by national governments. The second, contained in GATT Article XVI[13] and in Track II of the Code,[14] is to provide substantive international law rules that prohibit certain kinds of government subsidies. Perhaps in a perfect world, only the second of these measures would be used, and countervailing duties would never be permitted because they can substantially distort the welfare in the importing country. International rules, however, often do not work satisfactorily.

Thus, an argument can be made for a fall-back or second best approach which would allow governments to utilize countervailing duties, in the general hope that the use of such countervailing duties will in the long run tend to discourage the use of subsidies, or at least those that affect internationally traded goods. This approach can be countenanced even though the motives of governments in applying countervailing duties are really not to maximize world welfare, but are instead to maximize the welfare of the producers who constitute important political constituencies within the country. Nevertheless, if the use of countervailing duties also has a beneficial effect on world welfare, then arguably such countervailing duties should be permitted.

This conclusion, of course, avoids the empirical question concerning whether or not countervailing duties do in fact tend to discourage the use of subsidies. A cursory study, primarily based on anecdotal evidence and some direct observations and discussions with officials, suggests that the use of countervailing duties by the United States has had some effect in discouraging the use of subsidies. Indeed, at the conference at which the articles contained in this publication were presented, private and government practitioners noted the decreasing frequency of complaints about foreign subsidies. Perhaps U.S. countervailing duty actions have already had some impact.[15]

11. General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, art. VI, 61 Stat. A3, A23, T.I.A.S. No. 1700, 55 U.N.T.S. 187, 212 [hereinafter GATT].

12. GATT Subsidies Code, *supra* note 5, 31 U.S.T. at 523, T.I.A.S. No. 9619, at 6, 1186 U.N.T.S. at 212.

13. GATT, *supra* note 11, art. XVI, 61 Stat. at A51, T.I.A.S. No. 1700, 55 U.N.T.S. at 250.

14. GATT Subsidies Code, *supra* note 5, 31 U.S.T. at 530, T.I.A.S. No. 9619, at 13, 1186 U.N.T.S. at 220.

15. The author has had personal discussions with foreign government officials who are planning to change their government subsidy programs due to pressures from exposure to U.S. countervailing duty actions.

It is important to note, however, that only large countries are able to use countervailing duties to create such an impact. Small countries will generally be unable to use countervailing duties to change foreign governmental activity. Thus, there is an important asymmetry in the use of countervailing duties by the United States or other large countries. This may explain part of Canada's frustration with the GATT subsidies system.

There are several other policy arguments which support some sort of a GATT system response to subsidization.[16] A brief summary of these follows.

First, it has been argued that short term subsidies could have an "in and out adjustment cost," which could total more than the welfare benefit received from the subsidy. This is not likely. In addition, most subsidies tend to be much longer in duration (despite fiscal incentives of governments to get rid of them), so it would be unwise to rely too heavily on this argument.

A second argument is based on an analogy from antidumping law, namely "the risk of predation." Unlike antidumping law, where the predation argument would be based on the action of firms (dumping goods to achieve market share, and then capturing new monopoly rents), subsidy cases generally involve government action. It seems anomalous to argue that governments would engage in predatory trading activity with a view to capturing future monopoly rents.

On the other hand, it has been pointed out that governments so motivated are much more likely to succeed than individual firms, which would have difficulty policing a coalition of firms attempting to have such an impact. The governments are generally larger, and can influence more firms, and thus could predate. A government might want to predate for purposes of what is now commonly called targeting. That is, a government may want to encourage a certain industry sector to obtain a global market share so as to allow that sector in the future to obtain monopoly rents and thus increase the welfare of that government's society.

Again, whether or not this actually occurs is an empirical question that has been little studied. Furthermore, the declining cost curve, or "learning curve efficiency arguments," must be considered. If government subsidization merely enables industries to more quickly gain the economies of scale that allow them to continue to produce at considerably lower prices (and not necessarily to capture monopoly rents), perhaps the whole world benefits from such targeting.

16. IMPLEMENTING THE TOKYO ROUND, *supra* note 8, Chapter 11.

Finally, it has been argued that governments and societies should be able to choose their own economic systems, without undue interference from foreign countries. Subsidies on goods exported to other countries to some extent interfere with the importing society's choice of an economic system. Such subsidies add a layer of risk to entrepreneurial decisions in the importing society and create a sense of unfairness at having to compete with foreign finance ministries. In some cases, such subsidies could lead to political pressure directed towards causing the government in the importing country to institute counter-subsidies.

This argument probably best supports the entitlement approach offered by Professor Diamond. However, this argument can be seen as a rationalization on the basis of a purely protectionist impulse—urging a government to reduce competition for domestic producers so that they will benefit at the expense of domestic consumers and of producers abroad who do not vote.

There is an additional policy that should be mentioned, which lurks behind all discussions of unfair trade practices in international trade.[17] This is the concept of interface, which suggests that even relatively minor differences between economic systems can, at certain times in the business cycle, cause uneven distress between trading partners. This distress can have a considerable political impact when specific groups in an importing country feel that their distress is due to unfair burden-sharing in the world trading system.

There are certainly policy grounds for arguing that a mechanism, presumably an international interface mechanism, should help ameliorate these political forces. To some extent, this argument suggests that a safeguard policy underlies or should underlie what has traditionally been analyzed as an unfair trade matter. In other words, it suggests that the unfair trade laws, including countervailing duty laws, may be substituted for inadequate safeguards, institutions and policies, which have very little to do with a lack of fairness.

Having discussed the policy underpinnings of countervailing duty law, this comment now relates these policies to Professor Diamond's discussion in the principal article. If the policies outlined above constitute a plausible basis for the GATT system response to subsidies, it would seem to follow that the entitlement model is not fully supported. The policies outlined, it seems, tend to support the distortion model, and possibly a predation prevention model, and this latter model is related to targeting policies. Quite probably the policies are mixed—there are certain elements of all of the

17. *See id.* Chapter 10 (discussing the interface principle in relation to antidumping duties).

above policies reflected in the actual rules applied, or in the desires of negotiators to change those rules.

An important criticism of the distortion model made in the principal article is that the model fails to take into account externalities. This is a valuable contribution of the article. It does not follow from this, however, that the distortion model should be abandoned and the entitlement model preferred. Another approach would be to amend the distortion model to include measures designed to cope with externality problems—that is, to better tune the distortion model.

The GATT System for Subsidy/Countervailing Duty Actions

The GATT system, as it pertains to the subject matter of this comment, may be easily described in three parts. First, the GATT; second, the 1979 Subsidies Code from the Tokyo Round; and third, the current Uruguay Round Negotiations.

For at least one hundred years, international trade policy makers have felt that at least certain kinds of subsidies were inappropriate and unfair. As noted above, the international system has responded with two different mechanisms for dealing with such situations: 1) permitting national governments to offset the subsidy element in imported goods by using countervailing duties; and 2) providing international rules concerning the use of subsidies in international trade.

The original GATT Treaty document of 1947 contains both approaches.[18] Article VI of the GATT permitted the use of countervailing duties in the case of subsidized imports that caused material injury to the competing domestic industry. Article XVI in the original GATT contained a soft reporting requirement along with some admonitions concerning the use of subsidies in international trade. Basically, however, the original GATT had very little international rule discipline on the use of subsidies.

It was only in the 1955 amendment to GATT Article XVI, that the first substantive international obligation against the use of certain kinds of subsidies (export subsidies) was included in the GATT. Even then, as stated in the Article XVI amendments, the discipline was very meager. First, for technical, treaty-amending reasons, it only applied to the industrial countries which were signatories to the GATT, and not to the developing countries.[19] Second, its obligation related only to export subsidies.

18. *See* J. Jackson & W. Davey, Legal Problems of International Economic Relations 727-28 (1986).

19. Implementing the Tokyo Round, *supra* note 8, at 256.

Even in that case, certain technical clauses undercut the rigor of the obligation, particularly as to primary products.[20]

Thus, by the time of the Tokyo Round in 1973-1979, there was a strong desire, spearheaded by the U.S. government, to develop additional international rules to discipline the use of subsidies in international trade. This became a major priority for the Tokyo Round negotiation. The resulting 1979 Code follows the GATT two track system. It further regulates the use of countervailing duties, although it does not provide a definition of "subsidy." In the second track, it lays down more stringent international rules which prohibited the use of export subsidies on non-primary goods.[21]

The second track has a number of provisions useful for defining subsidy, including the important annex regarding export subsidies. However, some signatory countries believe that the definition of "subsidy" for Track II purposes, does not necessarily apply to Track I. Operating on that assumption, national governments applying countervailing duties have considerable discretionary scope for defining "subsidy"—a risk for international trade policy.

An important new development in Track II of the GATT 1979 Code is the provision of international rules on so-called "domestic subsidies." Article 11 of the Code discusses these. It notes that some subsidies are appropriate governmental measures, but that they can have damaging impacts on importing countries. Signatories are obligated to seek to avoid causing such effects through the use of subsidies.[22]

Track I of the Code (concerning countervailing duties) does not have elaborate provisions concerning the calculation of the subsidy, or appropriate amounts of countervailing duties. Article 4 of the Code does limit countervailing duties to the "amount of the subsidy found to exist, calculated in terms of subsidization per unit."[23] In addition, Article 4 states that "it is desirable that the imposition be permissive,"[24] and "that the duty be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry."[25] This lesser duty rule is not binding and U.S. law prevents its use in U.S. countervailing duty law.

20. *See* Rivers & Greenwald, *supra* note 5, at 1461.

21. GATT Subsidies Code, *supra* note 5, 31 U.S.T. at 531, T.I.A.S. No. 9619, at 14, 1186 U.N.T.S. at 222.

22. *Id.* 31 U.S.T. at 530, T.I.A.S. No. 9619, at 13, 1186 U.N.T.S. at 224.

23. *Id.* 31 U.S.T. at 523, T.I.A.S. No. 9619, at 6, 1186 U.N.T.S. at 212.

24. *Id.*

25. *Id.*

Additional language in Article 4 (of Track I) of the Code provides that material injury must be found "through the effects of the subsidy."[26] This causal relationship has been the subject of some controversy in GATT unfair trade negotiations for several decades, but no resolution has been reached. Professor Diamond's analysis might very well provide a means to flesh out the causal relationships required in the Code.

When the Uruguay Round of GATT negotiations was launched at Punta del Este in September 1986, the negotiators felt that a priority subject for the new negotiation was revision of the subsidies rules. This is partly because many of the rules contained in the 1979 Code are ambiguous. The ambiguities that exist are in part attributable to a lack of substantive agreement among the negotiators in the Tokyo Round. One of fourteen of the Uruguay Round negotiating groups on trade in products (a fifteenth concerns trade in services) is devoted to revision of the subsidies rules.

One idea this negotiating group is considering is the so-called "three basket," or "red-green-yellow light" approach. This approach was initially suggested during the Tokyo Round, but was blocked by some of the negotiating partners so that it did not become the basis for the 1979 Code. One basic idea of this approach is to try to specify, directly in the treaty, exactly which types of subsidies can result in countervailing duties, and which cannot.

A "green light" basket would list a series of subsidy practices which would always be permitted, and should not be grounds for countervailing duties. An example might include broad societal infrastructure activities, such as the building of schools and roads or the provisions of fire and police protection. A "red light" basket might include a list of subsidy practices that would either be forbidden under international law, and/or always subject to countervailing duties, perhaps even without the requirement of an injury test. Some suggest that export subsidies would fall into this category. In the field of antitrust law, the analogous provision would be a list of practices that would, as a per se rule, occasion antitrust liability.

The middle basket, the "yellow light" basket, would consist of all other subsidy practices. Here, the injury test would be important. Countervailing duties would be allowed in the cases where these types of subsidies occurred, provided that they were causally related to the material injury of the competing industry in the importing country. As of this writing, it is not clear how much the negotiations will be able to achieve.

26. *Id.* 31 U.S.T. at 524, T.I.A.S. No. 9619, at 7, 1186 U.N.T.S. at 212.

Professor Diamond's analysis provided in the principal article could be exceedingly useful in helping negotiators determine into which category certain subsidy practices would fall. On the other hand, it must be recognized that the results of the negotiations need to be administrable, with a minimum of administrative costs. Thus, the categories cannot be too finely tuned, or administration may become too difficult. The economic analysis of the principal article could be used to ascertain when certain broad categories of subsidies have, because of their effect on the marginal cost of the subsidy recipient, a causal relationship to material injury in the importing market. In addition, as discussed below, this analysis could reinforce the idea that unless a subsidy has some effect outside the subsidizing country, the GATT system should not allow countermeasures.

One way to test the analysis of the principal article is to determine how it might apply to different types of subsidies. Appendix A lists hypothetical subsidy situations useful for the purpose of testing some of the analysis.

Comments on Several Selected Problems and Applications

This comment will now address certain selected problems in applying countervailing duties. It will discuss Professor Diamond's approach in connection with these problems and in light of the principles outlined in the previous sections of this comment.

In international discussion, some nations have advocated a "cost to the government" approach rather than a "benefit to the recipient" approach in determining the existence of a subsidy. The Subsidy Code Annex is cited to argue that the cost approach is required by the international rules. However, if the model is largely a distortion model, then clearly the benefit to the recipient is the preferred approach. Assume a government pays eight percent for its borrowing. When it then lends at ten percent and the market charges twelve percent, a benefit has been received that distorts in the sense that it sends the wrong effiency oriented signals. In one sense, there is no cost to the government. However, if one presumes an opportunity cost approach, one can conclude otherwise. The principal article uses the term "cost" to describe the effect of the benefit received on the marginal cost of the firm. This seems to be consistent with the benefit approach of the terminology used in the international discussions.

General Approaches and Administrability

If the essential policy underlying countervailing duties is not confined to an entitlement theory, then the application of countervailing duties would differ from the rather fine-tuned neutralization goals of the principal article. For example, if deterring subsidies is the (or one of the) primary goals, then the system might not be so hesitant to apply countervailing duties that were larger than necessary to neutralize the impact of the subsidy. The same might be true of a safeguards policy.

On the other hand, if the primary or only goal is preventing predation or targeting, then a substantially different approach would be necessary. At least at the injury phase, attention would have to be given to many factors not later involved in countervailing actions, such as the structure of competition, intent, and the likelihood of future price increases to capture monopoly rents. Unfortunately the reality of the situation is likely to be one of mixed goals. Even if the GATT system does not wish to heavily sanction the use of subsidies, it may desire some sanctioning element, while focusing generally on neutralizing.

Even focusing on neutralization under an entitlement theory, it is interesting to consider whether or not the result in most cases would be much different than the current practice in the United States. Quite clearly, certain cases would be different—indeed in some cases, the principal article seems to suggest that no countervailing duty should result, whereas the current practice requires them. But in a number of other cases, the working through of the difficult economics to ascertain the marginal cost effect might result in relatively minor differences in duties. Thus, the greatest utility of Professor Diamond's analysis might be in its attempts to define certain categories of cases that should be dismissed at the outset (for example, those which should incur zero countervailing duties). Certain regional aids may be the prime candidates. The participants at the conference at which the articles in this publication were presented entertained a wide variety of opinions on the administrative feasibility of the proposal.

The Lesser Duty Rule

The Subsidies Code recommends but does not require the "lesser duty rule." The Europeans use this rule in administering their anti-dumping actions, and also in countervailing duty cases to the extent that they have had them. Their approach is to apply a duty that somehow is deemed to eliminate the injury. Professor Diamond's analysis would seem to confirm this approach, but it may not be identical to it. In fact, the lesser duty rule as used by the European Economic Community (EEC) may actually result in still smaller duties than the neutralization goal of the principal analysis. Such a case might occur if, for example, a government decided to apply a countervailing duty that offset part of the subsidy but did not fully neutralize the subsidy's effect. If the importing market sector would make very large (unconscionable?) profits, but for the competition of subsidized imports, that government might decide to offset only part of the harm of the imports, having in mind that down-stream industries (one form of consumer) will be harmed by the countervailing duties.

Effect Across A Border

This author previously argued for a requirement in countervailing duty law that a subsidy be shown analytically to have some cross-border effect,[27] a principle which in one sense parallels Professor Diamond's analysis. Where such a showing is not made, the international community has little reason to take cognizance of the subsidy; it should not be actionable under my terminology. This is because if a sovereign nation for its own good reasons (for example, income redistribution, assistance to minorities, or promoting religion) wishes to take an action that lowers its own welfare, but does not affect other societies, that should be within the discretion of that nation's government. The regional aids case provides an important example.

Consider the following illustration. Suppose Italy wants a certain glass factory to be located in a depressed mountainous region. Suppose further that a private enterprise would also choose to invest in such a factory, but would locate it at a port. If the government granted a subsidy just sufficient to offset the added costs of the unpreferred location, arguably the only economy that suffers overall reduced welfare is Italy. It is unlikely there will be any effect on the amount or price of exports. In such a case, no countervailing duty should be applied by the foreign importing country. Under current U.S. law, however, the administration is required to countervail (unfortunately, by rather explicit Congressional mandate.)[28]

It can be argued that this type of issue should be handled at the injury phase of the case—that a showing be made that no injury is caused by the subsidy. But this assumes margins analysis[29] at the injury phase (which is currently uncertain), and also in any event imposes expensive process costs. Thus, it would be better to dismiss such cases at the outset, or perhaps in the preliminary injury phase. Categories of cases could be identified and outlined, enabling administrators to easily dispose of some cases.

Professor Diamond's analysis seems to strongly support this approach, phrasing it perhaps more eloquently. That analysis would presumably show in such cases that no effect occurred on the marginal cost of the firm, and thus no countervailing duty should be imposed. However, the

27. *See* IMPLEMENTING THE TOKYO ROUND, *supra* note 8, at 265.

28. *See* 19 U.S.C. § 1677(6) (1982) (defining "net subsidy").

29. "Margins analysis" refers to the argued need to link the injury not just to subsidized imports, but also to the margin of the subsidy.

analysis should focus on the marginal cost of the exports to the foreign market. The principal article touches on this, but might elaborate more.[30]

Professor Diamond's hypothetical case of a government subsidy offered to decommission a facility[31] fits into this line of reasoning. In fact, if Professor Diamond's thesis, as applied, did nothing more than achieve the result of avoiding countervailing duties in cases like these two hypotheticals, this would be a substantial contribution.

Specificity

One of the most significant limiting principles of U.S. countervailing duty law is the specificity or general availability test. This test has worked reasonably well in providing administrators with a relatively administrable rule for eliminating some cases, particularly those troublesome cases involving the general structure of society and its infrastructure, such as roads, schools, fire and police. If countervailing duties are not to apply to virtually every import, such a rule is very important. Unfortunately, the international rules in the Subsidies Code do not clearly mandate this principle, and a possible target for negotiators is to establish this rule in international law as well.

It is thus both interesting and important to explore how Professor Diamond's analysis might treat cases in comparison to how they are treated under the specificity test. In the alternative, one could explore how the analysis treats the road and school cases. The author of the principal article has stated that his work assumes the specificity test and only applies to cases of specific subsidies. However, his analysis could be used to help justify the specificity test or to assist in determining in which cases it would be appropriate to conclude that specificity did not exist.

Centrally Planned Economies

One of the most significant pending policy questions about countervailing duty law is its application to non-market economies (NME), centrally planned economies, or state trading countries. Currently, administrative decisions confirmed by appellate court decisions, have ruled that U.S. countervailing duty law does not to apply to such economies. The argument relied upon by the government is that it is usually impossible to ascertain what is a subsidy in such economies. One cannot measure the effect of government treatment in a market where no market exists.

30. *See* Diamond, *supra* note 4, at 537-39.

31. *Id.* at 542.

The current law exempting non-market economies from countervailing duty law is not likely to endure. The issue is certainly part of the negotiation for China's entry into the GATT, and will also be so with respect to the USSR's entry negotions. Various proposals include an import benchmark price derived from market economy imports, which will serve to flag NME imports which are priced too low.

Professor Diamond's analysis apparently does not address this case. The paper discusses the cases, but only to glean evidence that the government does not employ the distortion model as a policy. The principal analysis seems to depend on the existence of the market contrafactual to measure the subsidy that is the start of the analysis. It is speculative, at this point, whether the surrogate country technique is to be used, as it is in dumping cases, to construct a fictional market as the contrafactual in the NME cases.

Net Subsidy Idea

There has been some international discussion both in the GATT and in the context of the US-Canada Free Trade Agreement, concerning the net subsidy idea. Under this idea, a countervailing duty could be imposed on imports only to the extent that the exporting country's subsidies exceed the subsidies of the competing product by the importing country. Under current application, the domestic industry has a tremendous advantage in competing against imports, by using the benefit of subsidies (for example, local tax forgiveness to locate a plant) to undersell imported prices. A subsidy practice abroad will give rise to a countervailing duty on imports into the United States even when the United States industry receives that same subsidy in the United States. Thus it is argued that true neutralization should be applied only to the difference between subsidies.

Once again, Professor Diamond's analysis does not seem to address this issue, although he might be sympathetic to this approach. This depends on how one defines and perceives the entitlement. If, for example, the entitlement is considered truly a protectionist right, it could be hostile to the net subsidy approach.

Export Subsidies

The international rules flatly prohibit export subsidies (as opposed to general or domestic subsidies) on industrial goods, and there is widespread consensus that export subsidies in particular are to be condemned and deterred. The argument is that such subsidies clearly indicate that a nation is attempting to distort trade or impose burdens (political and economic) on foreign societies. It has been argued that, in addition to the

international prohibition, countervailing duties should be allowed in such a case even without an injury test. At least one author has suggested that duties in such cases should be *required,* not just allowed.[32]

Under Professor Diamond's analysis, in most cases, the marginal cost affecting analysis would likely result in a countervailing duty, perhaps nearly equal the subsidy amount. It is unclear, however, whether this analysis would go so far as to support a per se rule in these cases.[33]

Conclusion

Professor Diamond's principal article offers some important insights and a mode of analysis that can help advance knowledge about the appropriate international response to subsidies that affect international trade. Nonetheless, it leaves many questions unanswered.

A policy analysis of this subject might more appropriately begin at a different starting point—inquiring as to the rationale for any response before considering what response is most effective. To this author, it seems clear that the "thank you note" approach (no response) is justified only with respect to the goal of national welfare, as opposed to world welfare. World experience, especially with respect to agricultural products (with the United States and the EEC in a virtual subsidy war) reinforces the need for this broader perspective. In fact, even many "thank you note" proponents recognize a need to address export subsidy problems, in contrast to domestic subsidies.

The argument in favor of countervailing duties, of course, is weakened by such economic analyses as those presented in the Sykes[34] and Trebilcock[35] papers, which show that countervailing duties have the welfare limiting effects of any tariff. This leads some to emphasize a system of international rules as a way to control the world welfare damage of subsidies. It is interesting to note, for example, that in the current trade negotiations of the Uruguay Round, some proposals concerning services trade do not suggest countervailing duties, but do provide for international rules to discipline subsidies. Indeed, in some instances the international rule may be the only way to proceed. Such is the case when the goods are targeted to so-called third markets—neither the market of the subsidizing country nor the country complaining about subsidies.

32. Barceló, *Subsidies and Countervailing Duties—Analysis and a Proposal,* 9 LAW & POL'Y INT'L BUS. 779, 794 (1977).

33. *See generally* Diamond, *supra* note 4, at 554-56.

34. *See* Sykes, *supra* note 3.

35. *See* Trebilcock, *supra* note 3

Some feel, however, that a system of international rules is still a "second best" solution. There is much skepticism that the international rules can work adequately to achieve the discipline needed. Thus, countervailing duties and the various methods for measuring and applying them remain the primary subject of debate. Even though these duties may themselves cause welfare harms, future empirical exploration may indicate that they are effective, in the long term, in reducing the use of distorting subsidies. Many persons engaged in the study of subsidies and countervailing duties are of the opinion that such duties do influence governments to limit subsidies. It must be recognized, however, that the opportunity to make effective use of countervailing duties is not evenly spread among nations—countervailing duties utilized by a small market will not have much effect on large markets. Likewise, it must be recognized that pressures for more extensive use of countervailing duties normally come from competing producers in the importing country.

Nevertheless, as this author has stated elsewhere, if one believes that the world would be better off if there were a general reduction of the use by governments of subsidies relating to products that flow in international trade, one could argue that the U.S. policies, motivated for entirely different reasons, may fortuitously or coincidentally be having a salutary effect on the world economy.[36]

If we reluctantly accept the usefulness of countervailing duties, and that appears to be a political certainty, then the question of how to prevent the abuse of such duties arises. That is the subject of Professor Diamond's article. However, it is questionable whether the entitlement model is the optimal basis upon which to build such an analysis. Doing so may only facilitate the protectionist or competition-limiting goals of competing domestic producers. Furthermore, the legislative history of the relevant statutes only provides limited insight into this issue.

Despite all this, however, the analysis targeting the marginal cost effects of subsidies is a worthwhile contribution. While it does not adequately contribute to several important subsidy policy questions (for example, the specificity test, or the problem of non-market economies), it may provide a very useful way to help contain or discipline the unwarranted use of countervailing duties. It can help identify some large categories of subsidies for which countervailing duties would be inappropriate (for example, certain regional aids or subsidies to assist down-sizing or decommissioning), and could be used to analyze many of the subsidy-type practices listed in Appendix A. Furthermore, this analysis is potentially

36. IMPLEMENTING THE TOKYO ROUND, *supra* note 8, at 255.

very useful in relation to the evolution of the injury test and its related concept of cause.

It is this general policy analysis that hopefully will assist government officials and negotiators in the Uruguay Round, and contribute to a better understanding of the relevant issues. In the view of this author, this is more important than the marginal differences in duty that most likely would be calculated under the entitlement approach as compared with certain existing practices.

Appendix A

SUBSIDIES IN INTERNATIONAL TRADE

For each of the following situations, consider:
(a) whether you would view the government practice as a "subsidy"; and,
(b) whether you feel such practice is "unfair" when it benefits exports, so that an importing nation should impose an offsetting duty or other import restraint?

1. Government makes outright grant to a firm to assist its production of widgets.
2. Government makes outright grant to a firm for each widget it produces and exports.
3. Government makes outright grant to a firm which produces 12 or 15 different product lines, one of which is designed for export.
4. Government loans money to a firm which produces widgets for domestic and export sale, on the following terms:
   — government cost of borrowing is 8%, and
   — normal market cost of borrowing for comparable firm is 12%, and
   — government loan in this case is at 10%.
5. Government purchases shares (makes equity contribution) of firm producing widgets for domestic and export sale — purchase at market price, established by existing market in the shares.
6. Same, as in 5, except no market exists in those shares, so an appraised value is used:
   — based on book value, and
   — with no expectation of dividend for 10 or 20 years, and
   — knowing firm has business difficulties, and difficulty getting capital.
7. Widget firm goes bankrupt, writes off most debt, continues in business and produces widgets for domestic and export sale.
8. Government makes grants to widget firm for use in encouraging the retirement or relocation of unneeded workers.
9. Government makes grants to *workers* who lose their jobs from widget firm because of business contraction and improvement of machinery, thus saving potential legal or moral obligations of the firm.
10. Government makes grants to workers to retrain for new work in a different production; such workers (retrained) then are employed by gadget firm which produces for domestic and export sale.
11. Government adds funds to normal unemployment compensation programs, making it politically easier for a widget firm to lay off or retire workers.

12. Government builds a road (or port or rail facility) for exclusive use by widget firm, to encourage it to stay in business at its location.
13. Government builds such road/port/rail/airport for use by general public, knowing that heaviest use will be by the widget firm.
14. Government upgrades existing road/port/rail/airport facility for greater use by general public, knowing the widget firm will benefit the most.
15. Local government gives real estate and corporate income tax relief to a firm for a 10 year period to induce it to locate in the locale; firm produces widgets for domestic and export sale.
16. Government heavily supports local college/university programs in engineering related to widgets; local widget firm produces for domestic and export sale.
17. Government provides funds for special training of workers to be hired by the widget firm.
18. Same, except training is done by local technical high school.
19. Government makes special law setting a limit on product liability recovery of consumers or buyers of widgets, where:
    —widget firm produces only for export, or
    —widget firm produces for domestic and export sale.
20. Government, to promote science and technology, revises its patent and copyright laws (computer programs?) to better favor high tech industries.
21. Government does the same as in 20, but limits it just for computer chips.
22. Government relieves firms engaged in substantial export from some obligations to install pollution cleaning devices.
23. Government relieves industry sectors deemed "export oriented" from environmental control problems.
24. Government is generally lax as to environmental problems. (Brazil?)
25. Government has no minimum wage law (or workmen's compensation law, or OSHA work place safety law, etc.).
26. Government makes grant (or gives other advantages) to firm conditioned on its location in depressed area and grant can be shown to just offset added costs of the location.
27. Government gives grant or advantage to firm conditioned on other social policy action, such as hiring handicapped or minority workers.
28. Government subsidizes production of a basic resource or input commodity (such as coal), which is then sold to a firm (such as steel producer) which produces for domestic and export sale.
    — in one case, "downstream" firm purchases input for less than it would otherwise, and

— in another case, it can be shown that the buyer firm pays the same for the input product as it otherwise would, (but the "upstream" producer would go out of business without the government aid).

29. Government owns a natural resource (coal, oil, timber, copper) and sells this resource to domestic firms at a price lower than the world market price. These firms produce for domestic and export sales. The government either refuses to sell the same resources to foreign firms, or sells to them only at a higher price.
30. Government owns a natural resource, and forms a government owned company to exploit the resource and use it for making widgets which are then sold for domestic or export purposes.
31. Government owns a natural resource, and sells it to highest bidder among domestic firms (only), which in turn use the resource to produce goods for domestic and export sale. The price these firms can obtain on their markets is essentially the world market price for the finished goods, and this essentially determines the amount the firms can bid for the natural resource.
32. Government shapes its defense procurement contracts to enable a firm to invest in the needed R&D to develop a product, which then has spinoff products suitable for domestic and export sale. (computers?)
33. Government gives special income tax deductions and credits for firms producing for export.
34. The tax benefits are for all widget firms, but only widget firms, and this sector produces for both domestic and export sale.
35. The tax benefits are available to all firms, but are shaped as depreciation deductions on capital equipment, so effectively only capital-intensive industries benefit.
36. The government owns most or all of the industry; prices are set by bureaucrats (domestic or export prices). Prices on widgets are set low for both domestic and export sale.
37. The government owns a few selected industries, but included is the widget industry which produces for export and domestic sale, and

    —the government widget industry has never paid a dividend to the government since "nationalization." (The government compensated original owners.)

    —the government has continued to add capital to its wholly-owned widget industry.
38. The government provides many housing, medical, and other social benefits for workers in industry, and because of this firms find they can pay less for labor input into the widgets they produce for domestic and export sale.

39. In a particular society, retirement tends to be at an early age (such as 55) but benefits are not too handsome, so there is a large eager labor pool of persons which desire part-time work (up to a certain specified limit). Certain industries, (e.g. assembling certain computer components, or entering textual data at a keyboard) have discovered ways to take advantage of this type of part-time labor, which is paid much less than for other workers. These industries export as well as produce for the domestic market.
40. The government provides a more favorable rate of exchange for foreign currency which is earned from exports, rather than from other transactions.
41. Same, but black market rate is even more favorable for foreign currency no matter how earned.
42. In each case above, a competing nation finds some of its markets in third countries taken from its firms by the exports mentioned above. What should be its reaction?
43. Government has an anti-monopoly law, but is lax in applying it to a particular industry sector which has many exports.
44. Government has an anti-monopoly law, but is lax in applying it generally.
45. Government has no anti-monopoly law.
46. Government has an export tax generally, but exempts from that tax the export of widgets.
47. Government has an export tax on unfinished logs but none on finished lumber. (Similarly for soybeans & soymeal, or coffee beans & processed instant coffee).
48. Widget imports can be shown to have benefitted by foreign subsidies to the extent of just under 0.5%, or 0.1%, or 0.05%. The legal procedures of a countervailing duty case can be shown to cost the foreign exporter about 10% of its gross returns from widget exports to the countervailing country.
49. The World Bank has financed, at concessional interest rates, the development of a widget plant in a developing country which now exports widgets.
50. A government has good fire and police protection in its society, and thus insurance costs for the widget plant are exceptionally low.
51. In a floating exchange rate world, a government grants an income tax advantage at the same level to *all* exports.
52. A government has an exceptionally fine school and university system, and its industry benefits from a well-educated work-force.
53. Societal norms favor "worker tenure" and other paternalistic worker benefits, which for some industries including the widget industry seem

to greatly increase worker output and efficiency, reducing strikes and resistance to change.

54. A government has a domestic sales tax of 4%, charged on sales of goods to consumers. Goods can be exported without paying this tax (usually in wholesale quantities). It is noticed that the importing country can charge a sales tax there.
55. A government has a domestic VAT (value added tax), which taxes goods at each level of finishing (at about 20%). When goods are exported, whatever VAT has been paid is refunded to the exporter. Goods which are imported are levied a VAT (in addition to tariffs) at the same rate.
56. A government rebates to producer-exporters 25% of the income tax which has been paid by the exporting firm insofar as the income tax can be attributed to that portion of the business devoted to production of the goods which are exported.