CHAPTER 7

About Knowledge and Rulemaking: Reforming WTO Rules on Subsidies[1]

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Thirty years after they were negotiated, the legal standards determining what types of subsidies are prohibited or actionable leave much to be desired. There has been virtually no advance in knowledge of subsidy measures, their policy goals, and their effects, detracting from the proper application of extant disciplines and inhibiting informed discussion on law reform. Any law reform exercise should be preceded by a serious and transparent, open, and expert-based knowledge-gathering effort. Stakeholders should devote the effort needed in improving our knowledge on subsidy policies and their effects to create the necessary learning base to prepare negotiations before diplomacy and politics kick in.

1. BACKGROUND

Subsidies are critical instruments that national governments widely apply to achieve a variety of policy goals. At the same time, subsidies may cause across-the-border spillovers, thus justifying some form of international control. Since, however, the attitude towards subsidisation has been very different (and at times contradictory) across nations and time, the regulation of subsidies has always represented a particularly difficult topic.

World Trade Organization (WTO) subsidy disciplines still represent the most comprehensive package of rules at the multilateral level. The Agreement on Subsidies and Countervailing Measures (SCM Agreement) includes the general disciplines regulating the obligations of members when granting subsidies and when imposing countervailing measures. Subsidies in the agricultural sector are specifically (but not exclusively) regulated in the Agreement on Agriculture (AoA), which operates differently by permitting domestic support that stays within a certain overall ceiling, or that does not distort international trade (developing economies are also permitted to grant certain export subsidies). Subsidisation in the services sector is hardly, and indirectly, disciplined in the General Agreement on Trade in Services (GATS) which mostly calls for negotiations.

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2 This paper is a joint effort and all sections have been written jointly by Siqi Li and Luca Rubini.

After 30 years since they were negotiated, WTO subsidy disciplines largely appear to be ineffective and incomplete.[3] The application of the rules has exposed several deficiencies, almost at every level. While the jurisprudence has ironed out some definitional questions, many – and new ones – remain open. Some interpretations of the Appellate Body have been controversial and, lacking action on the legislative side, remain for now the official reading of the rules. The legal standards of those subsidies that are prohibited or actionable are still unclear or too demanding, or both. The remedies, only applying prospectively, are weak. The governance side has left much to be desired. Transparency is rarely achieved, with the result that the work of the Committee on Subsidies has been suboptimal to say the least. Most importantly, the lack of transparency has been accompanied by virtually no advance in the knowledge of subsidy measures, their policy goals, and their effects, which is all crucial for the proper application of the disciplines and any discussion on law reform.

At the same time, the world has been changing. New challenges have emerged, such as the heightening of the climate change crisis, the occurrence of global financial and economic crises and health emergencies (the Covid-19 pandemic). Ironically, subsidies play a large role in the response to these challenges, but WTO disciplines do not refer to them at all. The political economy of subsidies has also been changing significantly in both developed and developing countries, especially in the context of a global value-chain world (Hoekman 2016a). Finally, with the emergence and coexistence of different varieties of capitalism, WTO subsidy disciplines are being tested to their limits, in the effort to accommodate economic and governance systems which are arguably very different from the one that officials, diplomats, negotiators, and members had in mind when they created the rules in the late 1980s/early 1990s.

In the light of the above, it is no surprise that the current discussions on WTO reform have focused significantly on industrial subsidies. Discussions in academic and policy circles on this topic have always been particularly lively.[4] Within their dialogue on competition policy, set up in 2001, the EU and China earmarked state aid control as a key common interest of discussion in 2017.[5] This initiative is intended to create a mechanism of consultation, cooperation, and transparency between the two parties in the field of state aid control. Leaving this initiative aside for now, the most recent proposals to change the WTO rulebook have been tabled *outside the WTO*. With the multilateral trade institution in crisis, a good deal of the action has taken place outside the WTO.[6] Thus, the US, the EU, and Japan started discussions in late 2017 to address the increase in what they called 'market-distortions', and in particular those caused by industrial subsidies. After various

3 For a brief overview see, e.g. Rubini (2019). More comprehensive analysis of the deficiencies of the current system are: Crivelli and Rubini (2020), Hoekman and Nelson (2020a).

4 As latest example, see Hufbauer (2021).

5 See 'State aid: Commission and China start dialogue on state aid control', Press-release, Brussels, 2nd June 2017. More generally on the EU – China cooperation on competition policy see https://ec.europa.eu/competition/international/bilateral/china.html.

6 Think of the dramatic increase in Preferential Trade Agreements (PTAs).

rounds, in January 2020 they came out with a proposed text which mostly represents a tightening of the current WTO rules (largely in line with proposals tabled during the Doha Round and provisions included in a variety of more recent Preferential Trade Agreements (PTAs)). The EU and Canada also raised concerns on industrial subsidies in their respective position papers on WTO reform. As did the countries participating in the 'Ottawa initiative', spearheaded by Canada. While some of these economies could negotiate WTO + subsidy commitments in their PTAs, the 'free rider' problem means that it is multilateral efforts that count the most.

Against the above backdrop, this chapter attempts to frame the discussion on the reform of WTO subsidy rules. Section 2 starts by outlining the key general questions in the field. After providing a brief summary of the proposals presented in the Doha Round in Section 3, the chapter critically takes stock of the current WTO reform discussions in Section 4. Section 5 points out the way forward, highlighting the importance of preparing any future negotiation with a specific work programme aimed at generating knowledge on subsidy policies, their goals and effects, and then outlining possible approaches to facilitate negotiations in the WTO. Section 6 closes with a few final comments.

2. QUESTIONS: NEW AND PERENNIAL

There are a few general issues that surround WTO subsidy rules, some perennial, some new. We believe that no law reform effort will be successful if it does not manage to tackle most, if not all, of these issues satisfactorily.

Putting aside for the moment the political differences between WTO members, what is startling in subsidies is that, in the end, there are more things that we do not know, than those that we do; more questions than answers. One of the themes of this chapter is therefore that any rulemaking exercise in the area should be preceded, and accompanied, by a serious knowledge-gathering exercise. Generating knowledge on subsidies, their objectives, and effects is the key precondition of any discussion on subsidy rules.

Information-related gaps and challenges include the following.

1) Transparency

Whereas the SCM Agreement sufficiently specifies the notification obligations of WTO members, the notification record is poor (Wolfe and Collins-Williams 2010). The reasons might be multiple, ranging from the lack of administrative capacity to collect subsidy information, the lack of common understanding of what constitutes a subsidy, to the worries of being targeted because of the reported subsidies. Hence, multiple actions are needed to improve transparency.

In practice, governments may provide subsidies in various forms, e.g. fiscal transfers, loans and guarantees, tax breaks, purchase of goods and services, etc. Some forms of subsidies and their magnitude are easily identifiable while others are not. Importantly however, the

consequence of the lack of transparency is a lack of comprehensive information to assess the incidence and magnitude of subsidies applied by WTO members. Improvement of transparency is therefore a 'must have objective' of any attempt to reform WTO subsidy rules.

2) Lack of systemic analysis

Second, there is a lack of systemic analysis of the impacts of subsidies, in general and more specifically in global value-chain networks. Assessing the economic effects of subsidies is complex, given that subsidies may be applied for various policy objectives which may affect different aspects of economic activities, and the spillover effects of subsidies may be magnified through today's frequent cross-the-border commercial activities. Since the current WTO disciplines only regulate subsidies in the goods sector, the impacts of subsidies on investment and services are neglected by WTO rulemaking, which are two important aspects of global value-chains (Hoekman 2016b).

The sustained generation of knowledge about subsidies and their effects is another important objective that should be given priority in any serious law reform agenda, both in the short-term and in the long-term. Important questions need answers in this respect (Hoekman and Nelson 2020b). What role does knowledge and epistemic communities play in the understanding and improvement of subsidy laws? How should we assess subsidy measures? What role should experts, auxiliary bodies, and the WTO Secretariat play in this new system? What role can other organisations holding subsidy information play? How can assessment be institutionalised and made to function in the context of a newly reformed governance of subsidies?

3) Defining subsidies

Third, there is the perennial issue of the definition of subsidy (Rubini 2010). In economic terms, any policy may amount to a subsidy (or a tax). In operational terms, no legal system can adopt such a broad approach. A legal definition is necessary which distinguishes what is legally relevant from what is not. This definition should be informed by economic analysis, legal systemic considerations (i.e. there may be other rules in the system that better deal with certain type of measures), and political reality (i.e. compromises and creative ambiguity may be necessary). Apart from a few important wrinkles, the WTO jurisprudence has generally advanced our understanding of the definition of subsidy. It is, however, now for negotiators to go back to the negotiating table and review the definition in the light of more than 25 years of practice, litigation, and analysis. Without wanting to be exhaustive, important issues to clarify are the definition of 'public body', the status of export restraints, of 'foreign' and 'transnational' subsidies, the relevance of public support along global-value-chains, the scope of the benefit analysis (and in particular the role non-market considerations/public policy objectives should play within it). We feel it

necessary to underline that, though difficult and politically sensitive, the definition is just a definition. It is about determining whether a measure is covered, not about whether it is good or bad, permitted or prohibited.

4) Distinguishing good and bad subsidies

Fourth, the viability of WTO subsidy rules depends on whether those rules do an adequate job in distinguishing good subsidies from the bad ones, i.e. what types of subsidies are most harmful and therefore, should be subject to multilateral rules in priority, and what types of subsidies can be presumed as legitimate and thus should be exempted (Rubini 2015). The challenges in drafting such balanced rules are to identify the necessary legal restrictions on subsidies while providing proper exceptions and constraining possible abuses, which requires both theoretical analysis and regulatory techniques.[7]

5) Going beyond goods

Fifth, it may be high time to reflect on the importance of subsidisation in the service sector, and on the difficulty involved in clearly distinguishing goods and services in many cases. This means that any serious subsidy law reform attempt should consider both goods and services. This would be in line with several PTAs of the latest generation that do not distinguish between the two.[8]

6) Remedies

Sixth, it may be necessary to revisit the mantra that there is no retroactivity in remedies in the WTO (Mavroidis 2010). We recall that this outcome departs from general public international law (Shaw 2008). We are fully aware that this may not be welcome among members that have already expressed their opposition to the notion that the 'withdrawal' of an illegal subsidy may imply something more than merely suspending its grant for the future.[9] We, however, believe that any law reform discussion should consider that, at least in some circumstances, the remedy of 'withdrawal' should encompass retrospectiveness, if we want to avoid scenarios where justice would in essence be denied.[10]

7) Development

Seventh, the development issue is inherently connected to subsidies, inasmuch as subsidies may be the perfect tool to address market failures and pursue equity goals connected to the process of development. For this reason, the instrumentality of public support in the development process should be fully considered in the law reform discussion. This does not

7 The techniques available are various, ranging from strict prohibitions to presumptions, conditional permissions, use of negotiated ceilings and thresholds, individual scheduling.
8 The EU and China shared this position in their recent agreement in principle for a Comprehensive Agreement on Investment ('CAI'), Section III (Regulatory Framework), Article 8.1.
9 WTO Dispute Settlement Body, Minutes of the meeting held on 11th February 2020, WT/DSB/M/75 (7th March 2000).
10 The best example is that of non-recurring subsidies paid before litigation.

necessarily mean negotiating more policy space but rather ensuring that the entitlement to adopt potentially distorting subsidies is closely grounded on their capability to achieve the proposed development objectives.

8) Link with state enterprises

Eighth, in recent decades, state enterprises (and in particular state-owned enterprises (SOEs)) have increasingly participated in international trade and competition, becoming a point of discussion due to their structural characteristics. Because of their links with governments, the governance of state enterprises and their financial relations with the government may not be fully transparent. In other words, the issue of state enterprises is largely a subsidy issue – from the double perspective of subsidies granted *to* state enterprises *and* of subsidies granted *by* state enterprises – and, as noted, the most important concern is one of transparency.

A comparative note may be useful here. The EU internal system of state aid control is the most advanced system of subsidy control in the world. It is therefore significant that one of the very first legislative actions taken by the European Commission in the field was the so-called 'Transparency directive'.[11] This directive, which was amended at various times, introduced a variety of obligations of transparency (ensuring, for example, transparency in the origin and use of public funds, and accurate and separate accounting of costs/revenues for undertakings with different activities).[12] To be clear, this move was not intended to discriminate against public undertakings, at the time very prominent and pervasive in many EU Member States, but simply to address a failure of information and truly ensure that all competition rules, including state aid ones, could equally apply to all operators in the market (be they private or public). Transparency is thus a precondition of a level playing field between all operators in the market.

As we outline below, while the aim should not be about creating a 'special regime' for state enterprises,[13] it is better to consider as a common objective the introduction of tools ensuring that the 'general rules', in principle applicable to all undertakings, can apply to all without hindrance.

11 Commission Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings as well as on the financial transparency within certain undertakings, OJ L195, 29.7.1980.

12 The latter scenario refers to those cases where the undertaking is entrusted with the performance of a public service and, at the same time, operate in a different market, fully open to competition. Accurate accounting requirements are needed to avoid anti-competitive cross-subsidisation of different activities.

13 The 'special rules' narrative may easily turn into or perceived as a discrimination against state enterprises and state intervention in the economy, which should not be the case.

Given the close links between the issues of subsidies and state enterprises, it would be good to negotiate both areas together, and aim for a balanced regulation that combines the need to restrict market distortion with the pursuit of commonly agreed legitimate public policy objectives. In this respect, significant inspiration can be drawn from the latest generation of PTAs concluded by the EU.[14]

9) Role of dispute settlement

The final two questions relate to the enforcement and administration of subsidy rules. The first concerns the difficult relationship between rules that are ambiguous and controversial like subsidy rules *and* dispute settlement. This is not the place for an assessment of the WTO jurisprudence on subsidies (Rubini 2017). Have we had cases of judicial activism? It is not easy to say. What has certainly often been difficult for adjudicating bodies is to make sense of rules where many ambiguities were created by the negotiators and members themselves. Disputes will always arise, and dispute settlement will be needed. Our suggestion towards ameliorating the concern of judicial overreaching is that law reform efforts put a special emphasis on producing clear rules and this would go a long way towards solving this issue.

10) Role of Secretariat

Finally, we believe that subsidy negotiations, and more generally any negotiation aimed at revamping the WTO, should really consider how to better use the utter expertise, professionalism, and independence of WTO officials. With specific respect to subsidies, ways should be considered to empower the Secretariat in certain key functions, for example in transparency and assessment exercises. This may really be a low-hanging fruit to harvest, and one that can deliver more than one could think. Arguably, from a legal perspective, this could be done without any change in the SCM Agreement but by simply making full use of the possibilities offered by Articles 24 and 25. The obstacle is political. What must be overcome is another of the unwritten WTO mantras whereby the WTO would be a 'member-driven' organisation.

3. THE DOHA ROUND NEGOTIATIONS: FAILURE

The Doha Round of negotiations has largely left all the questions above unanswered.[15] In particular, the Doha Development Agenda aimed for a modest clarification and improvement of the SCM Agreement, around which a range of subsidy-related proposals were submitted by WTO members. However, no concrete results have been achieved due to a distinct discrepancy of positions among the WTO membership. The US and India have sharply divergent views which conflict with each other. The former is quite pro-discipline,

14 See, e.g. EU – Singapore and EU – Vietnam. The most recent EU-UK is too quixotic to represent a useful model of inspiration.

15 A detailed exposition of the various proposals is Li and Tu (2020).

proposing to tighten up subsidy rules and make trade remedies more effective; while the latter is very anti-discipline, strongly arguing for domestic policy space in the name of developing members. Other developed members, i.e. the EU, Australia, and Canada, have taken a more balanced position, although they are more inclined to strengthen the subsidy rules. Certain developing members, e.g. Brazil, have taken a mixed stance with both pro- and anti-discipline proposals, while Egypt and Venezuela have adopted a more defensive approach to maintain or even weaken subsidy rules. What is certain is that it is very difficult for the pro-discipline supporters to convince the rest of the membership and achieve concrete multilateral outcomes.

4. CURRENT WTO REFORM DISCUSSIONS: A CRITICAL OVERVIEW

As noted, for now, the most recent proposals for reform on industrial subsidies rules come from initiatives and discussions outside the WTO. The trilateral work of the US, the EU, and Japan, in particular, is evidence of a new political economy momentum to draft more stringent rules on industrial subsidies. The trilateral group claim they aim to set the schedule for industrial subsidy discussions and finalise trilateral text-based work, in order to then engage other key WTO members as appropriate. We largely focus on the trilateral initiative, not necessarily for its legitimacy (it is clear that any discussion about law reform should be more representative, at least involving a 'critical mass' of participants, based on the interest in the issues discussed and on the degree of participation in world trade), but because it is the only one so far that has specifically focused on the reform of subsidy rules. When appropriate, we also make reference to the recent EU – China CAI initiative which, though focusing on investment, may both show a common understanding between the EU and China and constitute a sort of bridge between different positions.

Compared with wide-ranging issues covered in previously tabled proposals during the Doha Round, current concerns are mainly in five aspects, i.e. transparency, public bodies and SOEs, harmful subsidies, non-actionable subsidies and Special and Differential Treatment (SDT) for developing members.

4.1 Transparency

In light of continued notification failures by WTO members, the US, the EU, and Japan raised the transparency issue in their trilateral initiative, calling in particular for the introduction of specific disincentives in order to improve transparency (i.e. defining any non-notified subsidy that was counter-notified as prohibited unless the subsidising member provides the required information).[16] Together with other co-sponsors, they also submitted two proposals to the WTO. In these two proposals, they put forward suggestions ranging from administrative penalties for notification failures, to the encouragement for

16 Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States, and the European Union. Washington, D.C., 14 January 2020.

‘counter notifications’ and the establishment of a Working Group to enhance notification compliance.[17] The EU tabled proposals such as creating a ‘general rebuttable presumption’ according to which non-notified subsidies would be presumed as actionable, unless the subsidising member demonstrates the lack of adverse effects.[18] Canada highlighted the importance of transparency, while requiring a comprehensive review of the notification obligations to ensure they are not unnecessarily complex and burdensome.[19]

Developing members also tabled their proposals. China expressed views in five areas. First, developed Members should lead by example in submitting comprehensive, timely, and accurate notifications. Second, Members should improve the quality of their counter-notifications. Third, members should increase exchange of their experiences on notifications. Fourth, the WTO Secretariat needs to update the Technical Cooperation Handbook on Notifications as soon as possible and intensify training in this regard. Fifth, developing members should endeavour to improve their compliance of notification obligations, with technical assistance and capacity building requirements.[20] The African Group, Cuba, and India stressed the capacity constraints of developing members, thus strongly opposing to any transparency obligations that go beyond existing ones.[21]

4.2 Public bodies and State-Owned Enterprises (SOEs)

a. The definition of ‘public bodies’ and its relationship with SOEs.

The lack of a clear definition of a ‘public body’ in Article 1 of the SCM Agreement has represented a problem from early on. Closely linked to this concern is the still open question of whether, and to what extent, the notion of a public body can encompass SOEs.

The issue has arisen in various WTO disputes and centres on the legal standard necessary to prove whether an entity is a public body and, consequently, whether its actions may amount to a financial contribution and a subsidy. While initially, the meaning that prevailed was that of ‘control’ (i.e. a public body would be any entity subject to governmental control) and this control could be proved in various ways, mostly (but not exclusively) through public ownership, in the *US – AD/CVD* (DS379) case, the Appellate Body departed from this view (which had been followed by the Panel) and essentially replaced the legal criterion of ‘control’ with one of ‘government authority’. The Appellate

17 Procedures to Enhance Transparency and Strengthen Notification Requirements under WTO Agreements: Communication from Argentina, Costa Rica, the European Union, Japan and the United States, JOB/GC/204 (JOB/CTG/14), 1 November 2018; Procedures to Enhance Transparency and Strengthen Notification Requirements under WTO Agreements: Communication from Argentina, Australia, Canada, Costa Rica, the European Union, Japan, New Zealand, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, and the United States, JOB/GC/204/Rev.1 (JOB/CTG/14/Rev.1), 1 April 2019.

18 Negotiating Group on Rules, Improving Disciplines on Subsidies Notification: Communication from the European Union, TN/RL/GEN/188, 30 May 2017.

19 Canada: Strengthening and Modernizing the WTO: Discussion Paper, 30 August 2018.

20 General Council. China’s Proposal on WTO Reform: Communication from China, WT/GC/W/773, 13 May 2019

21 An Inclusive Approach to Transparency and Notification Requirements in the WTO: Communication from African Group, Cuba, and India (Revision), JOB/GC/218/Rev.1 (JOB/CTG/15/Rev.1, JOB/SERV/292/Rev.1, JOB/IP/33/Rev.1, JOB/DEV/58/Rev.1, JOB/AG/158/Rev.1), 11 July 2019.

Body has subsequently attempted to polish its finding on this strict legal standard (without retracting it) by focusing on the evidence that could be provided to satisfy it, and arguably coming out with even more confused language.

In other words, under the legal standard now prevailing in WTO law, in order to qualify as a 'public body', and hence as a grantor of subsidies, the relevant entity must not only be controlled by the government but must more specifically exercise governmental functions and powers. A lot has been written on this decision. Criticism has been raised from various quarters, most specifically because – so the argument goes – this interpretation would be unduly narrow and risk rendering the definition under-inclusive.[22] In other words, the risk would be that many SOEs and their financial contributions would not be covered at all by the definition of subsidy. The possibility of resorting to the concepts of 'entrustment' or 'direction' of a 'private body' to make the financial contributions under item (iv) of Article 1.1. of the SCM Agreement is not considered equally effective for two reasons: first, the still ambiguous meaning of the legal standards, and, secondly and most importantly, because they would require proof of a connection between the government and the 'private body' in each and every case of subsidisation (rather than generally attributing financial support actions of 'public bodies' to the government).

Accordingly, the US-EU-Japan trilateral argued that this approach would provide leeway for SOEs and other public entities to escape scrutiny and agreed to work on a 'public body' definition that softens the 'government authority' benchmark to better capture state enterprises as subsidising entities. Similar discussions are taking place in PTA negotiations.[23]

Criteria based on control, expressed in various ways, are indeed common in various jurisdictions (see, for example, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) analysed below). Once again, it is interesting to compare the similar notion of 'public undertaking' in EU law. The 'Transparency Directive' defines it as 'any undertaking over which the public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of it, their financial participation therein, or the rules which govern it' (Article 2(1)(b)). Most interestingly, both the EU and China seem to share a similar understanding in their recent agreement in principle on the Comprehensive Agreement on Investment (CAI).[24] While one cannot simply equate the notion of 'covered entity' in the CAI with that of 'public body' in the WTO SCM Agreement, it is interesting to note that the various notions of 'covered entities' in Article 3bis of Section II (Liberalisation of investment) all refer to elements of control, direction, empowerment or designation of the entity by either Party, without seemingly mentioning any exercise of governmental authority, quite the contrary. The Parties in fact hasten to make it clear that the provision 'does not apply to the activities conducted in the exercise

22 Critics include even prominent former negotiators and officials involved in crafting the rules. See Cartland, Depayre, and Woznozski (2012).
23 See, e.g. those between the EU and Australia and the EU and New Zealand.
24 See https://trade.ec.europa.eu/doclib/press/index.cfm?id=2237.

of governmental authority' or 'to non-commercial activities' (which are, thus, altogether excluded from the scope of the agreement). Where does this leave us? What is clear is that, without explicitly mentioning SOEs, this provision certainly covers several examples of SOEs or, in the EU jargon, 'public undertakings'. Whether this may have any influence on the evolution of the specific question of the definition of 'public body' in Article 1 of the SCM Agreement is an open question. We must wait and see whether the common understanding expressed by the EU and China in the CAI may also lead to a similar common position within the WTO subsidy disciplines context.

Though the solution of the 'public body' issue is central with respect to the scope of subsidy disciplines, we should perhaps reiterate the comment made above. To include SOEs within the scope of the SCM Agreement is *just* a preliminary and neutral step in the analysis. It is *simply* about determining whether a given body and its conduct are covered, and not about whether this conduct is good or bad, permitted or prohibited. Specific benchmarks, referring to market or commercial considerations, are used to assess the behaviour of the government or of public bodies. *Mutatis mutandis*, this is also the approach of the EU – China CAI where the issue of what entities are covered and their obligation to act in a non-discriminatory and commercial way are kept separate. While appreciating the political and symbolic value of a positive 'subsidy' determination, this distinction may somewhat diffuse the tensions and controversies surrounding the debate.

b. Specific rules on SOEs

WTO members hold divergent perspectives on crafting rules for SOEs, surrounding the principles of 'ownership neutrality' and 'competitive neutrality'.

On the one hand, incorporating specific SOE rules in the WTO may seem to contradict the principle of 'ownership neutrality'. The WTO recognises different types of national economic systems and has been neutral insofar as the ownership of enterprises is concerned, reflecting the logic that ownership does not matter as long as SOEs trade in competitive conditions. China supports this view.[25] In its proposal on WTO reform, China argues that SOEs should not be discriminated against on the basis of ownership, holding that no special or discriminatory disciplines should be instituted on SOEs when reforming subsidy disciplines.[26] We have commented already on this point, indicating what should be the spirit of any negotiation on any rules for state enterprises. On the other hand, the principle of 'competitive neutrality' supports the introduction of specific norms for SOEs in order to eliminate advantages that may derive from their close government connection and thus ensure that competition really operates fairly.

25 Indeed, this comes out also from the EU – China CAI where the Parties declare that '[n]othing in this Article shall be construed to prevent a Party from establishing or maintaining the covered entities', (see Section II 'Liberalization of Investment', Article 3bis, paragraph 2(a)).

26 General Council. China's Proposal on WTO Reform: Communication from China, WT/GC/W/773, 13 May 2019.

Once again, a parallel with the EU and its legal system may be useful. The two principles can already be found in the Treaty of Rome of 1957. On the one hand, Article 345 of the Treaty on the Functioning of the European Union (TFEU) clarifies that '[t]he Treaties shall in no way prejudice the rules in member states governing the system of property ownership'. If, in principle, it is for members to decide 'the system of property ownership', they are still subject to all the rules of EU law. All those entities that carry out 'economic activities' in the market are equal under the law. This is the meaning of Article 106(1) TFEU, which subjects public undertakings to all EU rules and in particular non-discrimination and competition rules. The practice and case-law has consistently developed ways to balance these two provisions with each other (Szyszczak 2007). It is also apposite to mention Article 106(2) TFEU, which includes an exception from this rule for those cases where it is necessary to enable entrusted enterprises to perform their public service mandates. Quite interestingly, this provision appears in many EU PTAs and also in the EU – China CAI (see Section III 'Regulatory Framework', Article 8.4).

The distinction between SOEs and private-owned enterprises is also included in recent PTAs that have gone further than the WTO in crafting disciplines on SOEs.[27] The CPTPP represents one of the best examples at the mega-regional level. The CPTPP defines the 'government control' over SOEs in terms of voting rights, equity shares, and appointment powers, and establishes separate disciplines on (1) financial advantages granted to SOEs under 'non-commercial assistance' provisions; and (2) the behaviour of SOEs under 'non-discrimination' and 'commercial consideration' provisions. While the SOE rules in the CPTPP may offer an insight into what participating countries presumably expect to be incorporated into the WTO,[28] the process will never be easy due to the economic and political resistance in the broader WTO context from a wide range of countries, especially those with large presence of SOEs in their economies. That being said, they highlight a significant convergence.

c. Additional transparency rules for public bodies and SOEs

An important factor complicating the possible distortive practices by public bodies and SOEs is their inherent lack of transparency. The Trilateral has argued that additional transparency rules should be introduced, especially for public bodies and SOEs.[29] For example, more information should be required, including the publication of a listing of all SOEs on a public website, the disclosure of government's shareholding in SOEs, titles of government officials participating on the board of SOEs, the annual revenues of SOEs, and other detailed facts on any policy programme that provides subsidies to SOEs (Katz 2018). We have already hinted at the EU Transparency Directive, which provides similar requirements.

27 See, for example, the recent EU – Vietnam PTA.

28 And have received some support in the literature. See Mavroidis and Sapir (2021).

29 Joint Statement on Trilateral Meeting of the Trade Ministers of the United States, Japan, and the European Union, Paris, 31 May 2018.

4.3 Harmful subsidies

One strong argument in support of subsidy rules reform is the ineffectiveness of WTO disciplines for harmful subsidies (Crivelli and Rubini 2019). Three groups of proposals have been tabled in this respect.

First, prohibitions can be the most effective discipline for addressing harmful subsidisation. To this end, the Trilateral proposed four types of unconditionally prohibited subsidies to be added to the SCM Agreement, most notably: unlimited guarantees, subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan, subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity, and certain direct forgiveness of debt.[30]

Second, since the standard of evidence for actionable subsidies is high, the Trilateral proposed four types of conditionally prohibited subsidies. These include: excessively large subsidies, subsidies that prop up uncompetitive firms and prevent their exit from the market, subsidies creating massive manufacturing capacity without private commercial participation, and subsidies that lower input prices domestically in comparison to prices of the same goods when destined for export. It is also proposed that the subsidising member should demonstrate there is no serious negative trade or capacity effect and that there is sufficient transparency about the subsidy, failing which the subsidy should be withdrawn immediately.[31]

Third, there are proposals to target subsidies that generate overcapacity. For instance, the Trilateral proposed to consider the situation where the subsidy distorts capacity as an additional type of serious prejudice, which should be included in Article 6.3 of the SCM Agreement. Additionally, along with the work of the G20 Global Forum on Steel Excess Capacity on steel capacity, subsidies and other support measures, the US-EU-Japan trilateral, together with Mexico and Canada, called for broader discussions in the WTO SCM Committee on the role of subsidies contributing to overcapacity.[32] China disagreed, arguing that the SCM Committee is not the proper forum to discuss the overcapacity issue, since it is a structural problem resulting from many factors, including trade protectionism.[33]

30 It is interesting to note that some of these instances were already present in the original SCM Agreement, in the Article 6.1 presumption, others were proposed during the Doha Round, others are included in the most recent PTAs.

31 Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States, and the European Union. Washington, D.C. 14 January 2020.

32 Committee on Subsidies and Countervailing Measures, The Contribution of the WTO to the G20 Call for Action to Address Certain Measures Contributing to Overcapacity, G/SCM/W/569; Committee on Subsidies and Countervailing Measures, Role of Subsidies in Creating Overcapacity and Options for Addressing this Issue in the Agreement on Subsidies and Countervailing Measures, G/SCM/W/572/Rev.1.

33 WTO, Subsidies Committee Members Again Cite Concerns on Lack of Transparency (April 2019), https://www.wto.org/english/news_e/news19_e/scm_30apr19_e.htm (accessed 15 November 2019).

4.4 Non-actionable subsidies

The original version of the SCM Agreement included limited exceptions for certain legitimate subsidies. These provisions expired in late 1999. China has suggested that the provisions on non-actionable subsidies be reinstated, and their coverage expanded.[34] In its recently published Trade Policy Review Communication, the EU supports this perspective by emphasising that 'there should also be consideration of a 'green box' that includes those subsidies that support legitimate public goals while having minimal distortive impact on trade. This would particularly be the case of certain types of environmental and R&D subsidies, provided they are subject to full transparency and agreed disciplines'.[35]

The basic rationale to reinstate non-actionable subsidies is sound and relates to the fact that subsidies may be the first-best policy to achieve legitimate policy goals and contribute to global public goods. This suggests that, also for the sake of legal certainty, such subsidies should be explicitly permitted under certain conditions (Horlick and Clarke 2017). The counter-argument is that, if not well defined and monitored, such socially 'good' subsidies could also produce market distortionary effects (Cosbey 2013). Hence, the legitimate question is whether the social benefits of these subsidies are significant enough to compensate for their potential distortionary effects and make it worthwhile to relax the SCM Agreement. What is clear however, is that the resurrection of the non-actionable subsidies category is not simply a question of reintroducing a couple of provisions permitting certain subsidies, but would necessarily require an upgrade in the governance of subsidies themselves, in particular with respect to transparency and assessment.

The EU and China went some way towards the direction of legally recognising legitimate subsidies in the recently published CAI text. On the one hand, they specifically provide for exceptions for subsidies to tackle natural disasters or public service obligations (see Section III Regulatory Framework, Article 8). On the other hand, there is a good argument that the general exceptions in Section VI, which are broadly modelled on GATT Article XX and GATS Article XIV, may apply to subsidies too.[36]

4.5 Special and Differential Treatment (SDT)

Debates on SDT are changing in the shifting global economic landscape. On the one hand, the development divides between developing and developed members still exist, with old divides that have not been substantially bridged, while new divides, such as those in the digital and technological spheres, become more pronounced. The developing members are still struggling for domestic policy space in order to compete in the international

34 General Council. China's Proposal on WTO Reform: Communication from China, WT/GC/W/773, 13 May 2019.
35 The European Commission. Trade Policy Review - An Open, Sustainable and Assertive Trade Policy, Brussels, February 2021.
36 This would not be new in international agreements. See, e.g. EU – Japan.

arena. On the other hand, the rapid economic growth enjoyed by some large developing members made developed members less willing to grant the same preferential treatment to the whole developing membership. Against this background, the SDT is hotly debated.

The views of developed members on the SDT are not necessarily the same. The US-EU-Japan Trilateral shares the view that overly broad classification of development, combined with self-designation of developing country status, inhibits the WTO's ability to negotiate new trade-expanding agreements. From this perspective, advanced WTO members claim developing country status should rather undertake full commitments in WTO negotiations. Specifically, the EU proposed a new graduation system of countries from developing country status to developed country status to opt-out of SDT.[37] The US proposed four groups of countries that can no longer enjoy SDT:

1. A WTO member that is a member of the OECD, or a WTO member that has begun the accession process to the OECD.
2. A WTO member that is a member of the G20.
3. A WTO member that is classified as a 'high income' country by the World Bank.
4. A WTO member that accounts for no less than 0.5% of global merchandise trade.[38]

Canada proposed to take a new approach that seeks the balance between reciprocity and flexibility based on previous experience of Trade Facilitation Agreement (TFA).[39] Norway proposed to adopt a flexible approach to adequately respond to specific development needs of members in different economic areas, rather than negotiating criteria for members' access to SDT.[40]

There is also a divide among developing members regarding the SDT. Brazil agreed to forgo SDT in future WTO negotiations, in exchange for US support for Brazil initiating the OECD accession procedure.[41] Korea decided not to seek SDT in future WTO negotiations.[42] By contrast, China, the African Group, India, and certain developing members reaffirmed the basic principles of the SDT in the WTO that:

37 The European Commission, WTO Modernisation: Introduction to Future EU Proposals (2018), https://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf (accessed on 17 October 2019).
38 An Undifferentiated WTO: Self-Declared Development Status Risks Institutional Irrelevance: Communication from the United States (Revision), WT/GC/W/757/Rev.1, 14 February 2019; Draft General Council Decision: Procedures to Strengthen the Negotiating Function of the WTO, WT/GC/W/764, 15 February 2019.
39 supra no. 16.
40 Pursuing the Development Dimension in WTO Rule-making Efforts: Communication from Norway, WT/GC/W/770, 26 April 2019.
41 Joint Statement from President Donald J. Trump and President Jair Bolsonaro (19 March 2019), https://www.whitehouse.gov/briefings-statements/joint-statement-president-donald-j-trump-president-jair-bolsonaro/ (accessed 10 November 2019).
42 South Korea to give up developing country status in WTO talks, Reuters (25 October 2019), https://www.reuters.com/article/us-southkorea-trade-wto/south-korea-to-give-up-developing-country-status-in-wto-talks-idUSKBN1X401W (accessed 5 February 2020).

- Developing countries' unconditional rights to SDT in WTO rules and negotiations must continue.
- Developing countries must be allowed to make their own assessments regarding their own developing country status.
- Existing SDT provisions must be upheld.
- SDT must be provided in current and future negotiations.[43]

Realistically, there is no viable prospect of reaching a consensus on fundamentally changing the current SDT arrangement in the WTO. It should therefore be asked whether it is good strategy to use up political capital over dealing with an issue which is probably intractable in negotiations. What might happen over time is a process of individual developing members volunteering to forgo their SDT in certain WTO agreements, as we saw with Brazil and Korea.

5. WAYS FORWARD

The outbreak of the Covid-19 pandemic has forced countries to deal with dramatic dilemmas regarding public health safety, economic recovery, and social stability. Largely in response to Covid-19, countries have implemented a wide range of subsidy measures to provide emergency liquidity and broad-based fiscal measures such as tax concessions, loans, and loan guarantees.[44] Massive public support is about to arrive for the reconstruction phase. It thus becomes even more important to assess the impact of these subsidy measures on trading partners and explore possible paths for reform of WTO subsidy rules in the post Covid-19 period (Ambaw et al. 2020). In other words, the public money spent during the pandemic and on the post-pandemic recovery may be massive, the impact of the several support measures should be fully evaluated. This should really be the precondition to any discussion about reforming outdated rules and governance.

What is the best process to achieve this? We need to divide the short-term from the long-term. The first phase would involve a robust and politically supported knowledge-gathering initiative, the second phase the start of the negotiations.

In the very short-term, the immediate and concrete focus should be on generating more knowledge about subsidy practices, their objectives, and their effects. As repeatedly noted, this knowledge-gathering exercise, which corresponds to the first two questions of Section 2 above, is the essential prerequisite for paving the way to any diplomatic and negotiating effort. The vehicle of this process could be a sufficiently representative and

43 Statement on Special and Differential Treatment to Promote Development: Co-sponsored by the African Group, the Plurinational State of Bolivia, Cambodia, China, Cuba, India, Lao People's Democratic Republic, Oman, Pakistan and the Bolivarian Republic of Venezuela, WT/GC/202/Rev.1, 14 October 2019.

44 OECD (2020), 'Government support and the Covid-19 pandemic, OECD Policy Responses to Coronavirus (Covid-19)'.

dynamic platform such as the G20 (which is broader than, for example, the US-EU-Japan trilateral, and includes China and other key WTO developed and developing countries). As Hoekman and Nelson (2020a,b) suggest, what should be on the agenda is the 'launch of a work programme to mobilise an epistemic community concerned with subsidy policies, tasked with building a more solid evidence base on the magnitude, purpose and effects of subsidy policies'. Better and high-quality knowledge about subsidies and their spillovers is essential in view of a potential law-reform. So is the role played by stakeholders, experts, and epistemic communities. To be sure, to work properly, a subsidy control regime should be continuously equipped with 'epistemic capacity' (Koulen 2016).

While, for the reasons outlined above, this learning exercise should find its stimulus in the G20, if the political willingness is there, it could also be linked to the WTO, perhaps in a second stage. This could be done in various ways. There could be a high profile joint-initiative with the creation of an ad hoc working party, or it could even operate through one of the 'subsidiary bodies', which the Subsidies Committee could set up under Article 24.2 (this is just one of the institutional flexibilities of the SCM Agreement which have never been used and could be exploited now).

The goal of this initiative is to create the necessary knowledge base to have an informed (and, if possible, less politicised) discussion about the rules and their changes. Law-reform discussions and negotiations must be prepared, and knowledge-gathering is one of the key prerequisites.

Once this is done, and the time is ripe for the actual rulemaking, two negotiating routes are available in the longer term: a multilateral or a plurilateral approach. Since a multilateral outcome among the whole WTO membership is less foreseeable, at least in the first instance, one can expect that a more flexible negotiation approach should be explored and a more feasible blueprint for improving subsidy rules should be considered (Li and Tu 2020).

5.1 A Revised Multilateral Approach

The renewed attention to subsidy rules may offer a window of opportunity for revitalising subsidy negotiations in the WTO. However, it is hardly expected that such a multilateral move be ambitious in nature, given the current divergent positions across WTO membership. That being said, the possibility of reopening such multilateral negotiation deserves attention and effort, with recalibrated negotiation objectives and well-designed flexibilities that are in accordance with the varying expectations and capacities of WTO members. Several dimensions should be considered.

a. The scope and priority of a possible multilateral subsidy initiative

The rationale of the Single Undertaking modality is that concessions can be exchanged among otherwise unrelated sectors. However, the large scope of the Doha Package did not make negotiations easy. In this regard, it appears more practical that the subsidy rules be negotiated as a stand-alone process and only be tied with progress in related issues. For

example, the industrial subsidy negotiation can be promoted in parallel with agricultural subsidy negotiation, making it possible for negotiation space between developed and developing members. Furthermore, even within the industrial subsidy negotiations, trade-offs can be made between different subsidy categories, i.e. prohibited, actionable and non-actionable subsidies. For the reasons explained above, it may make sense to conduct negotiations on subsidies and state enterprises simultaneously.

Focusing on priorities, the first step should be to increase the transparency of subsidies, launching a work programme to compile information on prevailing subsidies, to assess the spillovers of subsidies, and to diagnose the key gap in extant subsidy rules. This has been identified as the key initiative to carry out in the short-term but, as repeatedly said, the continuous assessment of subsidy policies and their effects should become an integral part of the permanent governance of subsidies. In this regard, the inadequate notifications by WTO members could be partially mitigated through more active involvement of the WTO Secretariat to act as a 'common agent' for members in assembling information, adding data from other international organisations and databases to provide a better picture of the subsidies in a sector or a market, with opportunities for those members concerned to verify the information.[45] Better information on subsidies could facilitate constructive discussions and develop common understandings of where new rules are needed, and which form they should take among WTO members (Hoekman and Nelson 2020b). If necessary, 'subsidiary bodies' to the Committee on subsidies could be easily created.[46]

b. The development dimension of a possible multilateral subsidy initiative

A useful lesson could be drawn from the experience in concluding the Trade Facilitation Agreement (TFA) that incorporates an innovative design of different levels of commitments as well as mandatory technical assistance for developing members. The key to adopting a similar asymmetric commitment approach in subsidy rules is how to provide different flexibilities for WTO members while ensuring such 'differentiation' of flexibilities would not substantially undermine the effectiveness of the agreement.

The first consideration is how to differentiate among WTO members. The SCM Agreement generally differentiates between three categories of countries, which are developing country members referred to in Annex VII,[47] other developing country members, and members in the process of transformation into a market economy. Such differentiation is too imprecise. More precise differentiation techniques would require a needs assessment of WTO members. For example, an Expert Group could be established to help evaluate the

45 Shaffer, Wolfe, and Le (2015) analysed how international organisations act as fora for collecting information on subsidies and formulate non-binding guidelines and initiatives on sectoral subsidies, e.g., export credits, shipbuilding subsidies, fisheries subsidies, and fossil fuel subsidies.

46 The power is already there, in Article 24 of the SCM Agreement but it has never been used!

47 The Annex VII of the ASCM refers to: (a) least-developed countries designated as such by the United Nations which are members of the WTO; (b) certain countries whose GNP per capita has not reached $1,000 per annum.

situation of WTO members claiming they have a capacity gap, and the SCM Committee can provide opportunities for members to specify their obstacles and inspire relevant discussions. This process should be, as much as possible, evidence based.

The second consideration is how to tailor commitments according to the differentiation among WTO members. Since commitments valued in absolute terms tend to favour richer members, commitments valued in relative terms that are more related to the relative position of the member offering concessions *vis-à-vis* other members would be more appropriate to address the individual member's situation and mitigate in part the issue of poorer members.

5.2 A FLEXIBLE PLURILATERAL APPROACH

Besides multilateral negotiations, the WTO offers alternatives for entering into plurilateral negotiations among a part of the membership. By gathering like-minded members to negotiate new rules, such a plurilateral process could be more ambitious and permit to have a broader and deeper agenda, which may draw inspiration from those big laboratories of rule-making that are PTAs. The negotiating parties may thus ask whether some of the new rules (e.g. SOE rules) that are incorporated in regional agreements can be developed under the WTO.

There are two types of plurilaterals, one is the 'open plurilateral', taking place within groups of members with the outcomes being implemented on a most-favoured-nation (MFN) basis, another one is the 'exclusive plurilateral', taking place within groups of members with the outcomes remaining confined only to the signatories. The WTO members have experiences in negotiating both types of plurilateral agreements, with the expanded Information Technology Agreement (ITA) as an 'open plurilateral agreement' and the Government Procurement Agreement as an 'exclusive plurilateral agreement'.

We would argue that for subsidy negotiations the 'open plurilateral' approach could be better than the 'exclusive plurilateral' approach. Subsidy rules are designed to ensure an overall level playing field in one country, which means that subsidy obligations undertaken by signatories of plurilaterals would be non-discriminatory and widely benefit other members. To this end, the 'open plurilateral' approach could better represent this non-discriminatory feature. In addition, 'open plurilaterals' are more transparent and inclusive since the benefits of such agreements are open to the whole WTO membership, encouraging future participation of 'outsiders', who, having observed the benefits of undertaking additional subsidy obligations, would like to follow similar paths for goals such as eliminating their ineffective subsidies and locking in their economic transformation.

The entry into force of the 'open plurilaterals' is conditioned on the commitments of a 'critical mass' of WTO members. Previous plurilaterals regarding market access usually count the 'critical mass' on the basis of world trade proportion. For example, the expanded

ITA consists of participants that accounted for over 97% of world trade in the information technology products covered. However, the same criteria of 'critical mass' in market access negotiations such as the ITA may not be applied directly for rule-making negotiations such as subsidies. While how to test the 'critical mass' of WTO members with respect to subsidies requires further research, it is clear that without the participation of China, India and other developing countries, no initiative is likely to lead to any reform.

6. CONCLUSIONS

The topic of subsidies is multifaceted for a variety of reasons, ranging from states' geo-economic positioning, to domestic social considerations. Traditional readings of the benefits and costs of subsidies are less applicable in the current world. The spillovers of subsidies are complex and may be magnified in the frequent cross-border commercial activities, with benefits and costs spreading along global value chains. In light of the changing context and the outdated WTO subsidy rulebook, the issue is where the rules might be heading in a process of WTO reform.

Before turning to legal text-based negotiations, we believe the following questions should be considered. First, what is the ambition of the WTO subsidy rules reform? Should it be a pioneering one only including large WTO members who have capacity to reach a progressive deal to constrain their domestic policy space? Or should it rather be an inclusive and incremental one including as many WTO members as possible and trying to find a balance between the development dividends and the negative spillovers of domestic industrial policies?

Second, what should be the scope of the WTO subsidy rules reform? The US-EU-Japan Trilateral paid much attention to industrial subsidies, while agricultural subsidies remain one of the unsolved Doha issue, and rulemaking of subsidies on investment and services remains barely blank (the EU–China CAI being a notable but limited exception). With different negotiation ambitions, different negotiation scenarios could be attempted, while a potential practical way that deserves to be carefully explored is resorting to 'open plurilaterals' in producing outcomes that apply on the MFN basis.

Last, but not least, we have reiterated the suggestion that any law reform exercise should be anticipated by a serious and transparent, open, and expert-based knowledge-gathering effort. The things that we do not know on subsidies are more than those we know. Considering the difficulty and importance of the task ahead (creating international subsidy rules for the twenty-first century), stakeholders should really invest significant efforts in improving our knowledge on subsidy policies and their effects. This would create the necessary learning base to prepare negotiations – before diplomacy and politics kick in. In line with similar suggestions in the literature (Hoekman and Nelson 2020b), we have suggested the G20 as the best forum for launching, in the short-term, a work programme in this direction.

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