26025

BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of Commerce And The United States Trade Representative

Benefits Of International Agreement On Trade-Distorting Subsidies Not Yet Realized

GAO reviewed three strategies used by the U.S. Government between January 1980-83 to reduce the use of trade-related subsidies under the 1979 international agreement on subsidies.

1. Persuading developing countries to assume increased discipline over the use of subsidies.
2. Persuading Agreement signatories to report the subsidies they use.
3. Using the Agreement's dispute settlement procedure to help eliminate the effects of subsidies.

GAO concluded that to date these strategies have met with little success.

Under U.S. law, the private sector initiates most disputes involving foreign subsidies, so GAO also reviewed how the Government shared information on foreign subsidy practices with the private sector and recommended ways to improve this information sharing.

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-205525

The Honorable Malcolm Baldrige
The Secretary of Commerce

The Honorable William E. Brock
U.S. Trade Representative

This report addresses the limited success of U.S. efforts to eliminate the adverse effects of trade-related subsidy practices of foreign governments. We initiated this review to help the Congress assess the benefits achieved by U.S. participation in the Agreement on Subsidies and Countervailing Measures negotiated during the Tokyo Round of the Multilateral Trade Negotiations.

This report contains recommendations to you on pages 44, 47, and 50. As you know, 31 U.S.C. §720 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the House Committee on Ways and Means, Senate Committee on Finance, other interested congressional committees and subcommittees, Secretaries of Agriculture and State, and the Director, Office of Management and Budget.

Frank C. Conahan
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE SECRETARY
OF COMMERCE AND THE
UNITED STATES TRADE
REPRESENTATIVE

BENEFITS OF INTERNATIONAL AGREEMENT ON TRADE-DISTORTING SUBSIDIES NOT YET REALIZED

D I G E S T

In 1979 the United States and other countries concluded several multilateral agreements reducing tariff and non-tariff barriers to trade. One agreement, the Subsidies Agreement, became effective on January 1, 1980. The Trade Agreements Act of 1979 (19 U.S.C. §2501 *et seq.*) approves and implements the Subsidies Agreement for the United States. GAO reviewed U.S. actions under the Act to reduce and eliminate foreign subsidy practices that distort trade. (See pp. 2 to 5)

THE SUBSIDIES AGREEMENT: WHAT THE UNITED STATES GOT VS. WHAT IT GAVE UP

The U.S. Government wanted stronger rules on the use of subsidies and better procedures for resolving subsidy-related disputes between governments. It appears to have achieved these goals with the Subsidies Agreement, however, the emphasis of the Agreement is not on the eliminating subsidies, but rather on dealing with their trade distorting effects. The Agreement states that signatories shall not grant export subsidies on products other than certain primary products, but recognizes that subsidies are widely used to promote social and economic policy objectives unrelated to exports. It permits export subsidies for certain primary products (farm, forest, or fishery products) provided the subsidizing country does not capture more than an equitable share of world export trade in such products or materially undercut the prices of another supplier to the same market.

The Agreement also established consultation, conciliation, and dispute settlement procedures for resolving signatories' conflicts over the legitimate use of subsidies within a specified time period. (See pp. 19 and 20.)

In return for the progress toward reducing trade-distorting subsidies, the U.S. Government agreed to use countervailing (or offsetting) duties only if it is determined that subsidized imports are causing or threatening to cause material injury to a like U.S. industry. The U.S. Government first adopted an injury test in 1975 but applied it only to complaints involving duty-free imports. Effective January 1, 1980, the injury test was extended to dutiable imports from countries that either signed the Subsidies Agreement or assumed equivalent obligations. (See ch. 6.)

ACTIONS TO REDUCE AND ELIMINATE TRADE DISTORTING SUBSIDIES PRODUCING MIXED RESULTS

Since January 1980, the Government has tried to use the Agreement to reduce and eliminate trade-distorting subsidies by:

--Persuading developing countries to make commitments to reduce or eliminate export subsidies that are inconsistent with their development needs.

--Persuading Agreement signatories to report the extent, nature, and effect of subsidies.

--Using the Agreement's conflict resolution procedures to help eliminate the effects of specific subsidy practices.

--Negotiating an improved Arrangement on the use of officially supported export credits and continuing to negotiate further improvements.

Attempts to persuade developing countries to reduce subsidies had limited success

The Agreement states that developing country signatories should endeavor to enter into a commitment to reduce or eliminate export subsidies when no longer needed. In May 1980, the

U.S. Government stated that developing countries which failed to make an acceptable commitment would not receive the injury test in proceedings under U.S. countervailing duty law even if they signed the Subsidies Agreement.

According to the Government, an acceptable commitment is one which has a promise to phase out existing export subsidies and to refrain from increasing subsidies or adopting new ones. The Government's commitment policy apparently has deterred some developing countries from signing the Agreement; only eight have signed as of July 1, 1983. Based on the commitments made so far, this policy has been inconsistently applied. Furthermore, certain developing countries found that they could not keep commitment promises. Nevertheless, the commitment policy may have impeded the expansion of undesirable subsidy practices. (See pp. 13 to 16.)

Reporting requirements have done little to improve disclosure of subsidies information

Article 7 of the Subsidies Agreement provides for improved disclosure of information about subsidy practices. One provision (cross notification) allows a signatory to notify a committee of Subsidies Agreement signatories about any subsidy which another has not reported to the General Agreement on Tariffs and Trade (GATT). Another provision allows any signatory to request information on the nature and extent of any subsidy maintained by another signatory and requires such requests to be answered quickly and comprehensively.

The U.S. Government formally used the cross notification provision to increase subsidy information on export credit programs during 1980-82. Some signatories did not report all of their subsidies to the GATT. The U.S. Government requested information under the second provision twice, both times in 1982. Responses by the European community and Brazil to these requests were neither complete nor timely.

GAO found that the European Community and U.S. Government disagreed about what constitutes a reportable subsidy practice under Article 7. The European Community stated that it is obliged to respond to a request for information only if the requester substantiates an alleged

subsidy's effect on trade. The U.S. Government believed that such a requirement defeats the purpose of this provision because a request for information may be for the purpose of determining whether a trade effect exists.

GAO concluded that the reporting provisions of the Agreement have done little to improve disclosure of subsidies information. (See pp. 17 to 19.)

Conflict resolution procedures not working well

In seeking to resolve issues concerning alleged subsidies that adversely affect U.S. interests in foreign markets, the United States has sought to use the conflict resolution provisions of the Subsidies Agreement. If a dispute between signatories cannot be resolved on a mutually acceptable basis, the Committee of Signatories may authorize countermeasures, taking into account the nature and degree of the adverse effect found to exist.

Private parties can petition the U.S. Trade Representative to take action against alleged subsidies under section 301 of the Trade Act of 1974, as amended. From January 1980 through October 1982 the U.S. Government accepted 12 such petitions.

GAO found that considerable problems exist in reaching an understanding with other signatories as to how to apply some provisions of the Agreement. For example, provisions in Article 10 relating to (1) "an equitable share of world export trade," for certain primary products and (2) "prices materially below those of other suppliers [of such products] to the same market" have proven especially troublesome. Until these problems are resolved, it is likely that little relief will be obtained from the dispute settlement provisions of the Subsidies Agreement. (See pp. 19 to 27.)

Progress made in reducing export credit subsidies

The Subsidies Agreement does not prohibit official export credit subsidies if the financing practices are in accord with an international Arrangement on officially supported export financing. The Government has entered into several such "Arrangements", each one successively stricter in its limitations on export

credit subsidies. According to a Treasury Department official, no subsidies are now involved in the majority of export credits under the Arrangement.

The first of the official credit Arrangements predates the Subsidies Agreement; the most recent revision was made in June 1982. The revised Arrangement has reduced the subsidy element in official export financing by narrowing the gap between governments' borrowing and minimum lending rates and accepting the principle of a differentiated interest rate system for low interest rate countries by establishing a separate minimum rate for export credits financed in yen. (See pp. 28 to 35.)

PROCEDURES FOR TRANSFERRING SUBSIDY INFORMATION TO THE PRIVATE SECTOR SHOULD BE IMPROVED

Two provisions of the Trade Agreements Act direct the Government to help the private sector acquire relevant information on foreign subsidies by:

- --responding to requests for information on a specific foreign trade policy and practice under section 305 of the 1974 Trade Act, as amended, and
- --providing access to information by establishing a library of foreign subsidy information under section 777 of the 1930 Tariff Act, as amended.

The office of the U.S. Trade Representative (OUSTR) has not issued regulations on section 305 clarifying its interpretation of the statute concerning the necessary specificity of requests. GAO's review of OUSTR's responses to section 305 requests related to foreign subsidy practices from July 1979 to August 1982 found that OUSTR was trying to deter ambiguous requests by requiring more specific questions about a subsidy policy or practice. Furthermore, OUSTR's response time is fairly slow. (See pp. 42 to 44.)

The foreign subsidies library is the responsibility of the Commerce Department. Between January 1980 and June 1981, virtually nothing was done to establish the library. From July 1981, and especially from April 1982, some

steps have been taken to create an automated index system for subsidies information and to index some information, such as determinations under the countervailing duty statute. However, subsidy information included in Embassy reports and responses to section 305 requests are not routinely added to the library. (See pp. 44 to 46.)

RECOMMENDATIONS

GAO makes several recommendations to improve the flow of information on foreign subsidy practices to the private sector. (See pp. 44, 47, and 50.)

AGENCY COMMENTS AND GAO's EVALUATION

Written comments were received from the Departments of Agriculture, Commerce, and the Treasury. The Department of State, Office of the U.S. Trade Representative, and International Trade Commission did not provide written comments.

Commerce agreed to implement GAO's recommendation to the Secretary of Commerce. (See p. 47.) The other Departments did not comment on GAO's recommendations. (See pp. 44 and 50.)

Commerce questioned the manner in which certain information was presented in the draft report, and all three Departments offered suggestions to improve the report's clarity. GAO considered these comments and made changes in the report where appropriate.

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ABBREVIATIONS

EC	European Community
GAO	General Accounting Office
GATT	General Agreement on Tariffs and Trade
ITC	International Trade Commission
OECD	Organization for Economic Cooperation and Development
OUSTR	Office of the United States Trade Representative

CHAPTER 1

INTRODUCTION

Governments both subsidize trade and defend against subsidies, a fact recognized by the 1979 Subsidies/Countervailing Measures Agreement,[1] one of several agreements concluded during the Tokyo Round of the Multilateral Trade Negotiations. The Tokyo Round was the 7th major negotiating round in the context of the General Agreement on Tariffs and Trade (GATT) (Oct. 30, 1947, 61 Stat. A3, T.I.A.S. No. 1700). The GATT was concluded in 1947 to establish an international set of groundrules to govern international trade.

The Subsidies Agreement asks signatory governments to recognize that subsidies may have harmful effects on trade and production but are used by governments to promote important objectives of national policy. The Agreement attempts to strike a balance between what is acceptable and unacceptable about governments' use of trade-related subsidies. In his April 1979 report on the then newly concluded Tokyo Round, the Director-General of the GATT observed that subsidies

> "have become one of the most frequently used and controversial instruments of commercial policy * * *. Under the influence of political and social necessity, governments have embarked on massive financial commitments in order, among other things, to prop up ailing industries, to support depressed areas, to stimulate consumer demand or to promote exports. Subsidies have become an important instrument of protection. In some sectors-shipbuilding is a good example-world trade is being conducted less in response to normal market forces than on the basis of competitive subsidization."

After years of preparation, Mutilateral Trade Negotiations officially opened in Tokyo in September 1973, when representatives of 102 countries declared that, among other goals, the negotiations should aim to "reduce or eliminate non-tariff

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[1] Formally, an "Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade." (30 U.S.T. ____, T.I.A.S. No. 9619.) Article VI of the GATT in part concerns the use of countervailing or offsetting duties on subsidized imports, Article XVI concerns the use of subsidies, and Article XXIII establishes in part the dispute settlement procedures of the GATT. Other non-tariff measure agreements concluded during the Tokyo Round were Customs Valuation, Government Procurement, Technical Barriers to Trade (Standards), and Import Licensing Procedures.

measures or, where this is not appropriate, to reduce or eliminate their trade restricting or distorting effects, and to bring such measures under more effective international discipline."

The Congress granted the President authority to negotiate trade agreements in the Trade Act of 1974 (19 U.S.C. §2101 _et seq._), which authorized the President to seek, among other revisions to existing trade agreements, "any revisions necessary to define the forms of subsidy to industries producing products for export and the forms of subsidy to attract foreign investment which are consistent with an open, nondiscriminatory, and fair system of international trade * * *." (19 U.S.C. §2131(a) (11)).

Early in the negotiations (i.e., in late 1975), the United States proposed a three part framework which classified subsidies as

--"prohibited"-countervailable (where a subsidy's effect is offset by an import duty) without conditions, such as a finding that a domestic industry is being injured by subsidized imports;

--"conditional"-countervailable under specified conditions, such as an injury test; and

--"permitted"-not countervailable under any conditions.

In view of resistance from other countries, the Government abandoned this proposal in late 1977. According to a State Department official, the breakthrough in the subsidy negotiations came with the U.S. Government's decision to deal with the effects of subsidies, not with subsidies themselves. The agreement reached by the negotiators placed major emphasis on the effects of subsidies.

On April 12, 1979, representatives of several governments participating in the Tokyo Round agreed to submit a series of proposed agreements to their respective governments for approval. The Trade Agreements Act of July 26, 1979 (19 U.S.C. §2501 _et seq._), approves and implements the Tokyo Round agreements for the United States. The Subsidies/Countervailing Measures Agreement took effect on January 1, 1980. As of July 1, 1983, 30 governments have signed the Agreement. (See list in app. I.)

OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of this review was to evaluate the Government's actions to secure benefits under the terms of the 1979 Subsidies Agreement and Trade Agreements Act. Our review focused on the Government's efforts to

--reduce and eliminate trade distorting subsidy practices;

--acquire information on foreign subsidy practices; and

--share this information with the private sector.

We did not review the administration of the countervailing duty law by the Department of Commerce and the International Trade Commission.

We examined policy-related documents and interviewed officials at the Office of the United States Trade Representative (OUSTR), International Trade Commission, and Departments of Agriculture, Commerce, Labor, State, and the Treasury. We attended the Interface III proceedings, a conference of U.S. and foreign trade experts and government officials devoted to the subject of trade distorting subsidy practices. In Geneva, Switzerland, we interviewed officials of the U.S. Trade Representative's office and the General Agreement on Tariffs and Trade.

We examined the Government's procedures for collecting information on foreign subsidy practices and for making relevant subsidy information available to the public. We gathered foreign subsidy-related information reported during 1980 through April 1982 from U.S. Embassies in Brazil, Canada, France, India, Italy, Japan, and Mexico. We chose these countries because, with the exception of Mexico, they represented both developed and developing country signatories to the Subsidies Agreement. Mexico is not a signatory, but the United States and Mexico tried without success to conclude a substantially equivalent bilateral agreement during the period of our review. The United States has had disputes over subsidies with each of the above countries.

The 1979 Trade Agreements Act amended two provisions of law to assist the private sector's efforts to learn more about foreign subsidy practices. Private parties may request subsidy-related information from the Government under section 305 of the Trade Act of 1974 as amended (19 U.S.C. §2415). We examined the available information on all subsidy-related requests through September 1982 under section 305 and analyzed it in terms of the timeliness and completeness of the Government's response.

The Trade Agreements Act also amended the Tariff Act of 1930 to require a library of foreign subsidy information (19 U.S.C. §1677f). This library was established in the Commerce Department. We reviewed the development of the library and its procedures for acquiring subsidy information. We compared the

information contained in the library with the information collected pursuant to section 305 requests and reported from U.S. Embassies in the seven countries mentioned above.

Private parties also request foreign subsidy information from specific Government agencies. We examined the available information on all such requests to the Commerce Department during 1980 and 1981 and interviewed all available requesters to obtain their opinions on the usefulness of the information and assistance they received.

We also collected the Commerce Department's decisions in all countervailing duty cases alleging preferential financing subsidies between 1978 and 1981. We focused on each of the 16 instances in which an alleged financing program was judged not to be a countervailable subsidy; we specifically examined one 1982 decision in relation to the provisions of the Subsidies Agreement.

We selected for review 5 of the 12 petitions submitted since January 1980 under section 301 of the 1974 Trade Act, as amended, alleging that practices of foreign governments were inconsistent with the Subsidies Agreement. All of these cases concerned the alleged adverse effects of the European Community's agricultural subsidies on U.S. trade. They were the first group of cases accepted by OUSTR since the effective date of the Agreement, and currently are pending before OUSTR and are at various stages in the Agreement's conflict resolution process. We examined one case in detail in order to fully assess conceptual and procedural problems associated with this process.

We assessed the significance of the U.S. Government's decision in the Tokyo Round to deal with the effects of subsidies by examining material injury decisions in countervailing duty determinations. We reviewed all negative, or no injury, determinations made by the International Trade Commission between January 3, 1975, and December 31, 1981, as well as all affirmative decisions that were not unanimous. Negative injury determinations were selected because a countervailing duty cannot be assessed on subsidized imports in such cases, hence the importance of the determinations. We focused on split decisions because the Commissioners' interpretive differences over the injury standard are clearer in these kinds of decisions.

OUSTR's review policy delayed our access to relevant records. Although OUSTR expressed a desire to cooperate, it consistently found a need to refer our requests to higher authority for decisions on access to documents, with the end result that most requests are still pending after many months. Eventually, we did obtain most of these documents from other sources. We believe that we obtained the information essential

to carry out our review objectives, but OUSTR's policy on access to records made it necessary to seek information from a number of sources, thus making our work much less efficient and more costly.

Our review was performed in general accordance with generally accepted Government audit standards.

CHAPTER 2

THE SUBSIDIES AGREEMENT:

WHAT THE UNITED STATES GOT

VS. WHAT IT GAVE UP

In signing the Subsidies Agreement and passing the Trade Agreements Act, the U.S. Government granted to countries that either signed the Agreement or assumed equivalent obligations an injury determination or "test" on dutiable imports in countervailing duty cases.[1] This is a tangible benefit to countries that subsidize their exports, because a requirement to show that subsidized exports harm a domestic industry of an importing country presumably lowers the probability that such exports will be countervailed. Before 1980, only a duty-free import required an injury test as part of a countervailing duty investigation. We determined that three cases decided from February 1980 through May 10, 1982, would have been countervailed except for the Agreement. These cases represented dutiable imports from Agreement signatories for which the Government made affirmative subsidy determinations but found no injury.

In return for extending the injury test, the U.S. Government wanted stronger rules on the use of subsidies and better procedures for resolving subsidy-related disputes between governments. Under the Agreement, the United States gained an opportunity to further its objectives of reducing and eliminating trade distorting subsidies. To achieve these objectives, since January 1980 the Government has pursued strategies of (1) clarifying ambiguous concepts in the Subsidies Agreement, (2) invoking the Agreement's conflict resolution procedures in specific cases, (3) negotiating a strengthened international arrangement on officially supported export financing, and (4) negotiating an agreement restraining subsidized steel imports from the European Community (EC).

U.S. trading partners achieved their objectives in the Tokyo Round negotiations on subsidies when the emphasis was placed on the effects of subsidies and the United States agreed to extend the injury test. The burden of proof is on countries that import subsidized products because they must, as a general rule, demonstrate why a specific subsidy practice adversely affects their domestic industry or trade. Even the seemingly straight forward language of Article 9 of the Agreement--signatories shall not grant export subsidies on products other

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[1]According to the Agreement, the term "countervailing duty shall be understood to mean a special duty levied for the purpose of off-setting any bounty or subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise * * *."

than certain primary products--does not void this principle. Presumably the prohibition in Article 9 is constrained by Article 18, which states that countermeasures may be authorized by a committee of signatories pursuant to the Agreement's dispute settlement procedure in relation to the nature and degree of adverse effect found to exist.

The Government has preferred not to initiate disputes over foreign subsidy practices but to rely on the private sector to petition for redress from the adverse effects of such practices. In this circumstance, the Government seemingly has an interest in ensuring that the private sector receives needed information on foreign subsidies in order to initiate cases under U.S. trade law. Chapter 5 discusses the administration's efforts to transfer this type of information to the private sector.

WHAT THE UNITED STATES GAVE UP: IMPOSING COUNTERVAILING DUTIES WITHOUT AN INJURY TEST

In the subsidies-related Tokyo Round negotiations, extending the injury test to dutiable imports was the principal offer of the United States. Under the Tariff Act of 1930, as amended by the 1974 Trade Act (19 U.S.C. §1303), only duty-free imports required injury tests as part of a countervailing duty determination. Before the effective date of the 1974 Trade Act on January 3, 1975, the injury test was not part of U.S. countervailing duty law, which dates from 1897.

U.S. trading partners wanted the United States to conform existing U.S. law to Article VI: 6(a) of the GATT, which states that:

> "No contracting party shall levy any * * * countervailing duty on the importation of any product of the territory of another contracting party unless it determines that the effect of the * * * subsidization * * * is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry."

In October 1947 the U.S. and other governments agreed to apply provisionally on January 1, 1948, and thereafter the terms of the then recently completed GATT. The United States maintained that, under the Protocol of Provisional Application, domestic countervailing duty law (without an injury test for duty-free imports until 1975) was consistent with its GATT obligations, notwithstanding Article VI of the GATT. The Protocol states that contracting governments should apply part of the GATT, including Article VI, to the fullest extent not inconsistent with existing legislation. Article 1 of the Subsidies Agreement requires signatories to apply the provisions of Article VI of the GATT in countervailing duty investigations.

The Government's offer to extend the injury test was in the general U.S. economic interest. The offer, however, revealed a logical problem in the Government's negotiating tactics on a subsidies agreement. Consumers are unneccessarily "taxed" by barriers on imports that are not damaging domestic industry because a countervailing duty increases the cost of such imports. The Government's objective in the negotiations was to obtain the best possible arrangement (better rules on subsidy use and dispute settlement) for doing what was, in any event, the economically sensible thing in applying injury tests to all subsidized imports in countervailing duty investigations. Nevertheless, under the Subsidies Agreement some domestic firms lost the right under the countervailing duty law which protected them from import competition if the Government found that such imports were subsidized. The Trade Agreements Act of 1979 removed that protection. Since January 1980, only domestic industries that can prove that they are being injured or threatened with imminent injury by reason of subsidized imports can expect help through a countervailing duty if the imports are from a signatory to the Subsidies Agreement.[2]

We determined that from February 1980 through May 10, 1982, three countervailing duty decisions were made involving dutiable imports from Agreement signatories for which the Government made affirmative subsidy determinations but found no injury. For example, in 1980 the Government determined that the Government of Japan subsidized the export of certain scales and weighing machinery through a 5-year deferral of income taxes paid on export earnings, export promotion assistance, and preferential financing. The Government also found that the corresponding domestic industry was not injured by these scales although imports more than doubled between 1978 and 1979. The Government found in this case that both imported and domestic scale prices declined due to technological innovations and that domestic production more than doubled and U.S. exports tripled between 1977 and 1979. Imports of Japanese scales would have been countervailed under the law prior to 1980.

The countervailing measures part of the Agreement describes procedures for conducting an investigation to "determine the existence, degree and effect of any alleged subsidy." In the United States the existence and degree of subsidization are determined by the Department of Commerce (Import Administration), while "effect" is determined by the International Trade Commission (ITC). As in the GATT, adverse effect under the terms of the Subsidies Agreement and domestic law means "material injury,"

[2]As a result of bilateral agreements which predate the Trade Agreements Act, the following countries are accorded the benefit of a test of material injury under U.S. law in all countervailing duty investigations: El Salvador, Honduras, Liberia, Nepal, North Yemen, Paraguay, and Venezuela.

"threat of material injury" to a domestic industry, or "material retardation" of the establishment of such an industry. Private parties may petition Commerce and ITC to offset alleged injury caused by subsidized imports with a countervailing duty on the imports in question. The 1979 Trade Agreements Act establishes the timetable under which these two agencies conduct countervailing duty investigations. Chapter 6 discusses the injury concept and determinations under the countervailing duty statute. (App. II summarizes the process of such an investigation under U.S. law.)

WHAT THE UNITED STATES GOT: BETTER RULES ON SUBSIDY USE AND A FRAMEWORK FOR RESOLVING CONFLICTS

In return for extending the injury test to dutiable imports, the United States wanted a subsidies agreement that recognized the harmful effects of trade distorting subsidies and a framework for managing international conflict over these subsidy practices. Article 9 of the Agreement includes the requirement that signatories shall not grant export subsidies (left undefined) on products other than certain primary products; in place of a definition, the Agreement includes an illustrative list of such subsidies. (See app. III.)

Article 14 states that prohibiting export subsidies on industrial products does not apply to developing country signatories, provided that their subsidies are not used in a manner which causes serious prejudice to the trade or production of another signatory. Article 14 further states that a developing country signatory should endeavor to enter into a commitment to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with its competitive and development needs. The U.S. Government has substituted a more specific commitment policy (see ch. 3) for the general admonition in Article 14. If developing countries are to receive the benefits of the injury test under U.S. law, even if they sign the Agreement, they must make an acceptable commitment to reduce or eliminate the export subsidy practices they may use. A number of developing countries have made such commitments.

The Agreement is not specific concerning export subsidies on certain primary products (defined as any product of farm, forest, or fishery). Article XVI:3 of the GATT states that countries should seek to avoid subsidies on primary products. Article 10 of the Subsidies Agreement states that signatories agree not to grant such subsidies in a manner which (1) results in a signatory having more than an equitable share of world export trade in such a product or (2) materially undercuts the prices of another supplier to the same market. The phrase "equitable share of world export trade" is not defined in the GATT or in the Agreement. In response to several petitions from private parties, the United States charged in late 1981, that the EC was exporting subsidized agricultural products in violation of Article 10. In commenting on our draft report, the Administrator of the Foreign Agricultural Service stated that the Agreement attempted to bring

more precision to the concept of an equitable share of world export trade by indicating that it involved displacement of other exporters from the market. According to the Administrator, it was hoped that this refinement, plus the concept of price undercutting which was added in the Agreement, would be sufficient to permit a demonstration of the adverse effects of subsidies on primary products; the cases brought by the United States in 1981 were intended to test these ideas. We discuss one of these cases in chapter 3. Appendix V summarizes the status of all such cases.

Article 11 of the Subsidies Agreement concerns the use and effect of non-export or domestic subsidies. The Article notes that although such subsidies are widely used as important instruments to promote social and economic policy objectives, they may injure the domestic industry of another signatory or adversely affect the conditions of normal competition between signatories. Signatories are directed to avoid causing such adverse effects through non-export subsidies. The Trade Agreements Act also distinguishes between export and domestic subsidies and states conditions under which the Government can take action against imports benefiting from them. Chapter 6 discusses the basis of one such decision by the Commerce Department under the Trade Agreements Act.

The framework for resolving conflicts between signatories consists of "consultation," "conciliation," and "dispute settlement." The goal of all three stages is a mutually satisfactory solution; however, failure to find such a solution could result, as a final step, in a committee of signatories authorizing appropriate countermeasures, including withdrawal of GATT concessions or obligations, taking into account the nature and degree of the adverse effect.

Private U.S. parties may request the Government to take action against trade distorting subsidies under two provisions of law. Aside from petitions under the countervailing duty statute, private parties alleging that a foreign trade practice is inconsistent with the Subsidies Agreement, for example, also may petition the Government under section 301 of the Trade Act of 1974, as amended (19 U.S.C. §2411 _et seq._) to take action under the terms of the Agreement. Before the President can take action pursuant to such a petition, the U.S. Trade Representative must invoke the Agreement's conflict resolution procedures. Action at each stage (consultation, conciliation, and dispute settlement) should take place within a specified period of time. In commenting on our draft report, the Administrator of the Foreign Agricultural Service noted that section 301 does not limit the President to the use of the Subsidies Agreement to remedy subsidies problems and that the administration, in fact, must make a separate decision as to whether use of the Subsidies Agreement is the most appropriate procedure to follow. Appendix IV summarizes the process and time limits for an investigation under section 301 and the Agreement's conflict resolution procedures.

The Office of the U.S. Trade Representative is responsible for directing section 301 investigations through an interagency 301 committee. An OUSTR official also chairs the interagency Trade Policy Staff Committee and its subsidies subcommittee.

ACTIONS TO REDUCE AND ELIMINATE TRADE DISTORTING SUBSIDIES PRODUCING MIXED RESULTS

Since January 1980 the Government has tried to reduce and eliminate trade distorting subsidies by (1) clarifying the terms of the Subsidies Agreement (for example, by negotiating commitments with some developing countries to reduce or eliminate their export subsidies), (2) invoking the Agreement's conflict resolution procedures in response to private parties' petitions under section 301 of the Trade Act of 1974, as amended, (3) negotiating a steel import restraint agreement with the EC, (4) negotiating an improved arrangement on export credits, and (5) using agricultural export subsidies to demonstrate concern over the lack of progress in discussions with the EC on the effects of its agricultural export policy on U.S. agricultural exports to third-country markets.

Negotiations to reduce or eliminate trade distorting subsidies have produced mixed results. As discussed in chapter 3, the U.S. Government negotiated commitments with a number of developing countries to remove or modify their export subsidies. For the most part these commitments are vague and generally have not caused developing countries to significantly reduce their trade-related subsidies.

Some progress to control subsidies through a strengthened international Arrangement on export credits was negotiated in the summer and fall of 1981 and in June 1982. The Arrangement dates from 1978 and, as a result, export credits consistent with the Arrangement's terms are not prohibited by the more recent Subsidies Agreement. (See ch. 4.)

As of July 1, 1983, no cases have been fully adjudicated under the Agreement's conflict resolution procedures. The parties to some of these disputes have not adhered to the time limits established by the Agreement for the reasons discussed in chapter 3. The United States has not yet taken action against the EC's agricultural export subsidies under section 301.

The Subsidies Agreement states that a signatory whose products are the subject of a countervailing duty investigation, shall be afforded a reasonable opportunity for consultation with the aim of arriving at a mutually agreed solution. In January 1982, 7 U.S. steelmakers filed 94 countervailing duty petitions against foreign steel producers in 8 European countries, Brazil, and South Africa. Shortly before countervailing duties were to

be imposed, the United States and the EC concluded an import restraint agreement in October 1982 with the concurrence of all major producers in the U.S. steel industry. Under the agreement the EC will limit steel shipments to the United States from November 1, 1982, to December 31, 1985, to an average 5.46 percent of the U.S. market for 10 categories of steel. The Secretary of Commerce stated that the restraint agreement "removes one of the most severe trade frictions between the United States and the European Community * * *."

A mutually agreed solution between the United States and EC on the latter's agricultural export subsidies, however, remains elusive. Recognizing that there is widespread dissatisfaction with the application of GATT rules and the degree of liberalization in relation to agricultural trade, the members of the GATT in November 1982 agreed to undertake a 2-year work program to bring agriculture more fully into the international trading system. This declaration was followed by direct U.S. action in January 1983 when the Government stated that it will subsidize the sale of 1 million metric tons of wheat flour to Egypt. The sale is an apparent attempt to dislodge subsidized EC exports from the Egyptian market and thereby underscore U.S. concern with the EC's agricultural export policy.

On December 1, 1975, the Millers' National Federation filed a petition under section 301 of the Trade Act of 1974 stating that the EC's export subsidies on wheat flour violated Article XVI of the GATT. On February 24, 1983, a panel convened under the dispute settlement provisions of the Subsidies Agreement stated that it was unable to conclude whether the increased EC share of world exports of wheat flour has resulted in the EC "having more than an equitable share." The Panel also concluded that despite the considerable increase in EC exports, market displacement was not evident in the 17 markets it examined. With regard to price undercutting, the Panel found that, on the basis of available information, there was not sufficient ground to reach a definite conclusion as to whether the EC had granted export subsidies on export of wheat flour in a manner which resulted in prices materially below those of other suppliers to the same markets. (See app. VI for a more complete description of the panel's findings.) As of July 1, 1983, the Committee of Signatories had not acted on the Panel's report on wheat flour.

CHAPTER 3

USING THE SUBSIDIES AGREEMENT TO REDUCE SUBSIDIES HAS LITTLE SUCCESS

With the effective date of the Subsidies Agreement on January 1, 1980, the U.S. Government continued to support its objective of reducing trade distorting subsidy practices by:

--Persuading developing countries to make commitments that specify their obligations under the Agreement to reduce or eliminate export subsidies that are inconsistent with their development needs.

--Persuading Agreement signatories to report the extent, nature, and effect of subsidies.

--Using the Agreement's conflict resolution procedures to help eliminate the effects of specific subsidy practices.

Any evaluation of these efforts must be tempered with the caveat that as of January 1983, the Agreement was only 3 years old. The administration's commitment policy toward developing countries has achieved little, if any, progress in eliminating and reducing their trade distorting subsidies although it may have inhibited new subsidies. The notification or "transparency" features of the Agreement have not caused governments to more fully disclose their subsidy practices. Finally, as of July 1, 1983, no case has been fully adjudicated under the Agreement's conflict resolution procedures, and the experience with these procedures indicates a difficulty in securing evidence needed for timely resolution.

ATTEMPTS TO PERSUADE DEVELOPING COUNTRIES TO REDUCE SUBSIDIES PRODUCING FEW RESULTS

Article 14 of the Subsidies Agreement recognizes that subsidies are an integral part of economic programs of developing countries but also states that export subsidies on industrial products "shall not be used in a manner which causes serious prejudice to the trade or production of another signatory." This subsidization, however, should not continue indefinitely. Article 14.5 states that a

> "developing country signatory should endeavour to enter into a commitment to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with its competitive and development needs."

Article 14.6 provides an incentive for such a commitment, stating that export subsidies covered by commitments shall not be subject to countermeasures by another signatory under the Agreement's conflict resolution procedures.

The question of what constitutes an acceptable commitment was clarified in negotiations with Brazil. In late 1978, about 5 months before the Tokyo Round concluded, Brazil agreed to phase out over a specified time a subsidy program that was then the subject of a countervailing duty investigation. A phaseout, together with a pledge not to extend subsidies to new products or to increase the rate of existing subsidies--in effect a standstill--became the model of an acceptable commitment for the U.S. Government.[1]

In discussions with congressional, business, and labor leaders on draft texts of the Agreement and the Trade Agreements Act, Government officials said that in their view an acceptable commitment under Article 14.5 would contain specific phaseout and standstill provisions.

In the May 8, 1980, Signatories' Committee meeting, the U.S. Government formally presented its commitment policy, stating that the United States was flexible as to the content of a developing country's commitments as long as there was a promise to eliminate export subsidies as soon as that country's competitive and development needs permitted. The U.S. delegate, however, said that the United States would not extend the injury test as part of a countervailing duty investigation involving dutiable imports from a developing country if that country signed the Agreement but failed to conclude an acceptable commitment. Other developed countries agreed that the United States should seek to negotiate commitments. However, the United States was the only one insisting that developing countries submit acceptable commitments as a precondition to receiving the injury test.

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[1]On Nov. 16, 1981, Brazil unilaterally postponed compliance with its commitment by revising the phaseout schedule of the rate of subsidization of an export tax rebate scheme. Brazil stated that it would continue to observe the June 30, 1983, deadline, at which time its tax subsidy would terminate. As a result of U.S.-Brazil consultations, Brazil agreed to terminate its tax rebate by March 31, 1983, or 3 months sooner than called for in its original commitment. The U.S Government agreed to Brazil's desire to forego further reductions in the rate of subsidization through most of the remaining phaseout period. According to Government officials, the U.S. Government discussed in December 1982 and later agreed to Brazil's request for a 2-year extension of the March 1983 deadline due to its economic difficulties.

Despite the precedent set by the Brazilian commitment, the Government compromised its ability to attain its goal of getting strong commitments when it accepted in March 1980 a commitment from Pakistan that did not contain specific phaseout or standstill provisions. Between the precedents of a "strong" Brazilian-type commitment and a "weak" Pakistani one, other developing countries understandably wanted to follow the easier path. For example, in June 1980, Korea, an advanced developing country stated that it does not maintain export subsidies that are materially incompatible with its obligations under the Agreement. Korea's commitment, however, contained an escape clause allowing it to establish subsidy programs in extraordinary economic conditions.

The United States had a prolonged confrontation with India over the issue of what defines an acceptable commitment. During the spring and early summer of 1980, in preparation for signing the Subsidies Agreement, India negotiated a commitment that was acceptable to most of the relevant U.S. Government agencies. India signed the Subsidies Agreement on July 11, 1980, to become effective on August 10, 1980. Senior U.S. and Indian trade officials reached an agreement on the text of India's commitment in August 1980. The former U.S. Trade Representative, however, rejected the draft commitment, stating to the Indian Government that it did not contain sufficient phaseout and standstill provisions. On August 27, 1980, the U.S. Government invoked Article 19.9 of the Subsidies Agreement against India, which states that:

> "This Agreement shall not apply as between any two signatories if either of the signatories, at the time either accepts or accedes to this Agreement, does not consent to such application."

One effect of invoking Article 19.9 was to deny India the benefit of an injury test in U.S. countervailing duty cases. India countered by claiming that the U.S. Government was violating Article I of the GATT, which established the "most favored nation" principle in international trade. Article I states that "[w]ith respect to customs duties * * * any advantage, favour, privilege or immunity granted by any contracting party [to the GATT] to any product * * * shall be accorded immediately and unconditionally to the like product * * * of all other contracting parties." India alleged that the U.S. Government's action was inconsistent with the most favored nation principle of Article I. At the same time, India stated in the Signatories' Committee that Article 14.5 requires only a voluntary commitment and that the U.S. Government's use of Article 19.9 was coercive. As a result of this dispute, other developing countries, such as Egypt, Malaysia, Singapore, and the Philippines, were reluctant to sign the Subsidies Agreement until the dispute with India was resolved.

In early 1981, some observers believed that a GATT dispute settlement panel would have strongly favored India on the merits of the case.

During April through August 1981, the administration detached itself from the previous administration's position on India's commitment; in September 1981 India made a commitment similar to the one rejected in August 1980. The U.S. Government ceased invoking Article 19.9 and India withdrew its GATT case.

By July 1, 1983, a number of developing countries had signed the Agreement and negotiated commitments with the United States for discipline on export subsidies. (See app. I.)

Although Brazil's commitment contained a specific schedule for phasing out some subsidies, it did not explicitly cover, for example, its preferential financing programs. The Korean commitment states that Korea grants no subsidies materially incompatible with the Agreement, and the commitment contains an "escape clause" that allows Korea to establish subsidy programs in extraordinary economic conditions, an admission that commitments are subject to change. The Indian and Pakistani commitments are especially vague. For example, the Indian Government stated that it does not anticipate establishing new export subsidy programs. The Pakistani Government stated that any export subsidy would be reduced or eliminated when it ceased to be consistent with development and competitive needs.

Uruguay's December 1979 commitment pledged to phase out all subsidies for non-traditional exports by 1982, but a February 1980 decree reinstated export subsidies. This decree was suspended in February 1981. Uruguay's commitment did not contain an escape clause, and there are no procedures in the Subsidies Agreement to deal with countries that deviate from their commitments. As a result of balance-of-payments problems in mid-1982, the Government of Uruguay instituted a 10-percent across the board export subsidy together with a 10-percent import surcharge. In late 1982, the export subsidy and import surcharge measures were eliminated after Uruguay devalued its currency.

The U.S. Government has not been able to negotiate a commitment with Mexico to reduce and eliminate Mexican export subsidies. In 1981 U.S. and Mexican officials discussed the conditions necessary to grant Mexico the injury test under U.S. countervailing duty law. Although Mexico was not prepared to sign the Subsidies Agreement, it was willing to discuss a bilateral agreement substantially equivalent to this agreement. Given Mexico's advanced stage of development and the competitiveness of Mexican goods in the U.S. market, the U.S. Government desired a firm commitment by Mexico to eliminate its export subsidies. Efforts to negotiate a bilateral agreement with Mexico during the Lopez Portillo administration in 1981-82 did not result in an agreement.

REPORTING REQUIREMENTS HAVE
DONE LITTLE TO IMPROVE DISCLOSURE
OF SUBSIDIES INFORMATION

Article 7 of the Subsidies Agreement includes provisions designed to improve disclosure of information about the subsidy practices of signatories. One provision allows a signatory to notify the Signatories' Committee of any trade-related subsidy which another has not reported to GATT under Article XVI:1 of the General Agreement ("cross notification"). A second provision allows any signatory to request information on the nature and extent of any trade-related subsidy maintained by another signatory and requires such requests to be answered quickly and comprehensively.

The U.S. Government formally used the cross notification provision during 1980-82 to increase subsidy information on export credit programs. It was aware that some signatories had not reported all of their trade related subsidies to GATT. The U.S. Government was constrained from notifying the Committee of the subsidy practices of other countries because of a concern that this would result in cross notification by U.S. trading partners on some U.S. practices that they perceived to be trade-related subsidies.

The Government requested information under the second provision twice, both times in 1982. The responses to these requests were incomplete and not timely. These results indicate that the request for information provision of the Agreement has done little to improve disclosure of information about foreign subsidies. It is not clear to us why the Government made so little use of this provision of Article 7, since it was attempting to resolve specific subsidy issues with other signatories to the Agreement.

Article XVI:1 of the GATT states that if any member of the GATT grants or maintains any subsidy which operates directly or indirectly to increase exports of any product from or to reduce imports of any product into its territory, it shall notify the member governments in writing of the (1) extent and nature of the subsidization (2) estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory, and (3) circumstances making the subsidization necessary. Member governments were supposed to report any such subsidies every 3d year and any changes each intervening year. The latest full reports under this procedure were due in January 1981. Although the U.S. Government has reported on a number of occasions, it, along with other GATT members, has also ignored the self-reporting procedures. Other governments tended to avoid self-incrimination, especially at a time when the injury test was not part of U.S. countervailing duty law or was relevant only to duty-free imports.

Article 7 of the Subsidies Agreement states that any signatory may request information from another signatory on the nature and extent of the kinds of subsidies referred to in Article XVI:1

of the GATT. Further, if a subsidy practice is not reported, a signatory may bring the subsidy practice in question to the notice of the Signatories' Committee. There are no time limits for providing requested information under Article 7, but signatories are supposed to respond to requests as soon as possible.

The U.S. Government's notification under GATT Article XVI:1, submitted in February 1982, stated that the U.S. Government maintained four subsidy programs, including export credits. The U.S. Government, in reporting export credits, hoped to get other signatories to report their export credit programs and to quantify for the record the subsidy element in such programs. As an example for others, the Government in February 1982 reported the estimated present values of U.S. export credit subsidies for fiscal years 1979-81--$152 million, $641 million, and $1,131 million respectively.

In March 1982 the Committee of Signatories discussed GATT subsidies notifications at a special meeting. As discussed in chapter 4, the United States and its major trading partners at this time were preparing to resume negotiations to reform an export credit "Arrangement" that would bring officially supported minimum interest rates closer to actual market rates. The administration believed that the reporting process could be a helpful, but not decisive, tool for setting the stage for successful export credit negotiations.

The European Community, however, took a somewhat different view; generally it questioned the appropriateness of reporting publicly available subsidy-related information under the GATT, since to do so would be redundant. Specifically, the EC said that it would not report its member governments' export credit programs, because it thought that export credit programs consistent with the terms of an existing international "Arrangement" were not notifiable subsidies under the GATT.

Government officials believed that their ability to use the information or cross notification provision to challenge others' subsidies was constrained by questions that had been raised about the United States living up to its obligations under the Agreement.

The EC and others had questioned why the U.S. Government did not report on the Domestic International Sales Corporation program --a program to defer Federal income taxes on part of the export income of certain corporations--which the EC and others viewed as an export subsidy. Informally, some countries also questioned the effect on petrochemical prices arisng from price controls on natural gas.

A major obstacle to the Government's use of the information provision was removed in March 1982 when Canada filed a cross notification with the Signatories' Committee concerning the U.S. program to defer income tax on export income. In April 1982 the Government proceeded to use the information provision,

noting at a Signatories' Committee meeting that, with the exception of four countries, signatories had not reported their subsidized export credit programs. The Government subsequently sent requests to several countries asking that they promptly report such programs.

Aside from differences over the requirements of Article XVI:1 of the GATT, the United States and the EC disagree over the meaning of the Subsidies Agreement's Article 7 (requests for information). The EC contends that an appropriate Article 7 request is one where a signatory has reason to believe that a particular subsidy affects trade; this belief moreover should be substantiated in the request for information.

The administration contended that the EC's approach to Article 7 "puts the cart before the horse." Article 7 is a means to increase information and should not be seen as a theater for "staging jurisdictional contests over subsidy effects before information can be exchanged." The U.S. Government has requested information under Article 7 twice in support of a petition submitted under section 301, as discussed later in this chapter. However, we believe that the responses have not been timely or complete.

SUBSIDY INFORMATION PROBLEMS DETER TIMELY CONFLICT RESOLUTION

U.S. countervailing duty law provides a unilateral means for dealing with subsidized exports to the United States. In seeking to resolve issues concerning alleged subsidies that adversely affect U.S. interests in foreign markets, however, the United States has relied on the conflict resolution provisions of the Subsidies Agreement. These provisions include consultation, conciliation, and dispute settlement stages, with specified time limits for action at each stage. If a dispute between signatories cannot be resolved on a mutually acceptable basis, the Committee of Signatories may authorize countermeasures taking into account the nature and degree of the adverse effect.

Private parties can petition the office of the U.S. Trade Representative under section 301 of the Trade Act of 1974, as amended, which authorizes the President to take all appropriate and feasible action to enforce U.S. rights under any trade agreement, including the Subsidies Agreement.[2] From January 1980 through 1982, the U.S. Government accepted 12 petitions under section 301 from private parties alleging harmful foreign subsidy practices. (See app. V for the current status of these petitions and one filed in 1975 under the provisions of the GATT.)

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[2]Section 301 can also be used to respond to any foreign act, policy, or practice which is "unjustifiable, unreasonable or discriminatory and burdens or restricts United States commerce * * *."

We found that petitioners did not have access to some of the information needed to demonstrate the existence and nature of subsidy practices of foreign governments. Even if such information were available, considerable problems would remain in reaching an understanding with other signatories as to how to interpret some provisions of the Agreement, such as those in Article 10 relating to "an equitable share of world export trade," and "prices materially below those of other suppliers to the same market."

The U.S. Government, using the information provision of the Agreement, attempted to assist the petitioners by requesting subsidies information from the foreign governments involved. Because of disagreements over obligations arising from the information provision, its efforts were mostly unsuccessful. Until the issue concerning access to trade information held by foreign governments and application of other provisions of the Agreement are resolved, it seems probable that little relief will be obtained from the dispute settlement provisions of the Subsidies Agreement.

The initial set of petitions accepted under section 301 since the effective date of the Subsidies Agreement concerned the EC's alleged subsidies for agricultural exports. The Agreement forbids the use of export subsidies on primary products (defined as any product of farm, forest, or fishery) only when they have certain adverse effects defined by the Agreement. As Article 10 states, signatories agreed not to use an export subsidy on a primary product which results in (1) the exporting country having more than an equitable share of the world export trade or (2) material price undercutting of other suppliers to the same market. For example, U.S. poultry exporters filed a petition in 1981 alleging, in part, that their prices in the Middle East market were materially undercut by EC subsidies.

Requirements of petitions alleging Subsidies Agreement violation

A section 301 committee, chaired by OUSTR and composed of representatives from several agencies,[3] reviews section 301 petitions filed with OUSTR and advises OUSTR on whether the information provided by petitioners is acceptable. Not later than 45 days after the date on which the petition is received, OUSTR must determine whether or not to initiate an investigation.

Regulations concerning petitions filed under section 301 state that they shall include information, to the extent possible, on

--the volume of trade in the goods or services involved;

[3]The principal agencies are Agriculture, Commerce, Labor, State, and the Treasury.

--the economic or other impact on the petitioner and on U.S. commerce in general; and

--the nature of the alleged subsidy and the manner in which it is inconsistent with the Subsidies Agreement and burdens or restricts commerce.

The undefined regulatory phrase--information "to the extent possible"--leaves to OUSTR's discretion the extent and quality of data it deems necessary to make a case under the terms of the Agreement. This can pose a problem if the Government wishes to accept a petition without sufficient data. In such a case, the Government would have to use the 45-day assessment period to develop, rather than to validate and analyze, the sufficiency of information in preparing the argument required by the Agreement at the time of consultations. According to the Agreement, a signatory requesting consultations shall include a statement of available evidence concerning the existence and nature of the export subsidy in question. Depending on the nature of the allegation, a signatory may also include a statement of available evidence concerning the injury to the domestic industry or the adverse effects caused to the interests of the signatory requesting consultations. This statement is the basis for the Government presentation during consultations and possible referral to the Committee of Signatories for conciliation and dispute settlement.

The requirement to present evidence regarding the existence and nature of the export subsidy in question has been particularly difficult to comply with. Countries providing subsidies obviously have the most complete and accurate information and are obligated under the Agreement to report such information to other signatories upon request. However, as discussed earlier, there is some disagreement over the nature of signatories' obligations under the Agreement's information provision, and the Government has found that signatories are hesitant or unwilling to provide complete, timely responses to requests, particularly when the information may be adverse to their interests.

Government officials were divided over the sufficiency of evidence supporting allegations in some of the agricultural petitions accepted so far. During the first 45 days after receipt of the petitions, OUSTR and other agencies attempted to develop additional information in support of some allegations made in these cases. Similar efforts occurred when industry representatives and Government officials met to discuss the industry's problems prior to filing a petition. When sufficient information was not readily available to support the allegations in these cases, OUSTR believed that there was no realistic alternative but to try and supplement the available information from the foreign governments involved at the time of consultation or, in one case, through requests under Article 7.

Although the Government is reluctant to self-initiate cases and is not obligated to accept 301 petitions, OUSTR's

practice is to pursue subsidy-related allegations once petitions are filed. Administration officials, however, are divided on the wisdom of accepting petitions as a general rule.

OUSTR is reluctant to reject petitions if it perceives they have merit because it recognizes that the Government has a role in assisting the petitioner to get the required information to demonstrate adverse effect. This is consistent with congressional intent, as expressed in the Senate Committee on Finance report on the Trade Agreements Act, which stated that OUSTR should have the discretion necessary to reject frivolous cases and to take account of other matters so as to proceed on the basis best designed to secure U.S. interests in the matters alleged in the petition. The report also established an expectation that OUSTR will normally accept all but frivolous petitions and initiate investigations to actively seek information to support the petitions rather than narrowly focus on the accuracy of the allegations in the petitions. By the end of March 1983, two petitions alleging subsidy practices had been rejected, one had been terminated without prejudice, and others had been withdrawn.

Some officials believe OUSTR should be more willing to exercise its "gate keeper role." They argue that dispute settlement proceedings under the Agreement are not analogous to U.S. judicial proceedings; alleging that a sovereign government is violating its obligations under an international agreement is a serious and primarily political issue and only secondarily a judicial one. In order to maintain the credibility of the Agreement's dispute settlement system, these officials believe OUSTR should accept only cases that are strongly supported by evidence concerning the adverse effect alleged to exist and that the administration should consider the validity of the petitioners' allegations before accepting cases as well as whether pursuit of the cases is the best means of securing U.S. interests. One concern of these officials is that by accepting insufficiently supported petitions, the Government runs the risk that the dispute settlement process will not produce results favorable to the United States. Other officials expressed the view that a major determinant in the Government's decision on whether to accept a 301 petition must be the injury to the domestic industry concerned. They pointed out that section 301 provides the President with sufficient flexibility to take remedial action to protect domestic industries on his own initiative.

Difficulty in obtaining foreign subsidy data prevents timely resolution of conflicts

The Subsidies Agreement and the Trade Agreements Act specify time frames for each of the conflict resolution stages. If the time frames are adhered to, conflicts should be resolved within 9 or 10 months of the petition date for export and non-export subsidies, respectively. The various phases of a section 301 case are as follows.

Government determines whether to accept or reject petition	45 days
Bilateral consultations seeking mutually acceptable resolution	30 days (60 days in case of non-export subsidy)
Conciliation, with assistance from Signatories' Committee	30 days
Signatories' Committee period to establish a review panel	30 days
Review panel deliberations	60 days
Signatories' Committee develops recommendations based on panel report	30 days
OUSTR prepares report to President	30 days
President makes decision on counter-measures	21 days
Total	276 days (306 days in case of non-export subsidy)

The Agreement emphasizes the goal of reaching a mutually acceptable solution, which can occur at any time during the process and thereby terminate the proceedings.

The only inflexible milestones in the process are the requirements of the Trade Agreements Act, that the Government request consultations with the alleged subsidizing government on the day it decides to accept a petition, and the times for OUSTR's report to the President. The Agreement provides that all other time periods in the conflict resolution process may be extended by mutual agreement. Moreover, the 30-day periods for consultation and conciliation are the minimum required by the Agreement; no maximum period is specified.

An OUSTR official told us that the 45 days allowed to decide on acceptance of a petition is sometimes too short to develop and analyze information needed to support a request for consultations. Legislation introduced in 1982 proposed that OUSTR may delay up to 90 days, after accepting a petition, any request for consultations with a foreign government.

We found that the time frames have not been strictly adhered to in practice. None of the five cases involving EC agricultural subsidies had been resolved by the end of 1982, although each had been initiated more than a year earlier. The problems of securing information on foreign subsidies and the related impact on timely resolution of a case were particularly

well demonstrated in the case alleging that an EC subsidy on poultry meat violates the Subsidies Agreement. In that case, OUSTR, in an effort to strengthen the evidence, prolonged the consultation stage, never requesting conciliation or dispute settlement. Ultimately, in order to comply with the statutory deadline for disposition of the case, the President directed the U.S. Trade Representative to complete an examination of subsidized foreign exports and to proceed in the most effective manner to resolve the problem facing U.S. poultry products in competing against subsidized poultry overseas. The poultry case is discussed in detail below.

Case Study: Section 301 petition alleging poultry subsidies in the Middle East market

On September 17, 1981, the National Broiler Council and other U.S. poultry organizations filed a section 301 petition alleging that an EC subsidy on poultry violated the Subsidies Agreement because it:

1. Resulted in EC exporters having more than an equitable share of the world export trade in whole chickens and displaced U.S. whole chicken exports within the meaning of Article 10.

2. Resulted in prices for whole chickens that were materially below prices of U.S. producers in specific world markets within the meaning of Article 10.

3. Threatened serious prejudice to U.S. poultry interests with respect to world export trade in whole chickens as well as chicken parts and turkeys and turkey parts within the meaning of Article 8.

OUSTR accepted this petition on October 28, 1981.

Factors considered in accepting petition

Although some trade officials thought the allegation concerning market displacement in the Middle East was well supported, other trade officials believed that more and better data were necessary to strengthen some of the allegations before pursuing the case, including data on the trade and market shares of countries other than the United States and the EC in comparing world and regional market shares. According to an OUSTR official, "the EC obviously will argue that the reduced U.S. share of market during the past decade has been due, not to EC subsidies, but to the emergence of Brazil as a major exporter and increased exports by Hungary and possibly other countries in Eastern Europe." This observation was based on data compiled by the Agriculture Department from foreign trade sources for 1976

through the first 6 months of 1981. Updated figures through December 1981 showed that Brazil's share of world exports of whole chickens increased from 7 to 29 percent, while the EC share declined from 47 to an estimated 43 percent. The U.S. share during this period varied between 19 and 15 percent. In the Middle East market, Brazil's share increased from 12 to an estimated 40 percent while the EC share varied between about 50 to 63 percent. The U.S. share was 18 percent in 1976 but varied between 0.3 and 11 percent during the remainder of the period.

The observation concerning Brazil prompted the administration to (1) reevaluate the market situation in the Middle East to take account of non-EC suppliers, (2) establish whether or not such suppliers were subsidizing their exports, and (3) develop additional information on the level of the EC export subsidy.

An industry representative testified in February 1982 before a Senate subcommittee that the poultry case would help to clarify the "equitable share of the world market" concept. One of the principal factors in this concept is trade over a previous representative period. The Subsidies Agreement states that the representative period normally shall be the most recent 3-year period in which "normal market conditions existed." The petitioner argued that the 3 most recent years could not be used because subsidized market conditions could not be considered "normal." Historical data on market conditions prior to the initiation of EC poultry subsidies in 1967--when the United States allegedly had an average 96 percent share of the Middle East market for the period 1964 through 1966--were used by the petitioner to show market displacement.[4]

The poultry industry representative also testified that this case would provide an opportunity to determine the procedures for taking account of the trade of a second country (e.g., Brazil) that is not a party to the original case and that enters the market with allegedly subsidized products.

Dealing with the EC

The Trade Agreements Act directs the Government to request consultations at the time it accepts a petition under section 301. In the poultry case, the Government delayed making such a request for 16 days, until November 13, 1981. The EC responded on December 3, suggesting that before consultations could begin, the Signatories' Committee should meet to discuss the term "representative period" as it relates to an evaluation of market shares.

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[4]These figures assumed that U.S. and EC exporters were the sole suppliers to the Middle East market. If all exporters to the Middle East had been taken into account, the U.S. share for 1964 would have been 44 percent and the average share for 1964-66 would have been 33 percent.

Initial consultations did not in fact take place until February 16, 1982. The EC was not prepared to provide clarification on important aspects of its poultry export subsidy programs, but agreed to provide the information at a later date.

The February consultations with the EC reemphasized the need for (1) additional data about Brazil's market shares in the Middle East and other regional markets, (2) data on the operations of Brazil's poultry subsidies, and (3) additional documentation on price undercutting by the EC. After these consultations, the Government focused its efforts on obtaining additional information in order to better substantiate the petitioner's allegations.

In March 1982, the Government sent the EC a written request for the detailed subsidy information it had requested during consultations, and when no reply was received the OUSTR formally submitted a detailed request for information under Article 7 on June 10, 1982. The EC had not formally replied to the Government's request under Article 7 by the end of 1982, although it provided some information during informal consultations held on October 7, 1982.

Dealing with Brazil

The EC claims that its subsidization of poultry exports to the Middle East is set to meet competition from Brazil. In view of Brazil's growth in this market, its role as a major exporter of whole chickens to world markets and the degree of subsidization involved is relevant. The industry's petition did not provide information on Brazilian poultry exports. Rather than proceed with conciliation with the EC, the Government requested information from Brazil on June 1, 1982, under Article 7. Brazil provided some information during informal consultations on August 30, but not in sufficient detail.

Brazil's export rebate system on poultry was terminated in 1979. Currently Brazil provides preferential loans to exporters as a means of encouraging development in certain sectors, including poultry. According to U.S. Government officials, loans for poultry were available at preferential interest rates for up to 40 percent of the previous year's net exports (now reduced to 20 percent). It is impossible to accurately quantify the effect of subsidized credit rates because information is not available at the level of specificity needed. Brazil claimed that cumulative data on the amount of credit extended to individual exporters and the length of time the loans were held was not readily available in Brazilian records. The United States formally requested consultations with Brazil under Article 12 on September 21, 1982. Consultations were held in April 1983.

Disposition of the case

Within 21 days after receivng OUSTR's recommendations, the President was required to state what action he intended to

take, if any. In response to this statutory deadline the President on July 12, 1982, directed the U.S. Trade Representative to complete a detailed examination of Brazilian subsidized poultry exports and their effect on the U.S. poultry exporters and "to proceed in the most effective manner to resolve the problem facing U.S. poultry producers in competing against subsidized poultry in third country markets." In his statement, the President directed the U.S. Trade Representative to report no later than September 30, 1982, on the status of efforts to resolve the poultry issue and recognized that, by taking this action, the final disposition of the case had been delayed past the time envisioned under section 301. In his report to the President, the U.S. Trade Representative reviewed efforts to improve U.S. Government understanding of Brazilian subsidy practices and to get Brazil to participate in trilateral consultations with the EC. OUSTR interprets the statute to mean that once the President makes his decision, the applicable time limits within which a case should be resolved have been met. OUSTR believes that it is not bound now by any statutory deadline to resolve the complaint on EC poultry exports. As of July 1983, the Government had not referred the case to the Committee of Signatories for conciliation. The relevant agencies had agreed to request more information from Brazil, but there was no consensus as to whether the Government should proceed with conciliation and dispute settlement. Twenty months had passed since the petition was accepted.

As a result of the delays with this petition, partly caused by erroneous data, OUSTR now requests the Agriculture Department to affirm, if possible, the accuracy of data contained in section 301 petitions concerning primary products. The Commerce Department similarly is requested to affirm the accuracy of data in petitions concerning industrial products. According to an OUSTR official, this verification should take place during the 45-day period after a petition is filed and before it is either accepted or rejected by the U.S. Trade Representative.

CHAPTER 4

PROGRESS MADE IN REDUCING

EXPORT CREDIT SUBSIDIES

The administration considered officially supported export financing to be one of the most difficult and damaging export subsidy problems facing the United States during the period of our review. The Subsidies Agreement does not prohibit export credit subsidies if the practice is in accord with the International Arrangement on Guidelines for Officially Supported Export Credit, which attempts to restrain rather than prohibit such financing. The United States has sought changes to the Arrangement that would make financing a neutral element in international trade. Changes which lessened, but did not eliminate, subsidized export financing were successfully negotiated in October 1981 and June 1982 after prolonged and often stalled negotiations. A key element in the U.S. position was a willingness to intensify the competition by lengthening loan repayment terms if an acceptable agreement was not reached. Other leverage used in the negotiations was the U.S. suggestion that failure to acceptably change the Arrangement could mean a loss of status of subsidized export financing under the Subsidies Agreement as far as the U.S. Government was concerned.

AMOUNT OF SUBSIDIZATION IN EXPORT FINANCING REDUCED

The United States and other governments support selected exports with credit financing. A government subsidizes exports with financing when its lending rate is below its borrowing rate for the funds so employed. Achieving effective international control on this kind of subsidy has been a goal of every administration over the past 9 years. After initial discussions in late 1973, several European Community governments proposed in early 1974 that they, together with the United States and Japan, enter into a "gentlemen's agreement" aimed at harmonizing export credit terms. In 1978, 20 governments of the Organization for Economic Cooperation and Development (OECD) concluded an "International Arrangement on Guidelines for Officially Supported Export Credit." In October 1981 and June 1982, negotiations were concluded to improve the OECD Arrangement. The Treasury Department led the U.S. delegation at the credit negotiations.

The Arrangement, in part, establishes lending guidelines in relation to the (1) level of economic development in the borrower's country (2) minimum interest rates, and (3) maximum loan maturities. In the 1978 version, this interrelationship was as follows.

Borrower's economic development level	2 to 5 years	Repayment terms over 5 to 8.5 years	over 8.5 to 10 years
	(percent)		
Relatively rich	7.75	8.00	(a)
Intermediate	7.25	7.75	(a)
Relatively poor	7.25	7.50	7.50

[a]No official credit.

More liberal terms were permissible, provided a government gave prior notification to other participants, thus giving them an opportunity to match financing terms. The combination of export credits with foreign assistance funds (mixed credits) was not prohibited nor were other subsidy practices, such as the provision of cost-inflation insurance by governments to exporters of capital goods.

The U.S. Government soon sought changes to the Arrangement that would (1) include those sectors not previously covered (agriculture, aircraft, nuclear power plants, and ships), (2) increase interest rate minimums, and (3) reduce the subsidy aspect of official export financing. In commenting on our draft report, the Administrator of the Foreign Agricultural Service stated that the administration has always sought to exclude agriculture from the Arrangement. However, President Carter, in a March 1979 message to the Congress, stated that the United States proposed in October 1978 to have the Arrangement cover export credits for agricultural commodities in excess of 3 years but not more than 10 years.

The Subsidies Agreement does not define a prohibited export subsidy, but includes an illustrative list of them. (See app. III.) Although part one of Item K on the list defines the subsidy element in export financing, part two states that an export credit practice that is in conformity with an arrangement--which the U.S. Government interprets to specifically describe the OECD Arrangement or a successor undertaking--shall not be considered an export subsidy prohibited by the Agreement. In short, the 1978 Arrangement permits what the Subsidies Agreement seemingly prohibits, namely that "Signatories shall not grant export subsidies on products other than certain primary products." Part two of Item K reconciles this inconsistency by legitimizing an exception to the general prohibition. To do otherwise would result in abrogating the progress that had been made under the 1978 Arrangement. According to a Treasury Department official, export credit subsidies are permitted under the Subsidies Agreement to the extent that minimum rates specified in the Arrangement are lower than commercial rates on loans of the same

maturity and denominated in the same currency. The loans must otherwise be consistent with agreed guidelines; for example, such loans must carry terms no longer than permitted under the Arrangement and related undertakings. On the other hand, if the Arrangement's interest rate minimums are roughly equal to or higher than commercial rates in a given currency (such as now is true of the yen, dollar, deutschemark, Swiss franc, British pound, and others), the Arrangement does not sanction interest rate subsidies.

The United States in 1980 sought adoption of a principle that would have largely eliminated the subsidy element by automatically aligning officially supported lending rates with market rates. Negotiations in late 1980 failed to result in acceptance of this principle but according to a Treasury Department official, in April 1983 the EC and other delegations went on record favoring, in principle, an automatically adjusting interest rate system. The Treasury official called this a "substantial step forward."

In early 1981, the administration resumed its efforts to negotiate changes in the Arrangement. Its objectives for the near term were to raise the minimum interest rates and provide a mechanism that would allow automatic changes in the future to reflect market trends. The longer term objectives were (1) to replace the single matrix minimum rates applicable to all currencies with a differentiated system reflecting the wide differences in financial market conditions from currency to currency and (2) to have other governments agree not to subsidize trade credits in industrial country markets.

The Government took a number of actions aimed at persuading other members of the Arrangement to participate in constructive negotiations on desired changes. For example, it suggested in meetings with other signatories to the Subsidies Agreement in February and April 1981 that there might be a need to review the status of the export credit exception for the Arrangement under the Subsidies Agreement.

A potential action which the administration could have taken during early 1981 was to use a section 301 petition alleging that some European export credit practices were inconsistent with the Subsidies Agreement. However, the EC had announced that it regarded its export credits as fully consistent with Item K of the Agreement's illustrative list and that it might retaliate with an even stronger action against certain U.S. practices. Aside from a general reluctance to self-initiate section 301 cases, this possibility apparently helped to deter the administration from using a section 301 case as a negotiating tactic.

In April 1981, the administration announced that it would support legislation that would create a special $1 billion export subsidy fund to match highly subsidized credits from abroad if negotiations on a revised Arrangement were not

successful. According to a Treasury Department official, although the administration feared that immediate passage of this legislation could have had the effect of triggering the export credit "war" the United States wished to avoid, it also showed congressional support for the administration's negotiating effort.

In June 1981, the Deputy Secretary of the Treasury publicly stated that

> "* * * if we do not see quick signs of progress in the Arrangement talks, our competitors will find that our pockets are far deeper than theirs, our terms of credit much longer, and our resolve even stronger than is true of them * * *. There must be a multi-lateral agreement to cease export credit subsidies or there indeed will be a [credit] war."

As a result of these efforts, on October 20, 1981, the administration concluded, as an interim measure, an agreement with other participants to increase the Arrangement's minimum interest rate levels by 2.25 to 2.50 percentage points. Limited acceptance also was reached on the principle that minimum interest rates sanctioned by the Arrangement should be differentiated by currency.

This agreement still permitted a degree of subsidy, since the new rates were at below-market levels in many currencies. To emphasize the administration's view that the October changes were not sufficient, the Government signaled the Europeans again that the Subsidies Agreement was considered relevant to the U.S. objective of increasing discipline on subsidized export credits. On October 28, 1981, at congressional oversight hearings on trade policy, the U.S Trade Representative testified that:

> "Our plan consists of a multifaceted negotiating strategy * * *. As part of this strategy we will press for continued reform of the OECD Arrangement at the highest political level and we will explore how other trade options can be helpful. * * * Let me note that the Subsidies Agreement clearly states that such assistance [subsidized export financing] should not adversely affect the trade interests of others. Our companies and our trading partners should know that we are prepared to act firmly, using such available remedies as are appropriate to the particular circumstances, to ensure that goods are fairly traded in the U.S. market without being dumped or subsidized in an injurious way."

Pressure to conclude an acceptable Arrangement seemingly increased in early June 1982, when several labor organizations

filed a section 301 petition alleging that the Canadian Government supported the sale of subway cars to the New York Metropolitan Transit Authority with subsidized export credit. According to a Treasury Department official, this section 301 petition was not a major event in the negotiations but helped to dramatize the depth of U.S. public opposition to subsidizing trade with export credit, especially for imports into the U.S. market. The petitioners stated that the Canadian practice violated the interest rate and repayment terms of the Arrangement and thereby violated the Subsidies Agreement. The exception provided by Item K was not applicable, according to the petitioners. On June 16, 1982, the U.S. Government requested consultations with Canada under Article 12 of the Subsidies Agreement; consultations were held on July 5 but did not resolve the dispute. On September 3, this case was terminated without prejudice by the U.S. Trade Representative because a U.S. firm petitioned for relief under the countervailing duty statute on June 24. On February 4, 1983, Commerce determined under this statute that Canada was subsidizing exports of subway cars with preferential financing. Shortly thereafter, the petitioner withdrew its petition stating that it had established the principle that fairness in the market place must not be prejudiced by improperly subsidized financing.

Negotiations on a revised Arrangement were concluded at the end of June 1982 and came into effect on July 6, 1982. The October 1981 interim measure and June agreement on the Arrangement did not entirely satisfy the U.S. Government's negotiating objectives but according to a Treasury Department official, major progress had been made. The Arrangement, however, does not cover agriculture, aircraft, nuclear power plants, and ships. Export financing for commercial jet transports is covered by a separate Standstill Declaration on Aircraft Financing of May 1975 between the United States and other producer governments. The interrelationship between (1) maximum levels of economic development, (2) interest rate minimums, and (3) loan maturities in the June 1982 revisions is shown on the next page.

Export Financing Under the Arrangement (note a)

Borrower's economic development level	Repayment terms (note b) 2-5 Years	over 5 to 8.5 Years (percent)	over 8.5 to 10 Years
Relatively rich (gross national product per capita $4,000 and over)	12.15	12.40	(c)
Intermediate	10.85	11.35	(c)
Countries newly graduated from third to second category (note d)			
effective July 6, 1982	10.50	10.75	10.75
effective Jan. 1, 1983	10.85	11.35	11.35
Relatively poor (note e)	10.00	10.00	10.00

[a]Excludes special rates permitted for low interest rate countries, such as Japan. Officially supported export credits in low interest rate currencies must be at least 0.30 percent above the domestic commercial lending rate of that currency. In essence, this means that Japan will have to charge 0.30 percent over its long term prime rate (its market rate).

[b]Interest rates effective July 6, 1982, and to apply until May 1, 1983. The May expiration date has been extended to October 31, 1983.

[c]No official credit.

[d]Interest rates to countries graduated from the relatively poor into the intermediate category were applied in two stages.

[e]Category includes countries eligible for World Bank's International Development Agency loans.

The June revisions also reclassified countries according to gross national product per capita, resulting in the "graduation" of some countries to higher interest rate levels; for example, the Soviet Union graduated from the "intermediate" to the "relatively rich" category, while Algeria, Brazil, Korea, and Mexico rose from the "relatively poor" to the intermediate level. This change had the effect of reducing the extent of the subsidies provided to the "graduated" countries, which included a number of the largest users of official export credits.

The participating governments also agreed not to offer terms more liberal than the specified minimum interest rates and maximum repayment periods and not to offer mixed credits with a grant element of less than 20 percent after October 15, 1982, thus reducing a significant loophole in the 1978 Arrangement. Mixed credits, combining concessional aid financing with non-concessional government or private funds, are a conceptually troublesome issue according to a Treasury Department official. The OECD's Development Assistance Committee defines "official development assistance" as financial flows having a "grant element" of at least 25 percent. A number of countries use mixed credits to enhance their foreign aid contributions. As is true of much aid, the mixed credits are tied to procurement in the donor country. According to a Treasury Department official, the United States has no objection to the practice as long as the mixed credits are truly development-oriented and carry sufficiently high grant elements; otherwise, it regards mixed credits as an attempt to "buy" exports. Indeed, even a few mixed credits with grant elements marginally over 25 percent have occasionally been suspect on this ground, despite the Development Assistance Committee's rules and despite the subsidy level represented by a 25 percent grant element, according to the same Treasury Department official.

In initial meetings on the Arrangement in early 1983, the United States proposed that participants agree not to offer mixed credits with grant elements of less than 25 percent. The proposal also called for prior notification of other participants in cases where the grant element lay between 25 percent and 30 percent and for "prompt" (ex post) notification for grant elements of 30 to 50 percent. According to a Treasury Department official, the objective was to discourage the use of mixed credits for export promotion by making their use for this purpose as expensive as possible.

Under the June 1982 revisions, Arrangement participants also formalized the differentiated interest rate system for Japan, which now has a special separate rate because of its low commercial interest rates. Japan charges 0.30 percent above its commercial long-term prime rate for yen loans to all three categories of countries. In addition the Japanese have agreed to open their capital market to allow foreign export credit agencies to guarantee yen financing for their national exports through Japanese commercial banks.

Conclusion

As of July 1983, upward revision of the interest rate minimums resulting from the June 1982 revisions of the Arrangement have reduced the subsidy element in U.S. and other governments' export credit lending. According to a Treasury Department official, the 1982 revisions, together with falling commercial interest rates, have virtually eliminated interest rate subsidies for trade financed in dollars or other major trading currencies

(except the French franc). Nevertheless, without a mechanism to automatically align officially supported lending rates with borrowing rates, continued negotiations will be needed to restrain export credit subsidies if borrowing rates increase.

IS EXPORT FINANCING CONSISTENT WITH ARRANGEMENT ACTIONABLE UNDER U.S. LAW?

Commerce has not had to determine whether exports from a country belonging to the Arrangement are countervailable if they are supported by subsidized financing consistent with the provisions of the Arrangement.

Some governments, including governments that do not belong to the Arrangement, believe that Item K can be asserted as defense against the imposition of U.S. countervailing duties on imports supported by subsidized export financing. In May 1982, for example, the Commerce Department determined that the Mexican Government was subsidizing ceramic tile exports to the United States under three programs, including a preferential financing scheme. The Mexican Government defended its program, in part, by contending that its loans were compatible with the credit Arrangement guidelines and that Item K establishes the standard of review for preferential financing under U.S. countervailing duty law. The Mexican Government, in effect, argued that because its export credit program is compatible with the Arrangement and such programs are not prohibited under the Subsidies Agreement, exports supported by Mexico's financing program should not be countervailable under U.S. law. According to the Mexicans, to countervail exports benefiting from a "permissible" (or at least not prohibited) subsidy practice would seemingly undermine the U.S. Government's contention that its countervailing duty law is administered in substantial compliance with the spirit and letter of the Subsidies Agreement.

Commerce's decision on the case stated that the terms and rates of the Mexican program were different from those under the Arrangement, Mexico was not a member of the Arrangement, and the U.S. Government had not recognized loans under the Arrangement as non-countervailable.

In commenting on the draft of this report, the Acting Assistant Secretary of the Treasury for International Affairs stated that, in discussing the sale of Canadian subway cars to New York City and the impending competition for sale of cars to Houston with interested governments, the United States took the position that subsidized export credits for sales into the U.S. market could be countervailed if injury could be shown. According to this official, other governments vigorously protested that financing in conformity with Arrangement guidelines was immunized from countervailing duty action by Item K, paragraph two of the Illustrative List of the Subsidies Agreement. The

U.S. Government responded that paragraph two only provides that subsidized financing, when in conformity with the OECD Arrangement, is not a prohibited subsidy, and thus cannot be subject to the dispute settlement provisions of the Subsidies Agreement. According to the Assistant Secretary, Item K says nothing against the possible countervailability of the subsidized financing if injury can be shown.

In congressional testimony in May 1982, OUSTR's General Counsel stated that "All export subsidies can be countervailed under U.S. law. To the extent that export credit subsidies are consistent with the OECD Arrangement, however, they are not actionable under the [Subsidies Agreement] itself."

AGENCY COMMENTS AND OUR EVALUATION

The Under Secretary of Commerce for International Trade stated that our report appears to reflect an unwarranted interpretation of the U.S. position on the countervailability of export credits covered by the OECD Arrangement. He stated that the report should be revised to reflect the fact that Commerce has never had to make a definitive ruling on the countervailability of export credits clearly covered by the exemption in Item (K)(2) of the Illustrative List. We did not attempt to interpret the Government's position on this issue. The draft of this report recognized that Commerce has not ruled on the countervailability of export credits covered by the OECD Arrangement. Commerce's confusion about our intent apparently began when it attributed to GAO a position that was held by the Mexican Government in the countervailing duty case involving imports of ceramic tile. We have modified the report in order to emphasize that our reference was to the Mexican Government's interpretation of this issue.

CHAPTER 5

PROCEDURES FOR TRANSFERRING SUBSIDY INFORMATION TO PRIVATE SECTOR SHOULD BE IMPROVED

The Subsidies Agreement's emphasis on effects (subsidies are countervailable only if they harm another signatory's industry)[1] places the burden on an allegedly injured country to identify and take appropriate action against harmful foreign subsidies. The U.S. Government generally relies on private parties to initiate petitions, which then provide the basis for Government action against foreign subsidies under both domestic law and the Agreement's conflict resolution procedures. The private sector's ability to initiate petitions depends to a great extent on the information on foreign subsidy practices available to petitioners.

The 1979 Trade Agreements Act amended two provisions of trade law to encourage the Government's efforts to make information available to the private sector by:

--Responding to requests for information on foreign trade policy and practices under section 305 of the 1974 Trade Act.

--Providing access to information by establishing a library of foreign subsidy information under section 777 of the 1930 Tariff Act.

The Government also established U.S. Embassy reporting requirements on foreign government implementation of the Tokyo Round agreements. The objectives of the reporting requirements are generally to compile information on foreign subsidy practices and specifically to monitor signatory compliance with the Agreement, support U.S. complaints under the Agreement, and support the foreign subsidies library.

We believe that the Government needs to improve its efforts to share with the private sector the information it obtains on foreign subsidy practices and procedures.

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[1]As mentioned previously, Article 9 of the Subsidies Agreement states that signatories shall not grant export subsidies on products other than certain primary products. Article 18, however, states that the Committee of Signatories may authorize countermeasures pursuant to the Agreement's dispute settlement procedures taking into account the nature and degree of adverse effect found to exist.

ADMINISTRATION PREFERS TO RELY ON PRIVATE SECTOR TO INITIATE UNFAIR SUBSIDY PRACTICE CASES

As part of its July 8, 1981, "Statement on U.S. Trade Policy", the administration promised effective enforcement of U.S. trade laws and international trade agreements. In its report on the 1979 Trade Agreements Act, the House Committee on Ways and Means stated that it expects and strongly encourages

> "the aggressive use of the * * * authority to self-initiate [countervailing duty] investigations. The Committee is of the view that strong, aggressive and persistent enforcement of U.S. unfair trade practices laws is an essential element in a sound, broad based, trade policy."

Congressional admonition notwithstanding, the administration does not believe that, as a general rule, it should self-initiate unfair trade practice cases under the countervailing duty statute or the Subsidies Agreement's dispute settlement procedures. According to a senior Commerce official, the object of U.S. policy should be control and elimination of trade-distorting subsidies and not retaliation. Self-initiating subsidy cases under domestic trade law makes the issues more political than they would be otherwise according to administration officials. Officials we talked with believed that responding to private parties' petitions was less confrontational because U.S. trading partners recognize that governments have a legitimate obligation to hear complaints from individuals seeking redress from allegedly unfair foreign trade practices.

On a more practical level, administration officials told us that the information they need to fulfill their statutory responsibilities is held, in part, by private parties.

INFORMATION COLLECTED ON FOREIGN SUBSIDY PRACTICES NOT READILY AVAILABLE TO PRIVATE SECTOR

With the conclusion of the Tokyo Round in April 1979 and passage of the Trade Agreements Act that July, the administration began establishing procedures to monitor signatory governments' compliance with the various Tokyo Round agreements.

In September 1979, the President announced Reorganization Plan No.3 to consolidate trade functions of the U.S. Government. Concerning the Tokyo Round agreements, the President said:

> "I am dedicated to the aggressive implementation of the * * * Agreements. The United States must seize the opportunities and enforce the obligations created by these agreements.* * * The Department of Commerce will be responsible for

the day-to-day implementation of non-agricultural aspects of the * * * agreements * * * [including] monitoring agreements and targeting problems * * *. When American business needs information or encounters problems in [this] area, it can turn to the Department of Commerce for knowledgeable assistance."

With one exception, the reorganization took effect on January 2, 1980.

In April 1980, Commerce established a Tokyo Round agreements "Implementation Task Force," leading eventually to the creation of a "monitoring/enforcement" subcommittee. Concurrently, the interagency Trade Policy Staff Committee recommended for discussion a draft of the reporting requirements for U.S. Embassies in monitoring signatory governments' compliance with the Subsidies Agreement; reporting was particularly to support the newly authorized foreign subsidies library, which was eventually established at the Commerce Department.

After 9 months of consultation between various Embassies and Washington agencies, Commerce prepared a series of reporting requirements for the Tokyo Round non-tariff measure agreements and sent it to the Embassies early in 1981. The requirements requested a one-time comprehensive report and "alert," or periodic, reporting for example, of a host-government's "export and production incentives." The Embassies were asked not to analyze or characterize programs as violations of the Subsidies Agreement or U.S. law. Responding to Embassy comments on the need to tailor reporting to specific host-country situations, Commerce asked the posts to submit their own reporting plans by March 1981.

The U.S. Trade Representative testified before a subcommittee of the House Appropriations Committee in March 1982 that U.S. Embassies' activities in gathering information on subsidies could be limited to the extent that foreign governments might perceive such activity as inciting countervailing duty investigations. He said that, to get needed foreign cooperation to enforce the countervailing duty statute, it is necessary to keep U.S. Government neutrality in such investigations.[2]

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[2]The Subsidies Agreement states that the investigating authorities of a signatory may carry out investigations in the territory of other signatories unless the latter objects to the investigation. The Trade Agreements Act states that the administering authority (Commerce) shall verify all information relied upon (including governmental submissions) in making a final determination in an investigation.

Embassy responses to specific reporting requirements generally sparse

Embassies generally did not propose very elaborate reporting plans in relation to the Subsidies Agreement. As previously mentioned, we gathered information on foreign subsidies reported during 1981 and 1982 from seven U.S. Embassies, including the reporting plans of the Embassies in Canada, France, Italy, Japan, and Mexico. All these countries except Mexico are Subsidies Agreement signatories. The Embassies in Brazil and India apparently did not send reporting plans. The French plan consisted only of "We expect the bulk of our reporting [on subsidies] will be spot reporting as warranted." The Embassies in Italy and Japan promised reports on their host-countries' subsidy programs in March 1981, and the Embassy in Mexico referenced several prior cables on Mexican export subsidies. The Embassy in Canada said that:

> "Canada and various provinces have a wide variety of programs which might be considered subsidies under the [Agreement]. Most of these programs have been reported on over the years but this reporting clearly needs to be updated. In view of staffing limitations, it may take 1-2 years to complete this reporting."

We attempted to determine the magnitude of Embassy reporting from February 1981 under the specific reporting requirements. By April 1982, the time of our test, and 13 months after reporting plans were due, Embassies in 20 of 30 signatory countries and 51 non-signatory countries had submitted reporting plans. Embassies in 12 signatory and 21 non-signatory countries had reported on government programs that help exports with specific reference to Commerce's reporting requirements and their own reporting plans.

Embassies in the seven countries mentioned were even less forthcoming. Only those in Italy and Japan responded to the 1981 reporting requirement; in April 1981, the Embassy in Rome reviewed Italian laws providing subsidies to industry and the Embassy in Tokyo briefly described programs which assist exporters.

Such sparse reporting, however, is not fully descriptive of the seven Embassies' efforts. Embassies reported subsidy-related information without specific reference to the reporting requirements or their own reporting plans. In November 1981, for example, the consulate in Montreal, Canada, reported that the Quebec provincial government would soon implement a new program of financial and technical aid to encourage development of new products and, among other purposes, to stimulate exports.

In May 1981, an official in the Mexico City Embassy sent two publications to the Commerce Department which, he said, contained "summaries of Mexican export incentives which may be worth including in Commerce's subsidy library;" one of the

publications he said "contained the best summary of Mexican export incentives I have seen in print." The publications were not sent to the library; indeed in May 1981, there was as yet no library. However, information similar to that sent in May 1981 was part of the library when we reviewed library files in September 1982.

We do not want to leave the impression that Embassy reporting on foreign subsidy practices that possibly violate a government's obligation under the Subsidies Agreement began with the effective date of the formal reporting requirements in early 1981. For example in January 1980, in response to a request concerning French Government efforts to dominate the Tunisian computer market (then estimated to be worth $2 million over a 5-year period), the Embassy in Tunis reported that a U.S. firm underbid its French competitor for a minicomputer system and the French Government then allegedly offered to subsidize the price of the French system, in possible violation of its obligations under the Subsidies Agreement.

Embassy information generally not reaching foreign subsidies library

The interagency Trade Policy Staff Committee in April 1980 and the reporting requirements in early 1981 stated that one purpose of monitoring foreign subsidy practices was to support the public information requirements of the Trade Agreements Act, especially Commerce's foreign subsidies library. As discussed on pages 44 to 46, Commerce's attempts to establish the library have not shown meaningful results until recently.

We collected information on the subsidy programs and practices of the seven countries from the Departments of Agriculture, Commerce, and State. The information generally was not included in Commerce's subsidies library. For example, Embassy reports submitted in 1980 on competitor nation export promotion programs were not part of the library when we compared information we had collected with the library's information in September 1982. Section 1110 of the Trade Agreements Act of 1979 states that the President "shall review all export promotion functions of the executive branch * * *, and * * * submit to the Congress a report of that review not later than July 15, 1980." In support of this review, the overseas posts were asked in May 1980 to provide information on competitor nation export promotion programs, including tax credits and preferential loan treatment.

Similarly, the Foreign Agricultural Service's annual Agriculture Situation Reports were not part of the library when we made our review. The Foreign Agricultural Service in November 1979 requested its attaches to include in their annual situation reports the important changes in policy affecting foreign agricultural production, including subsidies. Attaches also were requested to outline the nature and changes in the countries' export promotion policies, including export subsidies, if the countries were major U.S. competitors for other foreign markets. A Situation Report is a general survey, but it

can contain potentially useful subsidy-related information. For example, the 1980 report on Brazil briefly discussed new export financing schemes.

OUSTR COULD INCREASE PUBLIC AVAILABILITY OF SUBSIDIES INFORMATION

The 1979 Trade Agreements Act permits private persons to formally request information about foreign subsidy practices from OUSTR. This office, however, is (1) interpreting the statute in a way that could limit its usefulness and (2) not always providing requested information in a timely manner or making it available to the foreign subsidies library for broader use by the public. Section 305 of the 1974 Trade Act,[3] as amended by the 1979 Trade Agreements Act (19 U.S.C.§2415), states that any person may request information from OUSTR on the nature and extent of a foreign government's specific trade policy or practice with respect to particular merchandise. Section 305 also states that, if the requested information is not available and the requester is an "interested party," the OUSTR within 30 days after receiving a request shall seek the information from the relevant foreign government or shall decline to request the information and inform the person in writing of the reasons for the refusal.

OUSTR needs to clarify interpretation of statute

From July 1979 to August 1982, OUSTR received 22 requests for information under section 305 of the Trade Act; 16 requests concerned foreign subsidy information and 13 of these requests were from Washington, D.C., law firms which represented a variety of clients. One of these firms made 9 requests. An OUSTR official is concerned that OUSTR not become, in effect, a research subsidiary of law firms making requests under section 305. Since June 1980, OUSTR officials have attempted to narrow the scope of requests to deter what they believe are "fishing expeditions" by some attorneys. For example, in late 1980, OUSTR informed a law firm that:

> "your request does not conform to the requirements of section 305 in that it does not specify the trade policy or practice of each foreign government in which you are interested, * * * and thus USTR is not obligated to seek [the] information from the foreign governments noted in your request or to provide reasons for its failure to do so."

The request to which this response refers was made 7 months earlier and asked for information on the nature and extent of any subsidies provided by 11 governments for a specific product.

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[3]Under section 305, OUSTR provides information similar to that provided under the Freedom of Information Act. The time limits included in this Act do not apply to section 305.

In April 1982, a request was initially rejected because, as an OUSTR official wrote to the law firm involved:

> "while your request does describe a specific policy or practice which may have a trade impact, it does not specify the particular merchandise which you have reason to believe is affected by the practice."

The administration has not issued regulations concerning section 305. Such regulations, for example, could clarify for potential requesters OUSTR's interpretation of the statutory phrase "the nature and extent of a specific trade policy or practice of a foreign government or instrumentality with respect to particular merchandise * * *." To date, the question of how specific a request must be in order to be accepted has been an issue dividing OUSTR officials and some private attorneys and apparently is being resolved on an ad hoc basis as it arises.

OUSTR responses to section 305 requests not timely

Section 305 does not require the Government to provide requested information within any specific time limit. OUSTR, however, is statutorily required to determine within 30 days after receiving a request whether it can provide the information without requesting it from the foreign government concerned.

Prompted by two instances of what it considered to be slow action on requests, OUSTR established a procedure late in 1980 to ensure that responses are made within the 30-day period. Under this procedure, OUSTR would forward a request to designated persons within each agency concerned and they in turn would distribute the request to their various trade and product specialists. The compiled information, if any, would be returned to OUSTR and sent to the requester. This procedure has not corrected the problem.

OUSTR's recordkeeping on section 305 requests was incomplete. We found relevant documents for only 10 of 16 subsidy-related requests and OUSTR's response time equaled or exceeded 4 months in 6 of these 10 cases. The requests for information were made after OUSTR adopted its new procedures in 4 of these 6 cases. While incomplete records at OUSTR make generalizations difficult, OUSTR took more than 7 days to inform the agencies of 8 of the 10 requests. Any delay at OUSTR, even 7 days, makes the 30-day deadline more difficult to achieve.

The timeliness of OUSTR's response does not seem related to whether it seeks information from a foreign government. We were able to confirm that U.S. Embassies provided information in response to at least 3 of the 16 requests. In one case, OUSTR

was sent a request in February 1980 and either misplaced or never received it. Follow-up requests were sent in June and August 1980 and several U.S. Embassies were notified of the request in late October. Most Embassies replied by late November. In another case, OUSTR received a request in April 1981 and requested information from an Embassy in July. The Embassy replied several days later. The requester in this case also was sent information obtained from Washington agencies in June 1981.

Subsidies-related section 305 information should go to foreign subsidies library

Information about foreign subsidies collected pursuant to a section 305 request is relevant to the purposes of Commerce's foreign subsidies library. Establishment of the library has been a long process and until June 1982 there was, in effect, no library. Some limited progress has been made since July 1982. Ideally, all Government non-confidential foreign subsidies information should be in the subsidies library. Then subsidies-related section 305 requests would be necessary only to get new information from foreign governments. Sending a copy of all non-confidential subsidy information collected in response to a request under section 305 to the foreign subsidies library is a practical step toward achieving this objective.

RECOMMENDATIONS TO THE U.S. TRADE REPRESENTATIVE

We recommend that the U.S. Trade Representative:

- --Direct the section 305 coordinator to send a copy of all non-confidential subsidy information collected pursuant to a request under section 305 of the 1974 Trade Act, as amended, to the Commerce Department's foreign subsidies library.

- --Issue regulations governing section 305 of the 1974 Trade Act, as amended, including, for example, interpretation of the statutory phrase "the nature and extent of a specific trade policy or practice * * * with respect to particular merchandise" in section 305(a)(1).

OUSTR'S COMMENTS

OUSTR did not comment on these recommendations.

ESTABLISHMENT OF FOREIGN SUBSIDIES LIBRARY INCOMPLETE

The objective of ensuring the private sector access to non-confidential foreign subsidies information was not well served

by the Government's sporadic efforts to establish a foreign subsidies library. Some progress now is being made by Commerce.

Section 777(a) of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979, states that:

> "There shall be established a library of information relating to foreign subsidy practices and countervailing measures. Copies of material in the library shall be made available to the public upon payment of the costs of preparing such copies."

The House Committee on Ways and Means report on the Trade Agreements Act noted that the library seeks to provide the maximum availability of information to interested parties consistent with protecting information accorded confidential treatment.

The Subsidies Agreement and the amended countervailing duty statute became effective on January 1, 1980. Reorganization Plan No. 3 to consolidate Government trade functions became effective the following day. Under the Plan, responsibility for administering the countervailing duty statute was transferred to the Commerce Department from the Treasury. Commerce assumed responsibility for establishing a foreign subsidies library as the administering authority of the countervailing duty law. Commerce took very little action between January 1980 and June 1981 to establish the library. In July 1981, it made a senior Import Administration official specifically responsible for establishing the library. Until that time, the Import Administration was preoccupied with establishing a system for managing countervailing duty case records. From October 1980 to June 1981, a consulting firm helped Import Administration to establish the new records management system. In July 1981, the consultants asked for a Letter of Intent to begin work establishing the library, and the Letter was issued in August. By the end of September, Commerce found that some of the consultants' work on the records system was inadequate. Moreover, the consultants told Commerce that so far they had found little available information on foreign subsidy practices at the various agencies they said they visited. In response to this news, and citing budget cuts, Commerce terminated its Letter of Intent with the firm, judging that little if any useful work on the library was being performed.

In January 1982, consultants were hired to evaluate Import Administration's automatic data processing needs, and a subsidies library feasibility study received high priority. The study was completed on January 31, 1982, and in April a contract was approved to begin work on an automated index system for the library. In June, documents describing the system were completed. As discussed previously, information on the subsidy programs and practices of several countries and information collected in response to section 305 requests generally were not part of the subsidies library when we reviewed the library's acquisitions in September 1982. In September, the library

generally consisted of (1) subsidy and injury determinations under the countervailing duty statute, (2) newspaper articles, books, and periodicals, and (3) some cables and documents from overseas posts, including GATT documents. In March 1983, a Commerce official told us that the library consisted of the same type of information as in September and that subsidy information from overseas posts and in response to section 305 requests was not being routinely added to the library.

Establishing an effective library was not on the agenda of the interagency Trade Policy Staff Committee or its subsidies subcommittee during the 1980 to mid-1982 period; it was apparently thought of as Commerce's responsibility.

NOT ALL RELEVANT INFORMATION SENT TO INQUIRERS

Private parties request information from the Government on how to obtain relief from injurious subsidized imports. The Commerce Department, for example, provides information about petitioning under the countervailing duty law. Most parties requesting such information don't petition for relief under the law. Although there are several reasons for this, Commerce could help to ensure that lack of information about a foreign subsidy practice is not one of them by informing parties seeking information about their rights available under section 305.

Congress intended that, to the degree practicable, Commerce advise and assist private parties seeking relief from foreign trade-related subsidies. Recognizing that small businessmen in particular may not have detailed information on foreign subsidies, the House report on the 1979 Trade Agreements Act stated that the requirements for information supporting countervailing duty petitions should not serve to discourage qualified parties from filing. Commerce's Assistant Secretary for Trade Administration remarked in November 1981 congressional testimony that Commerce had a special obligation to assist small businessmen seeking relief from the effects of unfair trade practices and noted that:

> "no agency, including mine, has the resources necessary to go out and do the entire [countervailing duty] case. In other words, we can't substitute for some of the information that the domestic industry has to give us. * * * [W]e need information from the business community. Basically, we verify [their] allegations."

During 1980 and 1981, we determined that small businessmen or their representatives sent Commerce 37 informal inquiries (as differentiated from formal countervailing duty petitions) alleging unfair foreign subsidy practices. As initial responses to

their allegations, Commerce typically sent them the texts of countervailing duty law and regulations, petition format, and other general information.

This information package does not mention the section 305 procedure for requesting information on foreign trade policies and practices. This procedure ought to be relevant to potential petitioners, because countervailing duty regulations state that a petition shall be dismissed if it is determined, in part, that it does not "properly allege the basis on which a countervailing duty may be imposed * * *, [or] does not contain information deemed reasonably available to the petitioner supporting the allegations * * *." The phrase, "information deemed reasonably available" is not defined in the information package sent to potential petitioners.

To reduce possible uncertainty about the requirements for information under countervailing duty law, the text of section 305 should be part of Commerce's information package sent to private parties seeking information related to foreign trade subsidies. If individuals seeking subsidy and countervailing duty law information were routinely informed of the possible relevance of section 305 to their needs, section 305 requests could increase. For this reason our recommendation on page 44 to issue regulations related to section 305 is additionally relevant.

RECOMMENDATION TO THE SECRETARY OF COMMERCE

We recommend that the Secretary of Commerce direct the Deputy Assistant Secretary for Import Administration to include the full text of section 305, "Requests for Information," (19 U.S.C. §2415), in the written material typically sent to potential petitioners under countervailing duty law. Inclusion of section 305 should be accompanied by the caveat that it is neither required nor recommended that potential petitioners seek subsidy-related information under section 305 and specifically that the statutory language, "petition * * * which is accompanied by information reasonably available to the petitioner supporting those allegations" (19 U.S.C. §1671a), does not mandate the use of section 305.

COMMERCE'S COMMENT

Commerce agreed with this recommendation and will explain the potential of section 305 to people seeking information on foreign subsidies from the Department.

PRIVATE PARTIES SELDOM INITIATE FOLLOW-UP INQUIRIES

Commerce Department officials told us that inquirers generally don't request additional assistance after the standard information package is sent to them. Three of the 37 inquiries

received in 1980 and 1981 resulted in petitions under the countervailing duty law. In two of these cases, the ITC found insufficient evidence of material injury.

As an example of an inquiry leading to a petition, Pacific Northwest lumber producers alleged that the price of standing timber (stumpage) on Canadian Government-owned forest land was less than the price of timber available in the United States, thus increasing Canadian competitiveness in the U.S. market. They asked Commerce if Canada's stumpage pricing system was a countervailable subsidy. Commerce informally advised the lumber producers that on the basis of the available evidence the pricing system was not a countervailable subsidy because:

1. The fact that a country provides goods or services at a fee lower than the world market price or the U.S. price does not mean a countervailable benefit is conferred.

2. Low prices or price ceilings placed on a natural resource (such as stumpage) does not per se constitute a subsidy under U.S. law. Commerce noted, for example, that the Government insists that the European Community not regard U.S. natural gas price controls as a countervailable subsidy.

3. There was no evidence of differential price discrimination. The Canadian pricing system appeared neither to favor one industry over another nor to benefit exported products more than domestic products.

The producers, however, filed a petition under the countervailing duty statute on December 12, 1982. In January 1983, the ITC determined that there was a reasonable indication of material injury. On May 24, 1983, Commerce determined that the Canadian Government was not significantly supporting its timber producers with countervailable subsidies.

The other 34 inquiries did not result in petitions under the countervailing duty law. During this same period, 23 additional countervailing duty proceedings were started, apparently without initial informal inquiries at Commerce.

We interviewed 25 of the 37 inquirers, who cited the following reasons for not submitting petitions.

--Difficulty in understanding applicable law and regulations.

--Belief that legal counsel was necessary and would be too expensive.

--Belief that allegations of material injury and/or prohibited foreign subsidy practices could not be adequately demonstrated.

--Belief that the administrative proceeding was too time-consuming.

The information that Commerce sends to potential petitioners should help them to assess the costs and benefits of formally starting the relatively lengthy, complicated, and legalistic countervailing duty proceedings. The administration's objective of reducing and eliminating trade-distorting subsidies partly depends on private parties to make the initial decisions about the merits of any unfair subsidy allegations they might contemplate. The fact that some of the 37 inquirers decided not to file primarily, or partly, because of the presumed costs of legal counsel, however, is troublesome. A witness in a November 1981 congressional hearing on United States-Canadian trade policies estimated that legal fees for a countervailing duty proceeding would be $100,000 to $120,000.

Testifying at the same hearing, the OUSTR's General Counsel noted the apparent irony of the situation when he stated that:

> "Congress felt [in amending the countervailing duty law in 1979] that it was essential to have much clearer legal safeguards to protect American industries from what were regarded as being arbitrary decisions by the previous administering authorities [i.e., the Treasury Department] * * * and in being excessively legalistic, they raised the cost of bringing [countervailing duty] cases."

As one possible remedy to the problem of cost, the same official suggested amending the Equal Access to Justice Act (5 U.S.C. §504, Public Law 96-481, Oct. 21, 1980) "which does not currently cover administrative cases; it only covers cases actually litigated in court. This act * * * would grant to successful plaintiffs, at least, attorneys' fees." In his comment on the draft of this report, the Under Secretary of Commerce for International Trade stated that such an amendment to the Equal Access to Justice Act could promote frivolous actions which are costly to the Government and disruptive of fairly traded goods.

The former Chairman of the ITC, testifying before Congress in November 1981, offered the personal view that each countervailing duty case:

> "involves complex procedures at the commerce department [sic] * * * at the ITC, and a high likelihood of judicial review in the court of international trade. The issues are so complex, * * * that representation by experienced

trade counsel is absolutely vital. * * * These are the consequences of an adjudicative system * * *. One possible method for defraying the costs to private parties might be for the government to assume the legal fees of successful petitioners. * * * [T]he fees could be paid from the additional duties collected in such cases."

Legislation introduced early in 1983 would authorize payment of reasonable expenses for small businesses whose cases under unfair competition laws are successful. Under the terms of H.R. 1269, such payments would be made from a trust fund consisting of receipts of antidumping and countervailing duty assessments.

CONCLUSION

The Government generally is relying on the private sector to initiate disputes over foreign subsidy practices to help reduce and eliminate trade distorting subsidy practices. To do so, the private sector must have access to available information on foreign subsidy practices.

The Government could take several practical steps to ensure that foreign subsidy information is made available to the private sector. The subsidies library should be the depository for all such information. Subsidy information reported by Embassies in response to their reporting requirements and section 305 requests should be routinely sent to the subsidies library. Establishing and maintaining a foreign subsidies library is the Commerce Department's responsibility. We believe that other agencies and departments, however, have an obligation to support Commerce's efforts in this regard. The Office of the U.S. Trade Representative and the Departments of Agriculture and State, for example, acquire information on foreign subsidy practices from their overseas offices. These organizations should establish procedures to ensure that the maximum amount of information on foreign subsidy practices is compiled systematically, screened for confidentiality, and sent to the subsidies library.

RECOMMENDATION

We recommend that the U.S. Trade Representative and the Secretaries of Agriculture and State each designate a representative to cooperate with Commerce's foreign subsidies librarian in establishing procedures to improve the flow of information on foreign subsidy practices to Commerce's library.

AGENCY COMMENTS

None of the above agencies commented on this recommendation.

CHAPTER 6

INJURY AND SUBSIDY DETERMINATIONS

UNDER COUNTERVAILING DUTY LAW

Private parties may petition the Government for relief from the effects of subsidized imports in the U.S. market under provisions of the Tariff Act of 1930, as amended by Title I of the Trade Agreements Act of 1979 (19 U.S.C. §1671 et seq.). The Commerce Department and International Trade Commission administer this countervailing duty statute.

Commerce is responsible for determining the nature and extent of any alleged subsidy. Officially supported financing is a commonly alleged subsidy practice in petitions under this statute. In the cases we reviewed, many alleged subsidies of this type were determined to be export subsidies within the meaning of the countervailing duty statute. In some cases, the determination was complicated by the fact that the allegation concerned non-export-oriented financing practices, which in some circumstances are not considered subsidies under the countervailing duty law.

The six-member ITC is responsible for determining injury as part of a countervailing duty investigation. The injury test was not part of countervailing duty investigations before 1975, and from 1975 to 1980 only duty-free imports required an injury test. Most injury investigations from 1975 through 1981 resulted in unanimous negative determinations by the Commissioners. In many of these investigations, they found that the volume of allegedly subsidized imports was not increasing and that the price of the like domestic product and the health of the domestic industry were not adversely affected by subsidized imports.

INJURY DETERMINATIONS BASED ON IMPORT VOLUME, PRICE, AND HEALTH OF INDUSTRY, BUT OTHER FACTORS CONSIDERED

Article VI of the GATT imposes a "material injury" test as a prerequisite to imposing countervailing duties. The 1979 Trade Agreements Act defines material injury as "harm which is not inconsequential, immaterial, or unimportant." The House Committee on Ways and Means report on the Act states that material injury "shall be based upon evidence showing that the threat is real and imminent and not upon mere supposition or conjecture."

The ITC also makes injury determinations under other provisions of trade law. For example, sections 201-203 of the Trade Act of 1974 (19 U.S.C. §§2251-53), as amended, provide formal procedures for responding to import injury from competition under fair trade conditions. The purpose of such import relief is to facilitate orderly adjustment to import competition. Before an affirmative import relief determination can be made, the increased imports must be judged a substantial cause or threat of

serious injury to a domestic industry. The House Ways and Means Committee report on the Act noted that it does not view overall injury caused by unfair competition, such as subsidization, to require as strong a causation link to unfairly competitive imports as would be required for determining the existence of injury under fair trade conditions.

The Trade Agreements Act directs the ITC to consider the following general factors in determining injury caused by subsidized imports.

--Volume of allegedly subsidized imports (i.e., significant increases in absolute terms or relative to production or consumption of like domestic products).

--Price effects on like domestic products (i.e., imported merchandise (1) significantly undercuts prices on like domestic products, (2) lowers prices on such products to a significant degree, or (3) prevents price increases which otherwise would have occurred to a significant degree).

--Health of a like domestic industry as defined by "all relevant economic factors" (The Act specifies 15 factors, including changes in output, sales, market shares, profits, and productivity).

Generally, the Trade Agreements Act follows the language of the Subsidies Agreement, which cautions that "one or several of these factors [cannot] necessarily give decisive guidance." The Senate Committee on Finance's report on the Act affirms this point and adds that "the significance to be assigned to a particular factor is for the ITC to decide."

The Subsidies Agreement states that it must be demonstrated that:

> "the subsidized imports are, through the effects of the subsidy, causing injury within the meaning of this Agreement. There may be other factors which at the same time are injuring the industry, and the injuries caused by other factors must not be attributed to the subsidized imports."

The Agreement in a footnote lists other factors; for example, contraction in demand, changes in the pattern of consumption, and developments in technology.

The language of the Trade Agreements Act states simply that the ITC must find the presence or threat of material injury to a U.S. industry "by reason of imports of that merchandise." The Act does not define the phrase "by reason of." However, the House Ways and Means Committee report states that the law does not contemplate that injury from subsidized imports be weighted against other factors, such as those cited as examples in the Agreement,

which may be contributing to overall injury to an industry. According to the report, any such requirement has the undesirable result of making relief more difficult to obtain. The report notes, however, that "of course * * * the ITC will take into account evidence presented to it which demonstrates that the harm attributed by the petitioner to the subsidized * * * imports is attributable to such other factors." The report cautions that under countervailing duty law, petitioners are not required to prove that such other factors have not caused material injury and the ITC is not required to calculate precisely the harm associated with such other factors.

Other factors were cited by the ITC in 14 (58 percent) of the 24 injury determinations we reviewed.[1] Imports from a country other than that being investigated was the other factor cited in 6 of the 14 determinations.

In the case of Certain Leather Wearing Apparel from Colombia and Brazil (Feb. 1979), the ITC, by a 3 to 2 vote, determined that the domestic industry was not being injured by reason of subsidized imports. Two Commissioners voting with the majority supported their determination by finding that although the domestic industry was suffering, it was not by reason of imports from Colombia and Brazil. They said that imports from other countries overshadowed the value of imports from Brazil and Colombia, so that imports from these two countries could not be considered the cause of any injury suffered by the domestic industry. For example, from January to November 1978, Colombia and Brazil together accounted for 5.1 percent of estimated U.S. imports of leather wearing apparel, while Korea and Taiwan together accounted for 53.3 percent.

The two dissenting Commissioners didn't refer to these figures, but noted instead that imports from Colombia more than doubled from 1977 to 1978 and almost tripled from 1976 to 1978, while the value of imports from Brazil nearly doubled from 1977 to 1978. The value of imports from Brazil and Colombia in 1978 equaled more than 5 percent of domestic producers' shipments. These Commissioners said that a 5-percent share of the market exceeds that which the ITC has found sufficient for an affirmative decision in other cases.

In Certain Iron-Metal Castings from India (Sept. 1980), the ITC, by a 4 to 1 vote, determined that the domestic industry was materially injured or threatened with material injury by subsidized imports. The dissenting Commissioner supported his no-injury determination, in part, by finding that the domestic public works casting industry[2] was affected by other factors,

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[1]Our focus was on 24 cases (22 negative and 2 split affirmative decisions). On pp. 54 and 55 we discuss the type of injury determinations we reviewed in more detail.

[2]Public works castings include such articles as manhole covers and frames and are used for drainage or access purposes to public utility, water, and sanitary systems.

such as the slowdown in residential construction, relatively high costs of energy and raw materials, and compliance with U.S. Government health and safety regulations.

Data submitted to the Commission by domestic producers of public works castings showed that during 1977-79 their annual energy costs increased by about 4 percent and pollution abatement equipment costs about 7 percent. According to the Government's figures, the price index for iron scrap, the most important raw material, peaked in January-March 1979 at 164, compared with a low of 95 in October-December 1977. The price index stood at 152 in January-March 1980.

In Lamb Meat from New Zealand (Nov. 1981), the ITC, by a 4 to 2 vote, made a preliminary determination of "reasonable indication of threat of material injury" to the domestic industry by reason of the subsidized imports. The two dissenting Commissioners concluded that any injury caused to the domestic industry was attributable to factors totally unrelated to imports. Since 1979 there had been a "fairly dramatic" increase in lamb slaughter, causing an apparent lamb glut on the market in late 1980. The estimated U.S. lamb slaughter decreased by 7 percent from 1978 to 1979 and increased by 11 percent from 1979 to 1980. The dissenting Commissioners also noted that the price of lamb relative to other red meats had increased considerably since 1974, causing consumers to substitute other meat products for lamb. Additionally, the dissenting Commissioners noted an overall decline in the consumption of meat products.

In Textiles and Textile Products of Cotton from Pakistan (July 1980), the ITC by unanimous vote determined that the domestic industry was not being injured by subsidized imports of a variety of textile products, including cotton towels. The investigation on towels covered pile as well as non-pile towels. Pile towels are commonly used as bath and hand towels. Non-pile or plainwoven towels are primarily for institutional and industrial use. Imports of towels were measured against the combined U.S. production of pile and non-pile towels. Most cotton towels imported from Pakistan were of pile construction but of lower quality than those produced in the United States. The Commission determined that Pakistani towels mostly were used by institutional establishments in the United States.

U.S. production of pile towels increased by 12 percent from 1977 to 1979 and non-pile towel production decreased by 30 percent. The Commission attributed some of this decline to other factors, such as the use of paper towels and blow dryers in public restrooms.

IMPORTANCE OF STATUTORY FACTORS VARIES IN COMMISSIONERS' DECISIONS

Of 28 injury determinations made between January 3, 1975 and December 31, 1981, the ITC determined for 22 cases that the

domestic industry was not being injured by reason of subsidized imports; 19 determinations were unanimous decisions and 3 were split votes. During the same period, the ITC made 6 affirmative determinations; 4 were unanimous decisions and 2 were split votes. Our focus was on 24 cases (22 negative and 2 split affirmative decisions). Petitions for some of these cases were filed before the injury test provisions were added to the countervailing duty statute. This may have affected the number of negative decisions, since an allegation of injury was not part of the original petition.

In 8 (42 percent) of the 19 unanimous no-injury determinations, the Commissioners did not find any injury by reason of the three statutory factors they are required to consider: (1) import volume, (2) prices of the domestic like product, and (3) the various factors defining the health of the domestic industry. In 4 (21 percent) of the no-injury determinations, however, the domestic industry was recognized as suffering some injury but not by reason of subsidized imports. The ITC determined in four other cases that the domestic industry was healthy although imports were increasing. Imports in these four cases were not adversely affecting the price of the like domestic product. Two of the remaining three cases essentially were considered frivolous by the ITC. They were part of an investigation involving numerous textile mill products from eight countries, and according to the ITC, should not have been included in the scope of the Treasury Department's investigation[3] because the products were not being exported to the United States. The ITC considered these investigations a waste of Government time and taxpayers' money. In the third case, involving chains from Japan, the petitioner and its constituent organizations provided the ITC with no information tending to show injury by reason of an alleged additional subsidy over the 2-percent duty being collected on the basis of the countervailing duty determination of the Treasury Department in August 1978. The ITC noted that there was no question about the obligation of parties to the petition to come forward with information reasonably available to them because, according to the Senate Finance Committee report on the Trade Agreements Act, "[t]he burden of proof under [the law] would be on the petitioner."

In Fresh Cut Roses From the Netherlands (Feb. 1980), the Commissioners found that domestic sales were stable from 1975 to 1979 and that, although profits varied from $3.2 million in 1974 to $0.7 million in 1978, there was no reasonable indication or threat of material injury due to the Netherlands imports. The Commissioners noted that such imports, as a percentage of total imports, declined from 19 percent in 1975 to 4 percent in 1979.

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[3]Under the countervailing duty statute as amended by the Trade Act of 1974, investigations by the Treasury and ITC were conducted sequentially; i.e., the Treasury first determined whether a subsidy was being granted and then the ITC made its investigation. The Trade Agreements Act of 1979 required that these investigations (now vested in Commerce and the ITC) be conducted concurrently.

Similarly in Unlasted Leather Footwear Uppers From India (Mar. 1980), several Commissioners noted that the domestic industry was depressed from 1977 to 1979; production and employment levels had both decreased. Imports from India, however, were considered insignificant compared with estimated domestic production and consumption. From 1977 to October 1979, Indian imports accounted for less than 0.5 percent of the uppers used in domestic production of footwear.

In contrast to these investigations, the Commissioners found a sharply rising import trend unrelated to the price of the domestic product or the health of the domestic industry in 4 of the 19 unanimous no-injury determinations we reviewed.

In Weighing Machinery and Scales From Japan (May 1980), imports more than doubled from 1978 to 1979. No adverse price effect was established, however, because both imported and domestic scale prices declined due to technological innovations. Domestic production more than doubled and U.S. exports tripled from 1977 to 1979.

The judgmental quality of the Commissioners' decisions is perhaps best illustrated by their five split decisions from January 1975 to December 1981. In three decisions the majority found that the domestic industry was not being injured, and in two decisions the majority found that it was being injured.

In Hard-Smoked Herring Filets From Canada (Dec. 1981), the Commissioners split 4 to 1 in finding that there was no reasonable indication of material injury or threat of material injury to the domestic industry from allegedly subsidized imports. Hard-smoking is a method of preserving and flavoring herring. Only one U.S. company produces hard-smoked herring filets, and officials from ITC and Commerce gave the producer considerable assistance with his petition.

Hard-smoked herring filet imports from Canada totaled about 595,000 pounds in 1978, 1,019,000 pounds in 1979, and 693,000 pounds in 1980 and accounted for more than 97 percent of total imports in each of these years. The petitioner's shipments during the same period totaled about 190,000 pounds in 1978 and 180,000 pounds in 1979 and 1980. Imports from countries other than Canada rose from about 7,000 pounds in 1979 to 17,000 pounds in 1980. The ITC majority found that the volume of Canadian imports and import market penetration showed no particular trend since 1978. The minority interpreted the same facts as showing increasing import dominance in the market.

The majority saw no adverse price effects. From January 1979 to January 1981, the price of the filets rose steadily, then declined during the first 7 months of 1981, and finally increased. The minority interpreted these fluctuations as conflicting signals but concluded that there appeared to be a

reasonable indication of potential price depression and distortion, warranting further investigation. The majority said there were no reported incidents of price cutting attributable to imports from Canada from 1978 to 1980 and concluded that the economic data indicated the domestic industry is currently in good health. For example, even though the petitoner's domestic shipments declined in volume, net sales increased by almost 50 percent from 1978 to 1980 and net operating profits doubled during the same period. The dissenting Commissioner concluded that the "domestic industry's condition * * * while not demonstrating reasonable indication of injury at present, causally linked to imports, shows, however, a reasonable indication of substantial susceptibility to import related injury."

We previously mentioned Certain Iron-Metal Castings from India in the context of the Commissioners' use of "other factors." In the determination, the Commissioners split 4 to 1 in finding that the domestic industry was materially injured or threatened with material injury. An issue in the case was the definition of the relevant domestic industry. Two Commissioners voting with the majority defined the domestic industry as that portion serving the Western region of the United States. Two Commissioners voting with the majority and the dissenting Commissioner defined the domestic industry as a national industry.

All five Commissioners recognized that Indian imports had increased 277 percent since 1977. One Commissioner termed this trend significant in both relative and absolute terms. Another Commissioner said that this staggering growth is one of the distinctive features of the case. The minority did not characterize the import trend, except to note that the domestic industry had remained fairly successful despite increasing imports, a faltering economy, and stringent governmental regulations.

All of the Commissioners noted that the Indian imports were underselling the domestic product. For example, the margins of underselling by imports of one kind of public works castings increased from 37.9 percent in January-March 1978 to 40.0 percent in October-December 1979. The minority noted that at the time the margins of underselling narrowed (Jan.-Mar. 1980), domestic producers began to show injury. A Commissioner voting with the majority said that the imports had prevented increases in the prices of the like domestic products. Two other Commissioners stated that the imported merchandise had lowered the prices of the like domestic products.

The Commissioners divided over the health of the domestic industry. The two Commissioners that limited their analysis to Western U.S. producers noted declining use of productive facilities, declining employment and net sales, and increasing inventories. Another noted that the domestic industry's adverse condition was exacerbated by the serious decline in housing starts which has a parallel effect on the public works casting industry. He also said that subsidized imports, although not as significant as this other factor, must be considered nevertheless

as a cause of material injury. The dissenting Commissioner said that, as a whole, the national domestic industry remained profitable through 1979 and that the financial situation reported by those domestic producers which import from India was not nearly as strong as that of the foundries that did not import. The ratio of net operating profit to net sales for foundries that imported as well as produced public works castings decreased from 6.9 percent in 1977 to 1.0 percent in 1978 and remained at that level in 1979. The ratio of net operating profit to net sales for the non-importing producers declined from 8.3 percent in 1977 to 5.6 percent in 1978, but increased to 7.8 percent in 1979. The dissenting Commissioner concluded that, despite financial losses in the first quarter of 1980, past history showed that the domestic producers can compete and succeed despite increasing low-cost imports from India.

In Oleoresins From India (July 1979), the Commissioners also split 4 to 1 in finding that the domestic industry was not injured by reason of subsidized imports from India. All agreed that the U.S. market penetration of Indian oleoresins had increased from about 2 percent in 1975 to about 8 percent in 1978. The majority did not characterize these facts, but the minority called it a sharp upward trend, additionally noting that the value of imports increased by more than 500 percent.

The majority recognized price undercutting by Indian imports but said that it had substantially decreased since 1976. The minority said that underselling occurred throughout January 1976 to May 1979.

The majority said that the economic condition of the domestic industry had improved continuously during 1975 through April 1979. For example, employment grew from 63 persons in 1975 to 68 in 1978. Net sales reached $16.5 million in 1978, a 28-percent increase over the 1976 level, and profits grew 262 percent between 1976 and 1978.

Significantly, the dissenting Commissioner did not discuss the health of the domestic industry. His decision largely turned on the relationship between import volume and underselling of the domestic product. Black pepper oleoresin, the foremost imported Indian oleoresin, undersold the domestic product in all but three 3-month periods during 1976 to May 1979. The amount of underselling in January-March 1976 was 7.5 percent, and in January-March 1978 was 11.3 percent. The dissenting Commissioner concluded that increasing penetration of the oleoresin market resulting from underselling was likely to cause injury to the domestic industry.

Summary

Under the countervailing duty statute, the Commissioners are required to compare the realities of the domestic market place with the requirements of the statute and determine whether a domestic industry is being materially injured or threatened with

material injury by reason of subsidized imports. In 68 percent of the 28 injury determinations conducted between 1975 and 1981, the Commissioners unanimously decided that the domestic industry was not being so injured. Almost half of these determinations were based on a unanimous conclusion that the:

--Volume of the allegedly subsidized imports was not significantly increasing either absolutely or relatively.

--Prices for like domestic products were not undercut, suppressed, or depressed by allegedly subsidized imports.

--Effect on the health of the like domestic industry was not adverse in terms of sales, employment, inventories, and other factors.

In four investigations, the Commissioners determined that the domestic industry was experiencing problems but not because of subsidized imports. The Commissioners attributed the industries' problems to other factors in some determinations.

DOMESTIC FINANCING SUBSIDIES USED BY EXPORTERS NOT ALWAYS COUNTERVAILED

Both the Subsidies Agreement and Trade Agreements Act distinguish between export and non-export-oriented (domestic) subsidies and state conditions under which the Government can take action against imports benefiting from such subsidies. A special difficulty arises when exporters use domestic subsidies, such as preferential financing programs, even though such programs are not specifically intended for exports. We reviewed subsidy determinations involving officially supported financing programs, including a non-export-oriented program allegedly used by German steel producers. Between 1978-81 the Government resolved 69 countervailing duty cases; preferential financing schemes of 23 countries were alleged in 46 cases (67 percent). A single petition may allege a variety of subsidy practices, including several different financing programs. For example, petitioners in several countervailing duty cases claimed that Brazilian exporters were benefiting from four different financing programs. During 1978-81, the Brazilian Government had programs to finance

--working capital;

--exports denominated in foreign currency, manufacturers exporting on consignment, and foreign importers;

--storage of exports; and

--loans in the form of short-term advances of Brazilian currency against foreign exchange contracts and receivables.

Petitions during 1978-81 also alleged that various governments' financing programs, aside from financing exports, specifically supported exporters in purchasing new machinery and raw material, adjusting to changing business and marketing conditions, defraying negotiating expenses, and financing research and development and pollution control equipment.

The 46 petitions alleged 93 instances of such practices; 35 instances were determined to be export subsidies within the meaning of the countervailing duty law, and 16 were considered not to be actionable subsidies. The remaining 42 allegations were dismissed because the foreign firms in question did not use the alleged subsidy (25), the amount of the subsidy was considered insignificant (8), and the alleged practice either did not exist or was not applicable to the import in question (9).

In 12 of the 16 negative determinations, the interest rate for government-supported financing was the same as or exceeded the prevailing commercial rate. In one of the remaining four cases, long-term loans to Austrian manufacturers were made from a special account maintained by the Austrian Government and established by a 1962 agreement with the U.S. Government. The account was created using monies from a Marshall Plan grant, with no contribution by the Austrian Government. A July 1979 decision on Mexican textile imports reflects the reason why a financing subsidy was not considered actionable in the three remaining cases. The Government's decision stated, in part, that Mexican textile manufacturing and/or exporting firms received low-interest loans available to all small and medium-sized enterprises and was in no way contingent on or related to the export of merchandise produced by the firms receiving the benefits.

This determination and other conceptually similar decisions illustrate the distinction the Subsidies Agreement draws between export subsidies which are countervailable and subsidies supporting national policy goals which generally are not. For example, on June 10, 1982, the Commerce Department made the following preliminary determination for steel imports from the Federal Republic of Germany.

> "The [German Government] guarantees loans made by commercial lenders to industrial firms. They are provided according to budgetary legislation and are meant to serve national social and economic objectives not realizable without such financial guarantees. Such guarantees enable steel companies to borrow at rates lower than they would otherwise pay. Since the loan guarantees are available on equal terms to all industrial borrowers in the [Federal Republic] and since we have no indication that a specific industry or group of industries is

> the main beneficiary of these guarantees, we preliminarily determine that these loan guarantees are not countervailable."[4]

The guarantee program seemingly has aspects of a subsidy (preferential borrowing rates), and German steel exporters as well as other industrial borrowers are presumably eligible to use it. Assuming that steel exporters are benefiting, why isn't the guarantee program an export subsidy within the meaning of the countervailing duty law?

The Subsidies Agreement's "Illustrative List" of prohibited export subsidies includes the "provision by governments of direct subsidies to a firm or an industry contingent upon export performance". (See app. III.) However, the guarantee program is not targeted to a specific industry nor is it contingent upon export performance.

Article 11 of the Agreement notes that possible forms of non-export subsidies include government financing of commercial enterprises, including grants, loans, or guarantees. Article 11 further states that signatories recognize that subsidies other than export subsidies are widely used to promote social and economic policy objectives and they do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives they consider desirable.

For example, the Agreement notes that governments use subsidies, under socially acceptable conditions, to facilitate the restructuring of certain sectors, especially where this has become necessary by reason of changes in trade and economic policies, including international agreements resulting in lower barriers to trade. Commerce's preliminary determination on German steel imports specifically ties the loan guarantee program to general social and economic policy objectives.

The Agreement also states that, to fullfill legitimate economic and social policy objectives, subsidies may be granted "with the aim of giving an advantage to certain enterprises" and that subsidies, other than export subsidies, are "normally granted either regionally or by sector."

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[4]At the same time, Commerce also made preliminary determinations on steel imports from the United Kingdom, the Netherlands, Belgium, Luxembourg, Italy, France, Brazil, and South Africa. In the determination on German steel, Commerce found seven practices to be potentially countervailable subsidies. Commerce made its final determinations on August 25, 1982, sustaining its preliminary decision on the loan guarantee program. On October 21, 1982, U.S. and European Governments signed an import restraint agreement on steel in lieu of countervailing duties on imports covered by the agreement.

The Trade Agreements Act states that a countervailable subsidy includes certain domestic subsidies if provided or required by government action to a specific enterprise or industry. According to the Act, such subsidies may include but are not limited to the provision of capital, loans, or loan guarantees on terms inconsistent with commercial consideration. Since the German loan guarantee program enables steel companies to borrow at rates lower than they would otherwise pay but apparently is not granted to a specific enterprise or industry, it therefore is not a prohibited subsidy practice under countervailing duty law.

In the same German steel case, however, Commerce preliminarily determined that German federal and state government research and development grants are prohibited subsidies within the meaning of the countervailing duty statute because the programs as implemented allocated funds to specific industries, including the steel industry.

In certain circumstances, signatories to the Agreement can take action against subsidies other than export subsidies. The fact that the guarantee program is not an export subsidy does not by itself preclude its countervailability under the Agreement.

The Agreement cautions that in pursuing various policy objectives, such non-export-oriented subsidies:

> "may cause or threaten to cause injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory or may nullify or impair benefits accruing to another signatory under the General Agreement [on Tariffs and Trade], in particular where such subsidies would adversely affect the conditions of normal competition. Signatories shall therefore seek to avoid causing such effects through the use of subsidies."

Under Article 12 of the Agreement, a signatory whose domestic industry is being injured by reason of a non-export subsidy maintained by another signatory may request consultations with that country. If the matter remains unresolved after consultations, conciliation, and dispute settlement procedures, countermeasures may be authorized, taking into account the degree and nature of the adverse effects found to exist.

AGENCY COMMENTS AND OUR EVALUATION

In his comments on the draft of this report, the Under Secretary of Commerce for International Trade stated that our discussion of the countervailability of the German Government's loan guarantee program was somewhat confusing and possibly misleading. We have reorganized this section of the report to clarify our discussion of why practices which might appear to be subsidies are not necessarily considered to be countervailable subsidies within the meaning of the law.

The Under Secretary also said that we should refrain from citing preliminary countervailing duty determinations, since they can represent first impressions from which definitive U.S. positions should not be inferred.

In our draft report we noted a preliminary decision in one instance (pricing system of Canadian stumpage) because a final decision had not been made by the time the report was sent to the Commerce Department. We have updated the report with a reference to the final decision. In the case involving the German Government's loan guarantee program, the final decision was the same as the preliminary decision.

Our aggregate statistics on determinations involving governmental financing programs include preliminary decisions if the case was terminated before a final decision was made. While such decisions may represent first impressions, they are not necessarily uninformed impressions. For example, preliminary and final decisions were made in 12 of the 16 determinations noted in the report which were found not be be countervailable financing subsidies. In 8 determiniations involving the nature, as opposed to the amount, of the alleged subsidy, the final decision was the same as the preliminary decision, and in 4 determinations, the final decision differed from the preliminary decision.

STATUS OF TOKYO ROUND SUBSIDIES AGREEMENT SIGNATORIES (note a) as of July 1, 1983

Australia
Austria
Brazil
Canada
Chile
Egypt
European Community (note b)
- Belgium
- Denmark
- France
- Germany
- Greece
- Ireland
- Italy
- Luxembourg
- Netherlands
- United Kingdom

Finland
Hong Kong (note c)
India
Japan
Korea
New Zealand (with reservation) (note d)
Norway
Pakistan
Spain (with reservation) (note d)
Sweden
Switzerland
United States
Uruguay
Yugoslavia

[a]Under U.S. law, in addition to signatories to the Agreement, El Salvador, Honduras, Liberia, Nepal, North Yemen, Paraguay, and Venezuela are accorded the benefit of the material injury test in all countervailing duty investigations. In addition, Taiwan assumed substantially equivalent obligations to those of the Agreement with respect to the United States and thus also receives the benefit of the injury test.

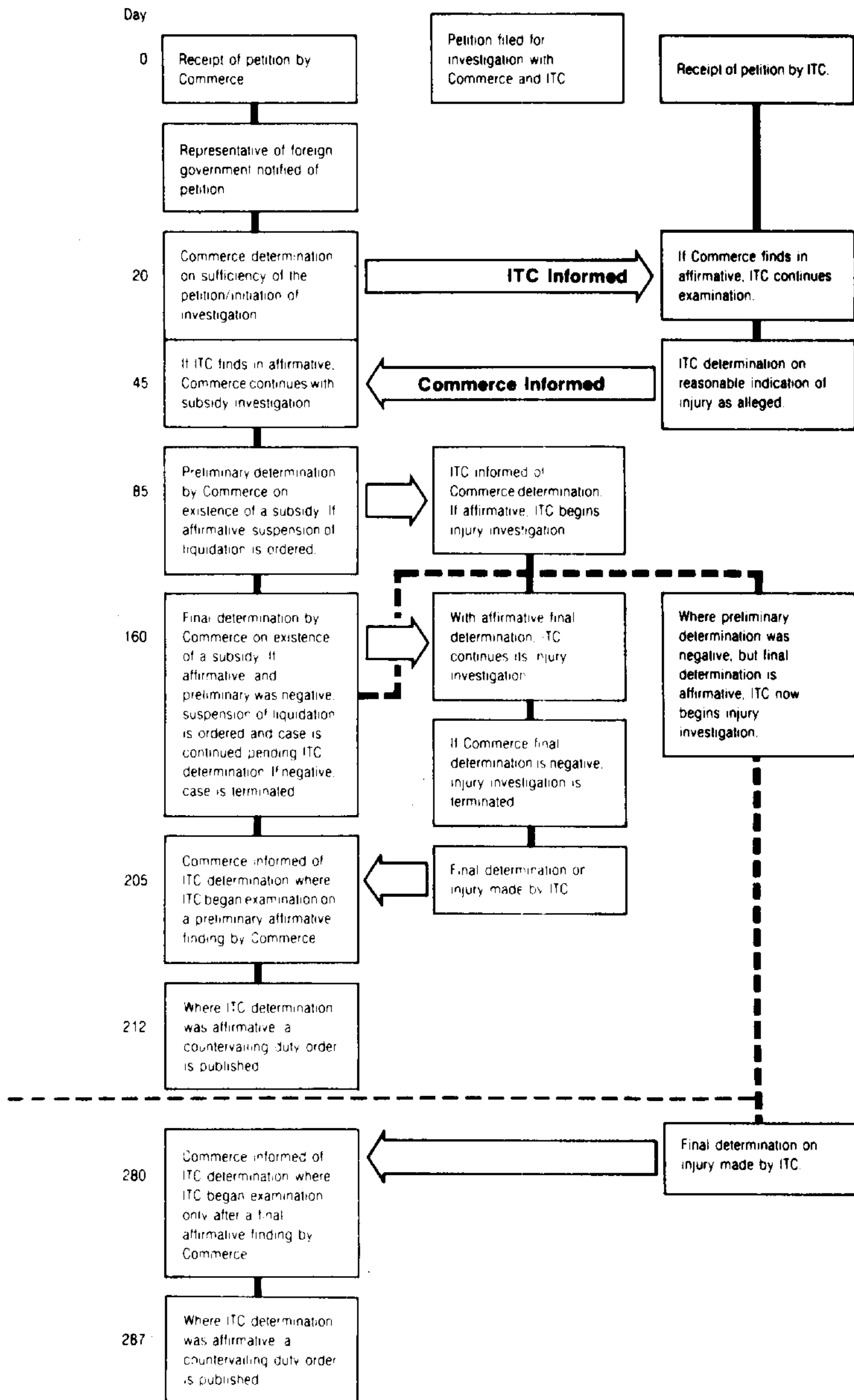
[b]Acceptance by the European Community has the effect of binding member states to the Subsidies Agreement without member states having to sign the Agreement individually.

[c]Although the United Kingdom's signature applies to Hong Kong as one of its territories, Hong Kong is listed separately to reflect the fact that it is considered a country under the Agreement.

[d]Accepted with reservation means that the country has agreed to be bound by the Subsidies Agreement except for certain obligations. The reservation must be assented to by all members of the Agreement. For New Zealand and Spain the reservation is temporary and when it expires the signatory will be bound by all agreement obligations.

Source: Prepared by GAO from information provided by OUSTR's Office of GATT Affairs.

PROCEDURES IN A TYPICAL COUNTERVAILING DUTY INVESTIGATION



Source: Department of Commerce

ANNEX TO SUBSIDIES AGREEMENT
ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

(a) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.

(b) Currency retention schemes or any similar practices which involve a bonus on exports.

(c) Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments.

(d) The delivery by governments or their agencies of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for delivery of like or directly competitive products or services for use on the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favourable than those commercially available on world markets to its exporters.

(e) The full or partial exemption, remission, or deferral specifically related to exports, of direct taxes[1] or social welfare charges paid or payable by industrial or commercial enterprises.[2]

(f) The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.

(g) The exemption or remission in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.

(h) The exemption, remission or deferral of prior stage cumulative indirect taxes[1] on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior stage cummulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior stage cumulative indirect taxes are levied on goods that are physically incorporated (making normal allowance for waste) in the exported products.[3]

(i) The remission or drawback of import charges[1] in excess of those levied on imported goods that are physically incorporated (making normal allowance for waste) in the exported product; provided, however, that in particular cases a firm may use a quantity of home market goods equal to, and having the same quality and characteristics as, the imported goods as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period, normally not to exceed two years.

(j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the costs of exported products[4] or of exchange risk programmes, at premium rates, which are manifestly inadequate to cover the long-term operating costs and losses of the programmes.[5]

(k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

Provided, however, that if a signatory is a party to an international undertaking on official export credits to which at least twelve original signatories[6] to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

(l) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of the [GATT].

Footnotes

[1]For the purpose of this Agreement:

The term "direct taxes" shall mean taxes on wages, profits, interest, rents, royalties, and all other forms of income, and taxes on the ownership of real property.

The term "import charges" shall mean tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports.

The term "indirect taxes" shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges.

"Prior stage" indirect taxes are those levied on goods or services used directly or indirectly in making the product.

"Cumulative" indirect taxes are multi-staged taxes levied where there is no mechanism for subsequent crediting of the tax if the goods or services subject to tax at one stage of production are used in a succeeding stage of production.

"Remission" of taxes includes the refund or rebate of taxes.

[2]The signatories recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected. * * *

The signatories reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length. Any signatory may draw the attention of another signatory to administrative or other practices which may contravene this principle and which result in a signficant saving of direct taxes in export transactions. In such circumstances the signatories shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of signatories under the [GATT], including the right of consultation created in the preceding sentence.

Paragraph (e) is not intended to limit a signatory from taking measures to avoid the double taxation of foreign source income earned by its enterprises or the enterprises of another signatory.

Where measures incompatible with the provisions of paragraph (e) exist, and where major practical difficulties stand in the way of the signatory concerned bringing such measures promptly into conformity with the Agreement, the signatory concerned shall, without prejudice to the rights of other signatories under the [GATT] or this Agreement, examine methods of bringing these measures into conformity within a reasonable period of time.

In this connection the European Economic Community has declared that Ireland intends to withdraw by 1 January 1981 its system of preferential tax measures related to exports, provided for under the Corporation Tax Act of 1976, whilst continuing nevertheless to honor legally binding commitments entered into during the lifetime of this system.

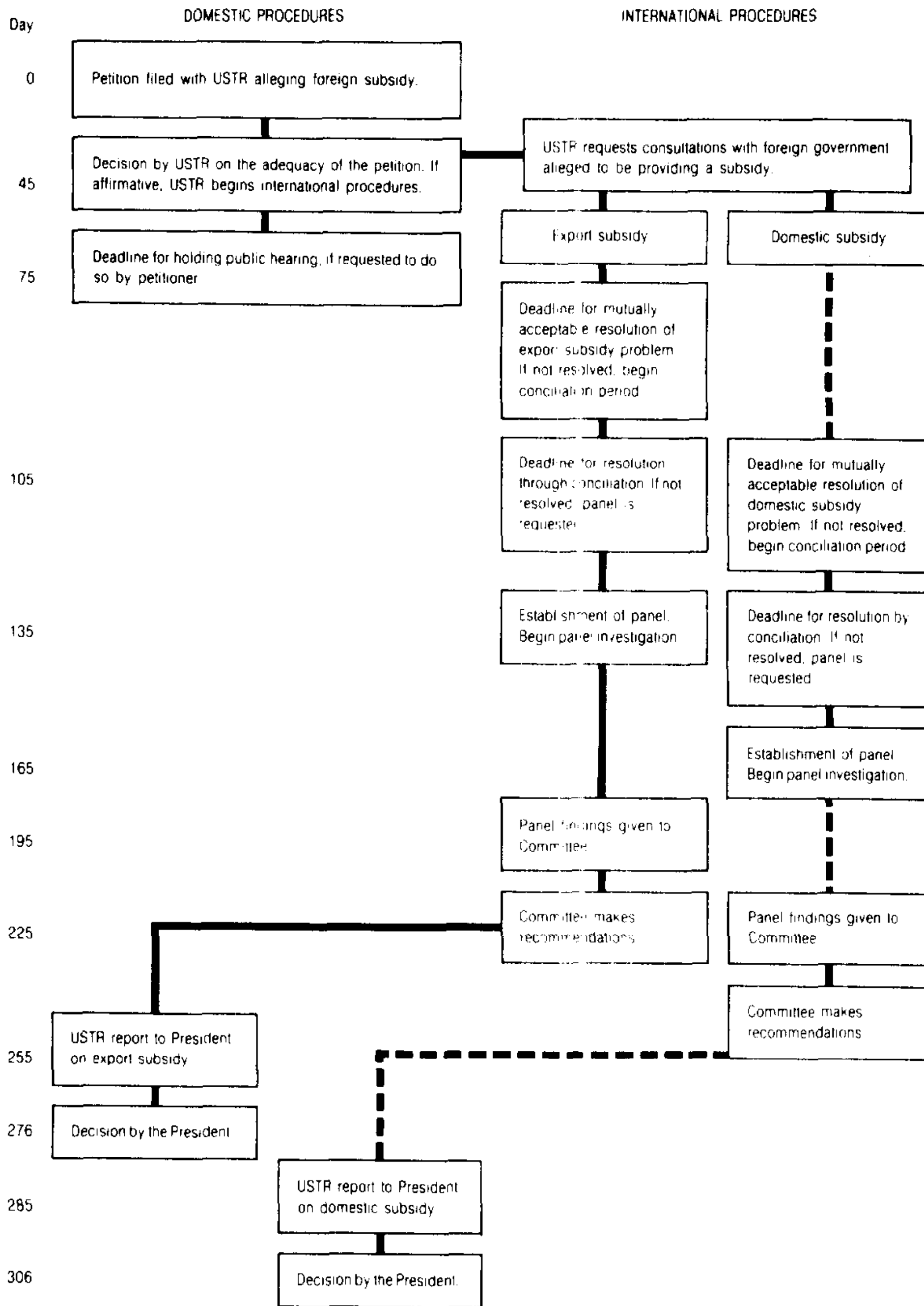
[3]Paragraph (h) does not apply to value-added tax systems, and border tax adjustment in lieu thereof and the problem of the excessive remission of value-added taxes is exclusively covered by paragraph (g).

[4]The signatories agree that nothing in this paragraph shall prejudge or influence the deliberations of the panel established by the GATT Council on 6 June 1978.

[5]In evaluating the long-term adequacy of premium rates, costs and losses of insurance programmes, in principle only such contracts shall be taken into account that were concluded after the date of entry into force of this Agreement.

[6]An original signatory to this Agreement shall mean any signatory which adheres ad referendum to the Agreement on or before 30 June 1979.

PROCEDURES IN SECTION 301 CASES CONCERNING SUBSIDIES



Source: Department of Commerce.

SECTION 301 PETITIONS ALLEGING HARMFUL SUBSIDIES
Jan. 1, 1980 to Feb. 8, 1983

Petitioner and product	Date filed	Petitioner's allegations	Status
Millers' National Federation—Wheat Flour	12-1-75	EC use of export subsidies gave EC more than equitable share of world trade.	Pursued under Subsidies Agreement from 9-81. Conciliation phase completed 12-15-81. Panel report 2-24-83. (See p.12 of this report for information on panel's report.)
Great Western Sugar Co.—Sugar	8-20-81	EC use of export subsidies gave EC more than equitable share of world trade.	Accepted 10-25-81. Completed Subsidies Agreement conciliation phase 4-30-82.
National Broiler Council, et al.—poultry	9-17-81	EC use of export subsidies displace U.S. poultry exports to third-country markets.	Accepted 10-28-81. Consultations with EC 2-16-82 and 10-07-82. Informal consultations with Brazil 8-30-82 and 3-1-83 and formal consultations 4-1-83.
National Pasta Assn.—pasta	10-16-81	EC use of export subsidies on non-primary products displace U.S. produced pasta in home market.	Accepted 11-30-81. Meetings of dispute settlement panel 7/12/82 and 10-08-82. Panel report 4-19-83.
California Cling Peach Advisory Board, et al.—raisins and canned peaches & pears	9-11-81 Withdrawn 10-22-81, Refiled 10-29-81	EC use of production subsidies displace sales of non-EC products in EC and impair tariff bindings on those products.	Accepted 12-10-81. Consultations 2-25-82 and 3-29-82. Panel met 9-29-82 and 10-29-82.
Tool and Stainless Steel Industry Committee, et al.—specialty steel (note a)	12-02-81 Refiled 1-12-82	Austria, France, Italy, Sweden, and U.K. use of production subsidies in specialty steel industries and their imports adversely affect U.S. industry.	Accepted 2-26-82. Consultations begun 3-15-82. Formal consultations 10-82 and 1-83 with various countries.
Industrial Union Dept. AFL-CIO, et al.—subway cars	6-04-82	Canada's subsidized financing violates Subsidies Agreement and is unreasonable and a burden to U.S. commerce.	Accepted 7-19-82. Terminated without prejudice 10-26-82.

Petitioner and product	Date filed	Petitioner's allegations	Status
Tool and Stainless Steel Industry Committee and United Steel Workers of America--specialty steel	6-23-82	Belgium's production subsidies adversely affect U.S. industry.	Accepted 8-09-82. Consultations 10-25-82.
J.I. Case, Company-wheel loader	7-17-82 Refiled 9-13-82	Canada's regulations allowing remission of customs duty and sales tax constitute unreasonable and discriminatory practice.	Accepted 10-28-82. Consultations 12-21-82.

[a]In addition to these five petitions, the Committee also submitted petitions against practices of Belgium and Brazil. Both petitions were rejected. Petition concerning Belgium refiled 6-23-82.

Source: Prepared by GAO from information provided by OUSTR.

United States Department of Agriculture

Foreign Agricultural Service

Washington, D.C. 20250

JUN 21 1983

Mr. J. Dexter Peach
Director
Resources, Community and Economic
  Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

This is in reply to your request for the Department's comments on your proposed report to the Secretary of Commerce and the U.S. Trade Representative: "Benefits of International Agreement on Trade Distorting Subsidies Not Yet Realized".

The Department has no comments of a policy nature, but does have a number of suggestions for changes which would clarify or correct certain points in the draft. The suggestions are as follows:

1. On pages iii and 17 it is stated that private U.S. parties may petition the U.S. Trade Representative under Section 301 of the 1974 Trade Act requesting the President to take action to enforce U.S. rights under the Subsidies Code and other agreements. While private U.S. parties could use Section 301 in this manner, it is more often used simply to request the President to take action against foreign unfair trade practices including subsidies. The distinction is important since Section 301 does not limit the President to the use of the Subsidies Code to remedy subsidies problems, and the Administration, in fact, must make a separate decision as to whether use of the Subsidies Code is the most appropriate procedure to follow.

2. On page 3 and elsewhere, it is said that "the breakthrough" in negotiation of the Subsidies Code came with the U.S. government decision to deal with the effects of subsidies rather than with subsidies themselves. This may be somewhat misleading. The original U.S. position as noted on this page was to suggest that subsidies could be categorized into those types which should be outlawed (importers could countervail without proof of injury), those which would be conditional (importers could countervail with proof of injury), and those which would be permissible (importers could not countervail). Agreement by the United States to accept an injury test in all cases might, in a sense, be considered equivalent to agreement to deal with the effects of subsidies rather than with subsidies themselves. Nevertheless, the Code provides a very important obligation not to use export subsidies at all on non-primary products. The decision to accept the Code, even though there was no equivalent obligation for primary products including agricultural products, was also essential to the conclusion of the

GAO note: Page number references in appendixes VI, VII, and VIII may not correspond to page numbers in this final report.

agreement, and was much more explicitly an agreement to deal with the effects of certain subsidies. The agreement meant that exporters of primary products would continue as before to have obligations only to avoid the use of subsidies which displace or undercut other exporters. The United States is now seeking a way to eliminate this different treatment of primary products.

3. On page 16, it is noted that the phrase "equitable share of world export trade" as it appears in the GATT and the Subsidies Code is not defined. The Code, however, did attempt to bring more precision to the concept by indicating that it involved displacement of other exporters from the market. It was hoped that this refinement, plus the concept of price undercutting which was added in the Code, would be sufficient to permit a demonstration of the adverse effects of subsidies on primary products. The cases brought by the United States in 1981 were intended to test these ideas.

4. On page 21 the discussion of the U.S. complaint against EC flour subsidies reports that the Panel in this case was unable to reach a conclusion as to whether the EC had granted export subsidies in a manner which resulted in prices materially below those of other suppliers. On the other hand, the Panel did reach a number of conclusions that were favorable to the United States and these should be cited also since they may form the basis for further action by the United States in the GATT. The Panel also found:

-- that the EC share of world exports of wheat and flour had increased considerably over the period when EC export subsidies were the general practice, while the share of the U.S. and other suppliers had decreased.

-- that it would be desirable for the EC to make greater efforts to limit the use of subsidies on exports of wheat flour.

-- that the situation as regards export subsidies and other aspects of trade in wheat flour is highly unsatisfactory and cause for concern over the effectiveness of the legal provisions of the GATT in this area.

-- that the EC without the application of export subsidies would generally not be in a position to export substantial quantities of wheat flour, and

-- that the EC by reason of its export subsidies had over time increased its share of the world market to become by far the largest exporter of wheat flour.

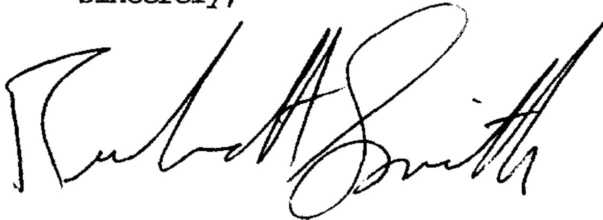
5. On page 39 the sentence beginning "One concern of these officials is" should precede the sentence beginning "Other officials expressed the view that".

-3-

6. On page 47 it is stated that USTR now requires the Departments of Agriculture and Commerce to affirm the accuracy of the data in 301 petitions. It would be more correct to say that USTR requests the Departments to affirm the accuracy of data if possible.

7. On page 51 it is stated that the U.S. Government sought changes to the OECD credit arrangement in order to include sectors not previously covered, including agriculture. According to our records the Administration has always sought to exclude agriculture from that arrangement.

Sincerely,

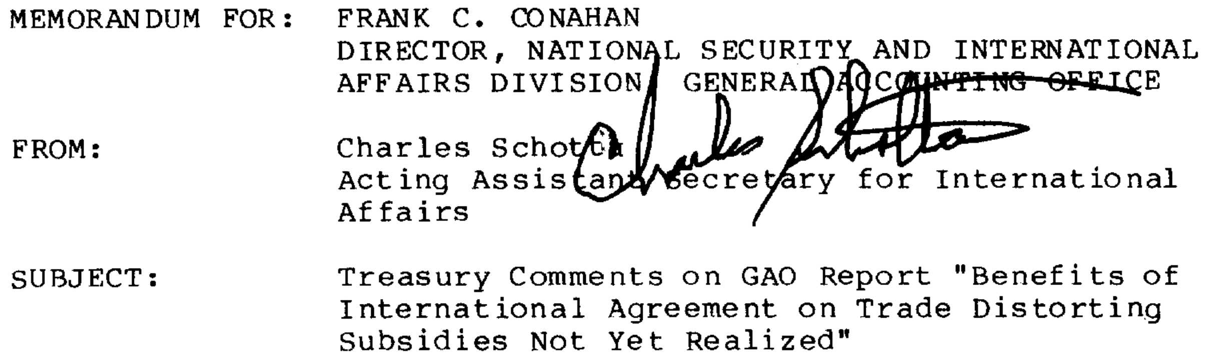


Richard [illegible]
Administrator

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

JUN 24 1983



MEMORANDUM FOR: FRANK C. CONAHAN
DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE

FROM: Charles Schotta
Acting Assistant Secretary for International Affairs

SUBJECT: Treasury Comments on GAO Report "Benefits of International Agreement on Trade Distorting Subsidies Not Yet Realized"

We appreciate being given this opportunity to comment on the GAO's report. The following are Treasury's suggestions for changes:

1. Page iv, first paragraph, fourth tick: Instead of the phrase "Negotiating an improved Arrangement...", we would suggest the phrase "Continuing efforts to negotiate an improved Arrangement...".

2. Page v, first paragraph, first sentence: We would suggest deleting this sentence, because the Administration does not have only one form of commitment which it would consider to be "acceptable", but instead considers the development level of the particular developing country. This could be considered an "ideal" commitment.

3. Page ix, first paragraph: We would suggest replacing the last sentence with the following: "The Participants to the Arrangement have over the past four years negotiated successively stricter limitations on export credit subsidies, to the point where there are now no subsidies involved in the majority of export credits under the Arrangement."

4. Page ix, second paragraph: Delete the words in line one "first of the official credit". Replace the last three lines with the following: "...minimum lending rates, and accepting the principle of a differentiated interest rate system for low interest rate countries by establishing a separate minimum rate for export credits financed in yen."

5. Page 19, first paragraph: We would suggest the following rewording: "Some progress to control subsidies through a strengthened international Arrangement on export credits was agreed to in the summer and fall of 1981, and in June 1982. The Arrangement's predecessor agreements date from 1975. In order to avoid duplicating negotiations, therefore,

negotiations on export credit subsidies were left to the OECD; export credits consistent with the Arrangement's terms are not prohibited by the more recent Subsidies Agreement."

6. Page 27, third paragraph, line 2: Add the word "explicitly" before the word "cover". (Brazil's commitment did cover financing programs indirectly, because Brazil was not supposed to increase the amount of other subsidies to compensate for the reduction in the IPI.)

7. Page 31, last paragraph, last three lines: We would suggest the following alternative language: "...credit programs, because it felt that export credit programs consistent with the terms of the OECD Arrangement were not "notifiable" subsidies under GATT."

8. Page 32, second paragraph, line 3: Add the word "DISC" after the words "income of certain corporations".

9. Page 49, end of page: Change subheading to read "Amount of Subsidization in Export Financing reduced by 1981 and 1982 Negotiations and By Declines in Interest Rates".

10. Page 50, first full paragraph: Add a fourth point: "(4) maximum 'cover' of 85 percent of export value." In point (3), add the word "maximum" before the words "loan maturities".

11. Page 51, first paragraph, second sentence: Change wording to: "The combination of export credits with foreign assistance funds (mixed credits) was not prohibited; nor were other subsidy practices, such as provision of cost inflation insurance by governments to exporters of capital goods."

12. Page 51, third paragraph, line nine: We suggest the following replacement language for lines nine through the bottom of the page: "...prohibited by the Agreement. In short, the Subsidies Code specifies that, with respect to export credit subsidies, the undertakings negotiated in the OECD Arrangement will take precedence over those in the Code itself. This reflected the fact that the OECD discussions on export credits began some years before the GATT Subsidy Code negotiations, and the countries involved in the GATT effort did not want to pursue duplicate negotiations. Part two of item k therefore provides an exception to the general rule given in part one. The practical effect is that export credit subsidies are permitted under the Subsidies Code to the extent that minimum interest rates specified...".

13. Page 52, paragraph at top of page, last sentence: Add to the currencies mentioned in the parantheses: "...pound, and others)".

14. Page 52, first full paragraph, second sentence: We would suggest the following rewording of this sentence: "Negotiations in late 1980 failed to result in acceptance of this principle, but at the April 1983 meeting, the EC and other delegations went on record favoring, in principle, an automatically adjusting interest rate system. This was a substantial step forward."

15. Page 53, last paragraph: We would suggest the following rewording of this paragraph: "In 1981 and 1982, the Administration adopted a multifaceted negotiating strategy in support of our efforts to bring the Arrangement's terms more closely in line with the market. The strategy combined (a) selective but aggressive matching of foreign subsidized credits by the U.S. Eximbank; (b) a broad political campaign by senior U.S. Government officials to urge Arrangement reform in any and all contacts with their foreign counterparts, including meetings during OECD Ministerials and at the annual economic summits; (c) the use of other trade policy instruments such as GATT dispute settlement procedures; and (d) efforts to mobilize wide domestic political consensus behind our negotiating objectives. In the latter context, Congress provided major assistance, both in the form of resolutions stressing support for the negotiations, and through proposals for legislation such as the so-called "war chest" bills creating special export credit subsidy funds with which to match foreign credit subsidies. While it never proved necessary to enact the latter bills into law, the U.S. delegation agreed that the very existence of the bills offered concrete evidence of the U.S. determination to protect our interests if negotiations did not succeed. As such, they provided significant and useful backstopping for the U.S. negotiators."

16. Page 55, first full paragraph: Change the wording of the fist line to read: "Pressure to restrict subsidized trade finance, particularly for sales in the U.S. market...". In line 6, delete the words "According to a Treasury Department official".

17. Page 56, first full paragraph: We would suggest moving the last sentence in this paragraph ("The interrelationship between...") up behind the first sentence in the paragraph. We would then also suggest moving the first paragraph on page 58 ("The June revisions...official export credits.") behind this sentence which has been moved to become the second sentence in this paragraph. We suggest that the sentence beginning "Some aircraft financing is covered..." be changed to "Export financing for commercial jet transports is covered by a separate understanding on aircraft financing between the United States and other producer governments."

18. Page 58, second paragraph: We would suggest that the references to a Treasury Department official in lines eight and fifteen be deleted. (The statements would be stronger without these references.)

19. Page 59, paragraph at top of page, lines seven and eight: Again, we would suggest deleting the references to the Treasury Department official.

20. Page 59, second full paragraph: In line three, add the word "commercial" before the words "interest rates". In line eight, replace the word "extended" with "for their national exports".

21. Page 59, Conclusion: We would suggest that the first sentence of the conclusion be changed to the following: "As of spring 1983, upward revision of the interest rate minimums resulting from the 1982 revisions, together with falling commercial interest rates, have virtually eliminated interest rate subsidies for trade financed in dollars or other major trading currencies (with the exception of the French franc)."

22. Page 60, fourth line: Add the word "commercial" before the words "borrowing rates".

23. Page 60, first full paragraph: We would suggest deleting the sentence beginning "Commerce has not determined whether...". We believe Commerce has decided such subsidized financing can be countervailed.

24. Page 61, paragraph at top of page, last line: We suggest adding the word "according to the Mexicans." after the words "letter of the Subsidies Agreement". We would also suggest adding the following paragraph before the final paragraph on page 61: "In discussions with interested governments concerning the sale of Canadian subway cars to New York City, and the impending competition for sale of cars to Houston, the United States took the position that subsidized export credits for sales into the U.S. market could be countervailed if injury could be shown. Other governments vigorously protested that financing in conformity with Arrangement guidelines was immunized from countervailing duty action by item k, paragraph two of the Subsidies Code Illustrative List. The U.S. Government responded that paragraph two only provides that subsidized financing, when in conformity with the OECD Arrangement, is not a prohibited subsidy, and thus cannot be subject to the dispute settlement provisions of the Code. Item k says nothing against the possible countervailability of the subsidized financing if injury can be shown."

UNITED STATES DEPARTMENT OF COMMERCE
The Inspector General
Washington, D.C. 20230

JUL 05 1983

Mr. J. Dexter Peach
Director, Resources, Community
and Economic Development Division
U.S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Peach:

This is in reply to your letter of May 24, 1983, requesting comments on the draft report entitled "Benefits of International Agreement on Trade Distorting Subsidies Not Yet Realized."

We have reviewed the enclosed comments of the Under Secretary for International Trade and believe they are responsive to the matters discussed in the report.

Sincerely,

Sherman M. Funk
Inspector General

Enclosure

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

JUN 24 1983

J. Dexter Peach
Director
Resources, Community, and
Economic Development Division
United States General Accounting Office
Washington, D.C., 20548

Dear Mr. Peach:

We have reviewed your proposed report, "Benefits of International Agreement on Trade Distorting Subsidies Not Yet Realized". Attached are our comments on that document.

We have limited our comments to those areas in which the Department of Commerce currently is the lead agency by virtue of our statutory responsibilities as the administering authority. Thus, for example, we have not commented upon the operation of dispute settlement under the Agreement.

Thank you for this opportunity to comment on the draft report. If the Department may be of further assistance, please do not hesitate to contact us. We look forward to receiving a copy of the final version of the report.

Sincerely,

Lionel H. Olmer
Under Secretary for
International Trade

Comments of the Department of Commerce on the
Draft Report of the General Accounting Office
"Benefits of International Agreement on Trade
Distorting Practices Not Yet Realized"

These comments are directed to those areas in which the Department of Commerce currently is the lead agency by virtue of our statutory responsibilities as the administering authority. Thus, for example, we have not commented upon the operation of dispute settlement under the Agreement.

1. Export Financing

The draft report at pp. 49-61 appears to reflect an interpretation of the U.S. position on the question of export credits which may be unwarranted. In fact, we must emphasize that the Department has never had to make a definitive ruling regarding the countervailability of export credits clearly covered by the exemption in item (k)(2) of the Illustrative List of Export Subsidies annexed to the Code (the List). We believe that the report should be revised to reflect this fact.

Testimony of former Deputy Assistant Secretary for Import Administration Gary N. Horlick before the Senate Finance Subcommittee on Trade in May, 1982, supports the view that a subsidy may exist to the extent that the terms and conditions of the official export credit are more favorable than those which the exporter could have obtained commercially. This is also implicit in the position adopted by the Department in the 1982 investigation of railcars from Canada, and differs distinctly from the position expressed in the report at pp. 49-61.

It should be recalled, however, that the financing offered by the Canadian Economic Development Corporation, (EDC) was at a rate which was below the OECD consensus and, therefore, not covered by (k)(2). In the case of ceramic wall tile from Mexico, also cited in the report, the Department did not agree with Mexico that its export financing regime was covered by the terms of item (k).

2. Countervailing Subsidies Which are "Permissible" Under the GATT

In its discussion of the subject mentioned above, the report at p. 60 states, "To countervail exports benefiting from a 'permissible' (or at least not prohibited) subsidy practice would seemingly undermine the U.S. Government's contention that its countervailing duty law is administered in substantial compliance with the spirit and letter of the Subsidies Agreement." This is tantamount to stating that domestic subsidies and export subsidies on primary agricultural products are not countervailable because they are not *per se* prohibited by the Code.

Apparently in support of this interpretation, the report cites testimony presented by former OUSTR General Counsel Donald DeKieffer before the Senate Finance Subcommittee on Trade. In fact, Mr. DeKieffer was explaining to the subcommittee that although a case could be made that, under certain circumstances, financing consistent with item k of the List could be countervailed, such financing could not be the subject of consultations and dispute settlement proceedings under Articles 12, 13, 17 and 18 of the Code. In other words, the phrase "actionable under the [Subsidies Agreement] itself" refers solely to dispute settlement.

We believe that this section could be improved by dealing separately with the issues of export credit financing and the more general question of the countervailability of subsidies not expressly prohibited under the Code. While the Department has never had to make a determination on the specific question of export credits which are consistent with item (k), the Department has made determinations on the general issue of countervailing subsidies not expressly prohibited by the Code. This position was most clearly defined in the final affirmative countervailing duty determinations regarding certain steel products from Belgium published on September 7, 1982 (47 FR 39304-31). For the reasons given in those determinations, we believe that our position is consistent with U.S. law as well as the Code and its negotiating history.

3. Subsidies Library and Section 305

We agree that the procedures for transferring subsidy information to the private sector should be improved. We believe that this should be done primarily through better inter-agency coordination and sharing of information and maintenance of the subsidies library by the Department. We appreciate the report's recognition of the recent progress made by the Department regarding the library. We note, however, that work on the library commenced in June, 1981, rather than April, 1982, as stated on p. x of the Digest. This fact is reflected in the body of the report itself at pp. 74-6.

We agree with the recommendation that the potential of section 305 should be explained to people seeking information. We will include such language in our letters.

4. Canadian Softwood Lumber Products

The description in the report at p. 80 of the results of this investigation suffers from an incorrect characterization of the Department's preliminary determination. The major issues did not involve export subsidies, but rather domestic programs. This section should be revised to reflect the final results of that investigation.

In addition, contrary to the statement on p. 80, the Department does not issue informal "determinations" regarding the question of whether a given program is a subsidy. We are willing to review a petition submitted in draft and offer an informal opinion, but such advice is not a legal opinion or determination.

5. Amendment of the Equal Access to Justice Act

We do not favor amendment of the Equal Access to Justice Act suggested in the report at p. 82. This could promote frivolous actions which are costly to the government and disruptive of fairly-traded goods. Rather, we favor attempts to simplify the procedure wherever possible in order to reduce the expense and uncertainty for all parties involved.

6. General Availability

The discussion at pp. 100-105 of why the Department does not consider generally available domestic loan programs to be countervailable is somewhat confusing, and possibly misleading.

The statute and the practice of the Department are quite clear -- domestic benefits which are generally available, i.e., that are not provided to a "specific enterprise or industry or group of industries" are not only not "prohibited" subsidies, they are not subsidies at all within the meaning of the law. This concept was supported and articulated in a recent decision of the Court of International Trade (Carlisle Tire and Rubber Co. v. United States CIT No. 79-5-00748, decided May 18, 1983). In that decision, the court concluded that such a standard was not only sensible, but was virtually necessary if the law was to be capable of rational administration. Otherwise, a wide variety of benefits and services which governments normally provide (e.g., government built highways and bridges) might well have to be countervailed, despite the fact that doing so would make no economic sense and would present insuperable difficulties.

Similarly, if companies which happen to be involved in producing merchandise for export avail themselves of investment tax credits or domestic loan programs which are broadly available in that country without regard to the nature of the industry or whether it is exporting its merchandise, it is contrary to the letter and spirit of the law, as well as common sense, to consider such programs as giving rise to subsidies.

We also note that the phrase "prohibited subsidies" at p. 105 is not proper in the context in which it is used, i.e., the U.S. countervailing duty law. As explained in points 1 and 2, above, certain export subsidies are prohibited under the Code; under U.S. law, a subsidy may be deemed countervailable, but not "prohibited."

7. Citing to Preliminary Determinations

We noted that, in several instances, the report cites preliminary determinations in its examination of U.S. Government positions on certain issues. We believe that the report should refrain from citing preliminary determinations and inferring definitive U.S. positions, particularly where the issues are of first impression. For example, on p. 102 the report cites the preliminary determination by the Treasury Department in the case of rayon staple fiber from Austria that Marshall Plan Aid was not countervailable. There was never a final determination in that case, because the petition was withdrawn. Thus, there has never been a definitive ruling by the administering authority on that issue, and we suggest that the reference to that investigation be deleted from the report.

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