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## RETHINKING THE RELATIONSHIP BETWEEN SUBSIDIES AND DEVELOPING STATES

### **Abstract**

*Apart from being a substantial tool for improving a state's economy, subsidies are one of the most controversial issues covered by the World Trade Organization. Especially, the question whether subsidies can exist in extraterritorial forms has given rise to heated debates in the academia. Taking into account the influence of subsidies on competition and, in general, on economies, the importance of possible answers to this question becomes clearer. Additionally, the status of "developing states" is still unresolved. Being considered a "developing state" increases chances to apply subsidies. But under which conditions is a state considered a "developing state" is controversial. Therefore, clarifying the criteria for developing states is also important.*

*In this article, subsidies have been analyzed from legal and economic points of view - in particular, the effects of subsidies on developing states' economies have been discussed. After reviewing the definition and impact of subsidies, some flaws in the World Trade Organization's regulation and case-law of the Dispute Settlement Body have been studied, and proposals are given to remove these shortcomings.*

### **Annotasiya**

*Subsidiyalar dövlət iqtisadiyyatını inkişaf etdirmək üçün əhəmiyyətli vasitələrdən biri olmaqla yanaşı, Ümumdünya Ticarət Təşkilatı tərəfindən əhatə olunan ən mübahisəli məsələlərdən biridir. Xüsusilə, subsidiyaların ekstraterritorial formalarda mövcud ola bilib-bilməyəcəyi sualı akademiya daxilində qızğın müzakirələrə səbəb olmuşdur. Subsidiyaların rəqabət və ümumilikdə, iqtisadiyyat üzərində təsirini nəzərə alsaq, bu suala mümkün cavabların əhəmiyyəti daha da aydın olur. Əlavə olaraq, "inkişaf etməkdə olan dövlətlər" in statusu hələ də həll edilməmiş olaraq qalır. "İnkişaf etməkdə olan dövlət" hesab olunmaq subsidiya tətbiq etmək imkanlarını artırır. Amma hansı şərtlər daxilində dövlətin "inkişaf etməkdə olan dövlət" hesab olunması mübahisəlidir. Ona görə də inkişaf etməkdə olan dövlətlər üçün kriteriyaların aydınlaşdırılması da vacibdir.*

*Bu məqalədə subsidiyalar hüquqi və iqtisadi aspektlərdən təhlil edilmişdir - xüsusən, subsidiyaların inkişaf etməkdə olan ölkələrin iqtisadiyyatına təsirləri müzakirə edilmişdir. Subsidiyaların anlayışı və təsirləri araşdırıldıqdan sonra isə Ümumdünya Ticarət Təşkilatının tənzimləməsində və Mübahisələrin Həlli Qurumunun məhkəmə təcrübəsində olan bəzi problemlər araşdırılaraq həmin çatışmazlıqları aradan qaldırmaq üçün təkliflər verilmişdir.*

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## Introduction

A subsidy is a financial tool that is widely used by governments throughout the world and it aims to promote strategic sectors of industry or support important local producers. In other words, it creates a more favourable position for certain actors on the market that consequently helps to achieve public goals. However, subsidies often disrupt the competition and lead to repetitive market failures such as monopoly. On the national level, there is usually a specific legislative framework that regulates subsidies and might prevent negative impacts of them if such impacts occur. However, with ongoing globalization and expansion of international trade relations, the market system has become more complex and acquired new elements of different jurisdictions in order to unify global regulations. At the same time, the forms and methods of state subsidies have evolved. If traditionally subsidies were provided in more direct forms such as agriculture subsidies and more direct methods such as cash, in modern days they are more subtle. Today we see new forms such as healthcare subsidies, and new methods such as tax concessions.

In order to cover all of these forms and methods and to facilitate trade between states and prevent them from adopting protectionist policies, international regulation is needed. In this regard, the laws of the World Trade Organization (hence the WTO) constitute the primary source of law on the regulation of subsidization in international trade. Thus, the WTO Agreement on Subsidies and Countervailing Measures (hence the ASCM) in conjunction with the General Agreement on Tariffs and Trade of 1994 (hence the GATT) sets out the most important provisions on this matter.

But these provisions do not solve all the problems related to subsidies: in the modern era of rapid technological development, the issue of subsidies acquired new edges. Companies carry out new innovative activities (such as related to renewable energy - concentrated solar power, wind turbines, etc.) for which some provisions adopted in the previous century might seem outdated. Moreover, the growth of some developing states' economies still partly or in full depends on state subsidies. It means that it is necessary to

establish the balance between the needs of the competitive market and the sensibility of emerging economies.

For the reasons mentioned above, this article's focus will be directed at the regulation of subsidies within the WTO system, their economic impact and flaws in regulation. In the first chapter, subsidies are analyzed from general point of view. Definitions and legal criteria to establish the existence of subsidies are given with references to relevant WTO provisions and case-law. Some exclusions for developing and least developed states are also studied. The second chapter is dedicated to economic features of subsidies and their potential impacts on states. The third and final chapter is about existing problems within the WTO system related to subsidies. Questions of the status of "developing states" and the extraterritorial scope are discussed and possible solutions are provided.

## **I. The definition and legal features of a subsidy**

In general, a subsidy is understood as an incentive provided by governments in the form of financial aid or any other support to an economic sector to improve it. Although it is not exactly known where and when the first subsidy was provided, the history of subsidies goes back to the period before Industrial Revolution where mercantilist approaches were strong.<sup>1</sup> As the time passed by, new types and forms of subsidies emerged and spread all around the world.

Considering its general effect on economies and potential distortive effects on international trade, subsidies are regulated by a separate WTO agreement – the ASCM. In this paragraph and subparagraphs, subsidies are reviewed from the perspective of the ASCM.

### **A. Definition and types of subsidies according to the ASCM**

In principle, a subsidy can be in any form – that is to say, direct cash flow, due tax payments that are not collected by the government, goods or services offered by the government and other mechanisms that cannot be exhausted. For that reason, rather than giving a definition of a subsidy, Article 1 of the ASCM lays down 3 criteria to determine whether there is a subsidy:<sup>2</sup>

- 1) there should be a financial contribution;
- 2) this financial contribution should be made by a government or a public body within the territory of a Member in question;
- 3) a benefit should be conferred.

In the most disputes, the first element is easy to determine since as already mentioned, there is an abundance of ways to provide financial aid or support. However, in some cases it is not that easy to determine whether there is a

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<sup>1</sup> Ron Harris, *Government and the Economy, 1688-1850*, in the *Cambridge Economic History of Modern Britain*, 204 (Roderick Floud and Paul Johnson eds. 2004).

<sup>2</sup> WTO, *Agreement on Subsidies and Countervailing Measures* (1995).

financial contribution. For example, in US – Softwood Lumber III case, the respondent strongly resisted to the argument that allowance by the government to cut trees amounted to the “supply” of a particular good and therefore the existence of a financial contribution.<sup>3</sup> However, as already mentioned, it is usually easy to show there is a financial contribution.

The main difficulty is in establishing the presence of the second and third elements. This is because usually, it is not the government itself that provides the financial contribution. Governments tend to “hide” themselves behind different mechanisms to avoid contributing to the existence of a subsidy. They usually do this by using different public bodies (for example, a public organization that oversees the management of public roads, or a body created by law and regulates aviation) or even private channels<sup>4</sup> where proving the participation of the government seems impossible. The key element to overcome this difficulty and prove there was a government intervention is to show that the public body or the private channel was under the control of the government or at least was influenced by it concerning private bodies. Another problem with the second element is about territorial scope. Traditional interpretation by the Dispute Settlement Body (hence the DSB) shows that the scope of the ASCM is limited to the territory of the Member States. However, China’s aggressive expansion in recent years casts a doubt on this interpretation.<sup>5</sup> Whether extraterritorial application of the ASCM is possible will be analyzed in later parts of this article.

In sum, proving the existence of a subsidy depends on three criteria, two of which are financial contribution and a government or a public body (in some situations, a private body) as a provider. Only if these criteria are met, the DSB will examine whether the third element exists.

Regarding the third element, in order to prove there was a benefit conferred, most of the time we need a benchmark to compare between the financial contribution provided by a government and provided by a market.<sup>6</sup> This method enables the DSB to conclude whether the government made a concession for the recipient. It is easier to show the benefit if the financial contribution is provided in the form of direct cash flow, but it takes some effort to establish the existence of the benefit when governments use more complex mechanisms. That is why the DSB usually carries out a market-based analysis to find out if there is a benefit. As the Panel pointed out, “it is

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<sup>3</sup> WTO, Report of the Panel, United States – Preliminary Determinations with respect to Certain Softwood Lumber from Canada (2002).

<sup>4</sup> WTO, *supra* note 2, art. 1.1 (a) (1) (iv).

<sup>5</sup> Being described as a “21st century silk road”, Belt and Road Initiative is a multibillion project implemented by China. For more information: What is China’s Belt and Road Initiative? (2018), <https://www.theguardian.com/cities/ng-interactive/2018/jul/30/what-china-belt-road-initiative-silk-road-explainer> (last visited May 23, 2022).

<sup>6</sup> WTO, Report of the Appellate Body, European Communities and Certain member States – Measures Affecting Trade in Large Civil Aircraft, para. 5. 119 (2016). Available at: [https://www.wto.org/english/tratop\\_e/dispu\\_e/316\\_abrw\\_e.pdf](https://www.wto.org/english/tratop_e/dispu_e/316_abrw_e.pdf) (last visited May 23, 2022).

*preferable to derive a market benchmark on the basis of data pertaining to the borrowing entities' own market-based borrowing*".<sup>7</sup> By applying this method, it is made clear whether the government supported the recipient in a way that is more preferable than normal market conditions.

After establishing the existence of these three elements, we still need to show that the subsidy was specific within the meaning of Article 2 of the ASCM, otherwise, it is not subject to this Agreement. In other words, a subsidy should be specifically provided to one company, one industry or a group of companies or industries in order to be considered WTO-inconsistent.<sup>8</sup> Regional specificity is also covered by the ASCM where a government targets a specific region of the country for subsidization.<sup>9</sup>

There are three types of subsidies under the ASCM:

- 1) prohibited subsidies;<sup>10</sup>
- 2) actionable subsidies;<sup>11</sup>
- 3) non-actionable subsidies.<sup>12</sup>

Now each type of subsidy will be analysed separately.

Prohibited subsidies are covered by Article 3 of the ASCM. According to this Article, if subsidies are contingent upon export performance, or the use of domestic over imported goods, they are prohibited.<sup>13</sup> Since export subsidies and subsidies induce the use of domestic goods (so-called "local content subsidies") have a direct distortive effect on international trade and since they are most likely against the interests of all Member States, the ASCM prohibits them all together and there is no need to show injury or serious prejudice, unlike actionable subsidies.

The second type of subsidy is actionable subsidies. These subsidies are not WTO-inconsistent *per se*, but subject to challenge only in the condition they cause adverse effects to the interests of other Members within the meaning of Article 5 of the ASCM.<sup>14</sup>

Finally, there are non-actionable subsidies covered by Article 8 of the ASCM.<sup>15</sup> These subsidies were intended to support research activities, in disadvantaged regions and to promote the adaptation of some facilities.<sup>16</sup> Since they were not contrary to the interests of Members and did not have any negative impact (or have a limited impact) on international trade, they were

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<sup>7</sup> *Id.*, para. 5. 114.

<sup>8</sup> WTO, Subsidies and Countervailing Measures: Overview. Available at: [https://www.wto.org/english/tratop\\_e/scm\\_e/subs\\_e.htm](https://www.wto.org/english/tratop_e/scm_e/subs_e.htm) (last visited May 23, 2022).

<sup>9</sup> WTO, *supra* note 2, art. 2.2.

<sup>10</sup> *Id.*, art. 3.

<sup>11</sup> *Id.*, part III.

<sup>12</sup> *Id.*, art. 8.

<sup>13</sup> *Id.*, art. 3.

<sup>14</sup> *Id.*, art. 5.

<sup>15</sup> *Id.*, art. 8.2 (a), (b) and (c).

<sup>16</sup> *Ibid.* Facilities which have been in operation for at least two years at the time when new environmental requirements are imposed.

allowed under the ASCM. However, none of the Member States resorted to non-actionable subsidies during its 5-year existence period. This type of subsidy elapsed at the end of 1999 and was not renewed by the WTO Committee on Subsidies and Countervailing Measures.<sup>17</sup>

## **B. Exclusions concerning developing and least developed states**

After reviewing the types of subsidies, now it is time to analyse concessions in the WTO system regarding subsidies.

At the time of negotiating the ASCM, it was not an optimal solution to prohibit subsidies without a transitional period since it would be detrimental to some countries' economies. Because countries with less developed economies needed to support their economic actors at that time. Therefore, instead of excluding prohibited subsidies for all Member States suddenly, negotiators decided to include an article – Article 27 which allowed developing countries to use this type of subsidies for a limited time period.

According to Article 27.2 (a) of the ASCM, the prohibition of export subsidies does not apply to developing countries referred to in Annex VII of this Agreement.<sup>18</sup> There are two types of developing countries referred to in Annex VII. The first category is the countries which are Members of the WTO and recognized by the United Nations as least-developed countries.<sup>19</sup> There are currently 46 countries recognized as least-developed countries by the UN,<sup>20</sup> 35 of which have become WTO members to date (Afghanistan, Angola, Bangladesh and 32 more).<sup>21</sup> The second category is the countries to which the prohibition will apply only when their Gross National Product (GNP) per capita reaches 1,000 US dollars per annum.<sup>22</sup> According to Article 27.2 (b), the prohibition of export subsidies does not apply to other (than referred to in Annex VII) developing countries for a period of eight years from the date of entry into force of the WTO Agreement.<sup>23</sup>

The ASCM is stricter concerning “local content subsidies” than export subsidies. This approach might be explained by the difference between possibilities of applying “local content subsidies” and export subsidies. There can be quite a lot of situations where export subsidies are needed, but fewer situations can force states to prefer and subsidize “local contents” over others. Therefore, if there is no phase-out period for least developed countries regarding export subsidies, according to Article 27.3 this period is eight years

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<sup>17</sup> WTO, *supra* note 8.

<sup>18</sup> *Supra* note 2, art. 27.2.

<sup>19</sup> *Id.*, Annex VII.

<sup>20</sup> United Nations, Committee for Development Policy, List of Least Developed Countries (2021), [https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/ldc\\_list.pdf](https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/ldc_list.pdf) (last visited Apr. 13, 2022).

<sup>21</sup> WTO, Least-developed Countries, [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org7\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/org7_e.htm) (last visited Apr. 13, 2022).

<sup>22</sup> *Supra* note 19, para. (b).

<sup>23</sup> *Id.*, art. 27.2 para. (b).

from the date of entry into force of the WTO Agreement regarding “local content subsidies”.<sup>24</sup> For other developing countries this period is five years.<sup>25</sup>

There are specific provisions in the ASCM regulating the phasing-out process regarding export subsidies.<sup>26</sup> Although the phase-out period is 8 years, the Member States should eliminate export subsidies within a shorter period if these subsidies are no longer necessary for their development needs.<sup>27</sup> Contrary, if the Member States wish to continue using export subsidies after the 8-year phase-out period, they should consult with the WTO Committee on Subsidies and Countervailing Measures at least one year before the expiry of this period.<sup>28</sup> The Committee decides to grant or refuse the extension of the period.<sup>29</sup>

It should be noted that this “right to export subsidy” is not definite and subject to challenge by the other Member States. According to Article 27.14 of the ASCM, if an interested Member State requests to review export subsidies applied by another Member State, the Committee will determine whether these subsidies respond to the development needs of the Member that applies them.<sup>30</sup>

In conclusion, the WTO system allows least developed and some developing states even to use prohibited subsidies. However, this allowance is subject to supervision of the WTO. The ASCM sets out conditions for using prohibited subsidies and time-limits for phasing out.

## **II. The impact of subsidies on developing states: economic analysis**

### **A. What is a subsidy in economic terms?**

After analysing the meaning of subsidies in legal terms, now the importance of this practice in the economy of a state will be discussed.

When subsidies are provided for suppliers, the industry will allow producers to produce more goods and services, which increases the supply of that product and thus the quantity demanded. Therefore, the price becomes lower. It can be said that when the government subsidizes the supplier, this results in a win-win situation for the consumer and the supplier: the latter benefits from the operation as if the goods were sold at a higher price, and he is capable of producing more and the former benefits from the product at a relatively lower price.

In order to better comprehend subsidies on the economic level, the classic

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<sup>24</sup> *Id.*, art. 27.3.

<sup>25</sup> *Ibid.*

<sup>26</sup> *Id.*, art. 27.4-27.7.

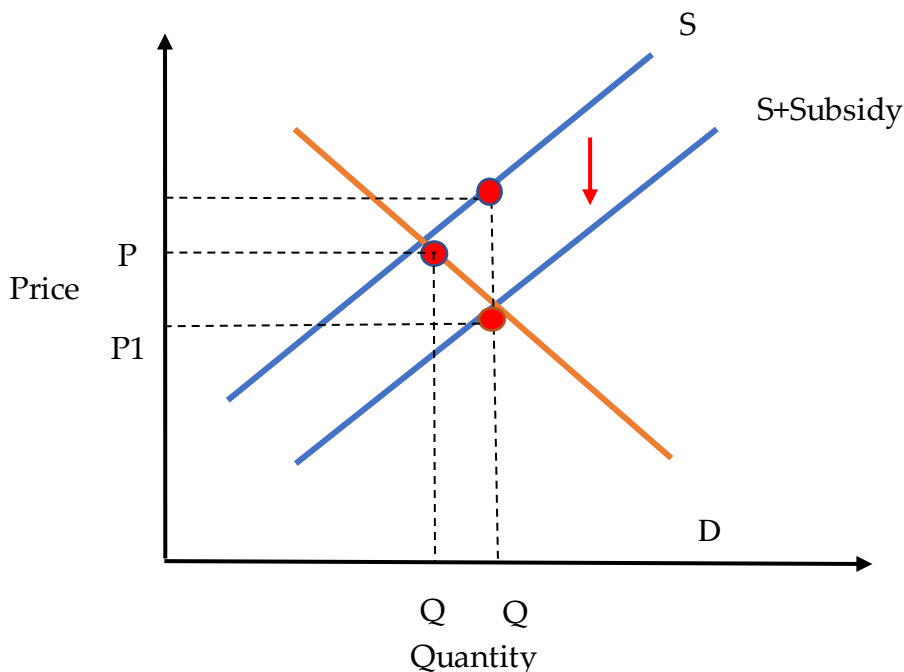
<sup>27</sup> *Id.*, art. 27.4.

<sup>28</sup> *Ibid.*

<sup>29</sup> *Ibid.*

<sup>30</sup> *Id.*, art. 27.14.

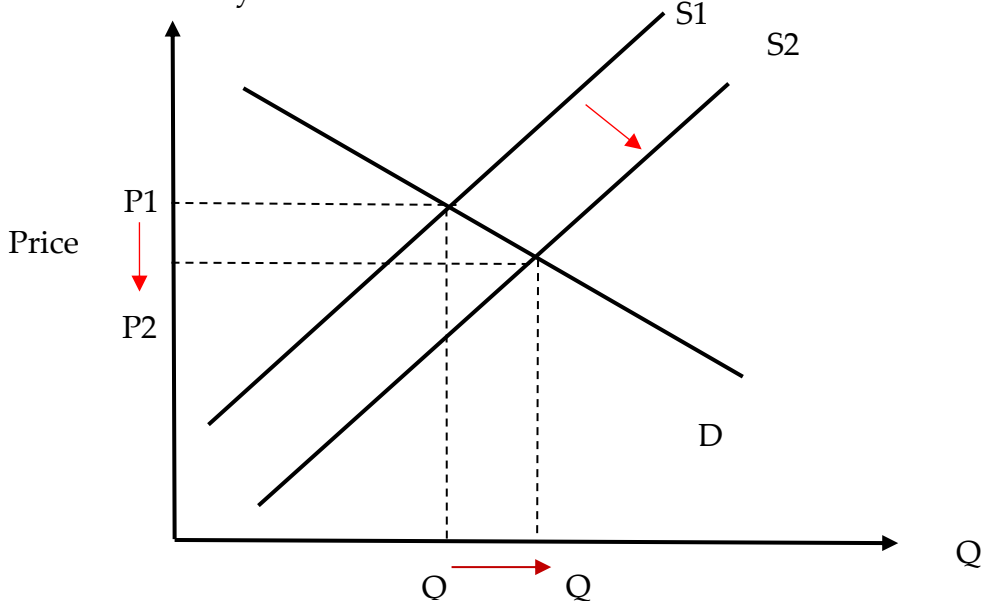
diagram of supply and demand can be helpful. The subsidy will shift the supply curve downwards, the new supply curve being parallel to the old one (see Annex 1), because subsidies decrease the price of supply. This results in an overall reduction in price and an increase in output.



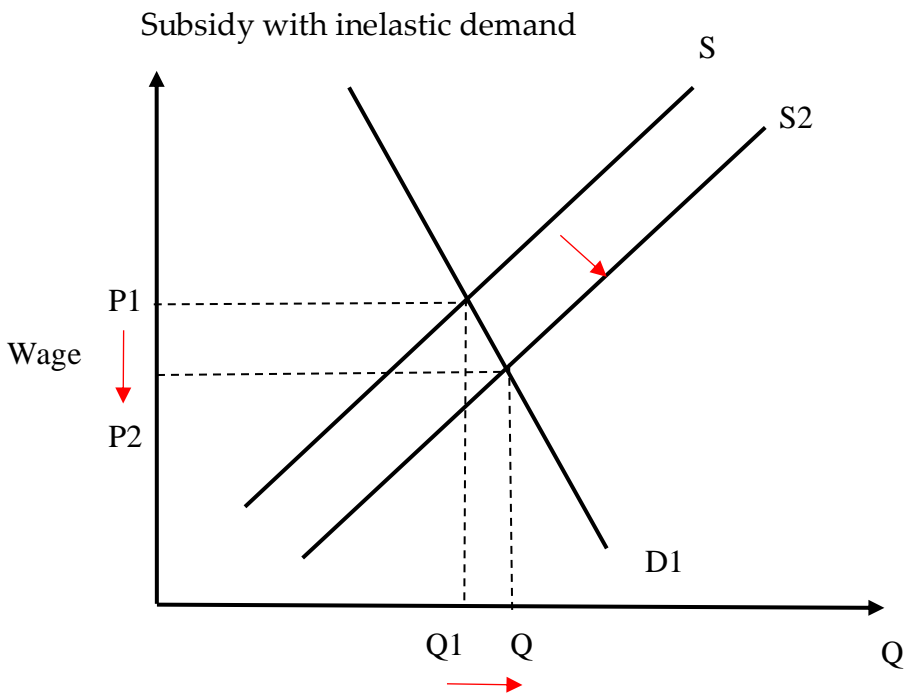
**Annex 1**

Now depending on how much the demand is elastic (varies drastically with the variation of price), the subsidy would have different impacts (see Annex 2). When the demand is elastic, the subsidy will cause a bigger percentage rise in demand. Thus, there will be a smaller fall in price. Therefore, producers benefit from the subsidy since their producer surplus increases more than the consumer surplus. On the contrary, when the demand is inelastic, the subsidy will cause an important fall in price and demand will only slightly increase.

Subsidy with elastic demand



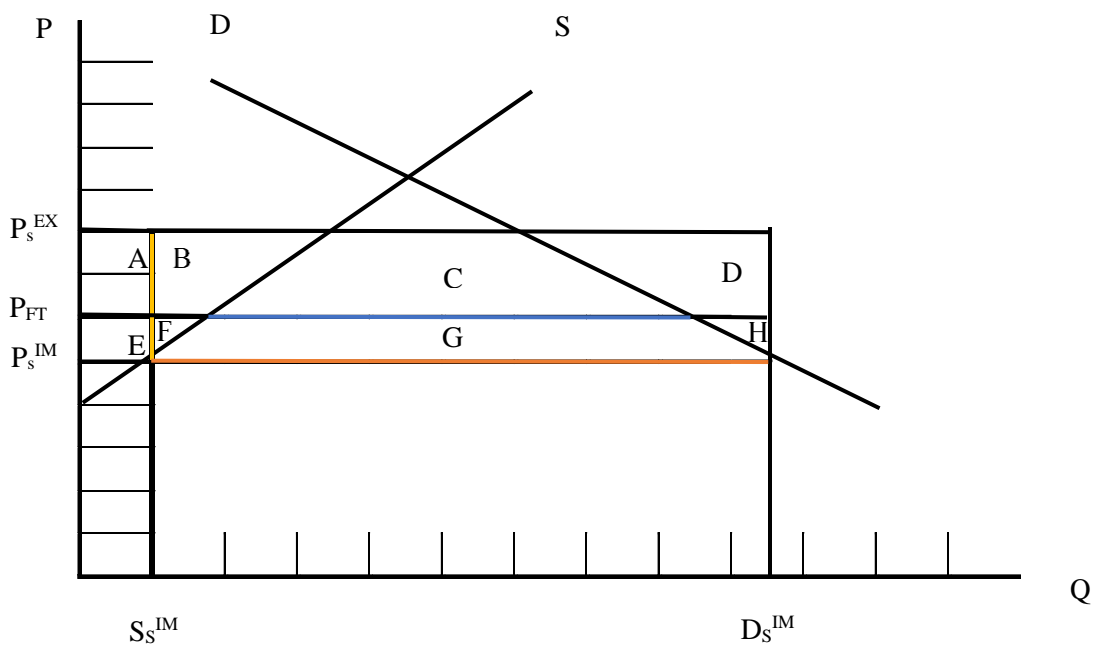


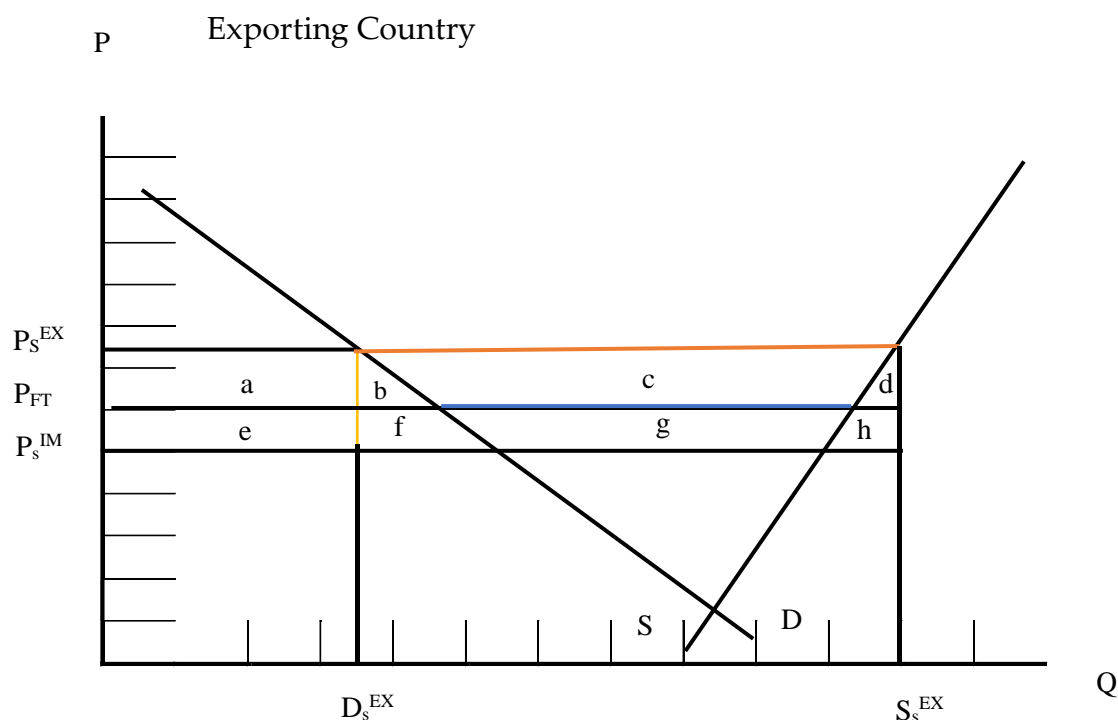


**Annex 2**

Annex 3 can help to study export subsidies in specific. Supposing that there are two trading countries, one being an importer and the other an exporter, as it can be seen in the graph in Annex 3, when the exporter country implements an export subsidy, the price of the good on the domestic market will increase and the price of the same good on the importer's market will decrease.

**Importing Country**





**Annex 3**

Explaining this phenomenon from a strict economic point of view is important to understand the mechanism of subsidies before studying their effect on the welfare of a state. Economically speaking, subsidies are beneficial for both suppliers and consumers within a state since they increase production and decrease prices. Therefore, subsidies are inextricably linked to wellness of states' economies.

**B. The impact subsidies can have on welfare in a state**

It is true that subsidization can lead to prices that reflect neither true resource scarcity nor the costs of consumption or production, however some states may recourse to this practice in order to develop their production.

The effect of subsidies in developed countries is known to have more adverse effect offshore. For example, Mozambique is known to be one of the more efficient sugar producers in the world in terms of unit cost and climatic conditions, whereas the European Union (hereinafter the EU) is one of the highest-cost producers.<sup>31</sup> However, because of subsidies, the EU is one of the largest producers (the third as of 2019)<sup>32</sup> of sugar in the world, and it influences sugar prices. Thus, subsidies in Europe would negatively affect trade outside its borders because other sugar producers would have to compete with subsidized products.

<sup>31</sup> International Sugar Organization, The Sugar Market, <https://www.isosugar.org/sugarsector/sugar> (last visited May 26, 2022).

<sup>32</sup> *Ibid.*

Article 27, as seen earlier in the article, provides an exception to the prohibition of export subsidies for certain developing countries.<sup>33</sup> It can be seen from the example of sugar production in Mozambique that allowing such a state to subsidize its exports can be beneficial for its trade. Export subsidies will increase the number of exports, and therefore the sugar produced in Mozambique can reach the international market more easily.

The agents that directly benefit from this practice are producers. As it is previously mentioned, export subsidies increase the price of the good in the exporter's market. This increase raises the producer's surplus in the industry. Apart from the increase in profit, and output, the subsidy leads to an increase in employment since it allows producers to produce more and thus recruit more.

To know the aggregate welfare effect of a country, calculation of the gains and losses to consumers, producers and the government is needed. Since consumers (because a subsidy can ultimately lead to very high demand and thus an increase in prices) and government (because it pays for a subsidy) will have more losses than gains, the subsidy results in a reduction in national welfare for the exporting country.

However, since this type of subsidy benefits the producers of the developing country, the exception given by Article 27 of the ASCM can be understood as it means for these countries to temporarily make use of this practice to develop production.<sup>34</sup>

Generally, subsidies improve economies in short term, but they are detrimental to the improvement in long term. Therefore, it is in the Member States' best interest to use them temporarily. Having said that, there are some problems in the WTO system related to this temporary usage of subsidies.

### **III. Problems that are not covered by the WTO law**

#### **A. The status of a developing state**

For many years the WTO law system has been standing for the fair competition and liberalization of trade. As was stated above, subsidies are an important encouraging tool in many developing economies, however they can significantly disrupt the situation on the market. This topic becomes even more controversial when serious problems arise in the application of some provisions of the WTO agreements. When in 1995 the WTO members adopted the ASCM some of the issues did not cause any concern. However, with new century international trade faces new challenges. In this regard the following chapter will be dedicated to the flaws of the WTO regulations in the matter of subsidies and their potential solutions.

The first big issue that was discussed for a while now is the status of a

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<sup>33</sup> *Supra* note 2, art. 27.

<sup>34</sup> *Ibid.*

developing state. It is important to note that the Dispute Settlement Understanding (hereinafter the DSU) singles out developing states as a special category of parties to the dispute.<sup>35</sup> The special status of these subjects of international trade relations was originally enshrined in the GATT 1947. Thus, Part IV “Trade and Development” outlines specific goals and priorities related to the needs and difficulties of less developed countries.<sup>36</sup> This emphasizes the need for action to ensure that the less developed contracting parties share in the growth of international trade, corresponding to the needs of their economic development. In this regard, it must be emphasized that the content of the concept of “developing state” is not enshrined in either the DSU or other agreements within the WTO. Clear criteria for classifying states as developing countries are also not presented. That is, members themselves determine their belonging to developing countries and, accordingly, notify the WTO of their status.<sup>37</sup> At the same time, other Member States are entitled to raise objections to this status.<sup>38</sup> Over two-thirds of WTO’s 164 member countries are considered as developing countries.<sup>39</sup>

The status of a developing state allows the use of the Generalized System of Preferences (hence GSP), on the basis of which states receive preferential treatment unilaterally in relation to products produced by them (for example, zero or reduced duty rates). However, the mere declaration of a state that it is developing does not automatically entail the right to use the GSP.<sup>40</sup> In practice, the country who provides the preference chooses the developing countries that will use these preferences.<sup>41</sup> It is easier with the status of least-developed states (such as Bangladesh, Chad, Haiti, etc.) which are listed by the United Nations Conference on Trade and Development (UNCTAD).<sup>42</sup>

In the context of subsidies such status brings certain benefits. For example, according to part VIII of the ASCM, a group of least-developed countries and low-income developing countries, whose GNP per capita is less than \$1.000 per annum can maintain such subsidies, pursuant to Annex VII of the ASCM.<sup>43</sup> Once these developing countries exceed the per capita GNP threshold, they will have to phase-out their export subsidies. The key issue in this dispute was whether these countries will have to phase-out their export subsidies immediately upon graduation or if they will get an eight-year phase-out period. The language of the phase-out period is less than clear. For

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<sup>35</sup> WTO, Understanding on rules and procedures governing the settlement of disputes (1995).

<sup>36</sup> The General Agreement on Tariffs and Trade, Part IV (1947).

<sup>37</sup> Who are the developing countries in the WTO?, [https://www.wto.org/english/tratop\\_e/devel\\_e/d1who\\_e.htm](https://www.wto.org/english/tratop_e/devel_e/d1who_e.htm) (last visited May 27, 2022).

<sup>38</sup> *Ibid.*

<sup>39</sup> Understanding the WTO: Developing Countries, [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/dev1\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/dev1_e.htm) (last visited May 27, 2022).

<sup>40</sup> WTO, *supra* note 37.

<sup>41</sup> *Ibid.*

<sup>42</sup> *Ibid.*

<sup>43</sup> *Supra* note 2, art. 27.2.

instance, Annex VII countries that may achieve export competitiveness in a product are entitled to an eight-year transition period to phase-out the export subsidies on such product under Article 27.5 of the ASCM.<sup>44</sup>

It seems reasonable to provide more clear and strict conditions on this matter but keep in mind the importance sensible economics of the developing states. For example, the list of developing states could be negotiated among all member states similar to schedules of concessions. Since schedules of concessions are a part of the WTO agreement, they were discussed and adopted by all Member States. Similar approach could apply to the list of developing states.

## **B. The territorial scope**

In order for state actions to be considered as a subsidy they should satisfy conditions listed in article 1 of the ASCM. This article is as following: "... a subsidy shall be deemed to exist if: there is a financial contribution by a government or any public body within the territory of a Member...".<sup>45</sup> The notion "within the territory of a Member" was traditionally understood as limiting the scope of the ASCM. So, the idea behind that was to address situations where a WTO Member is subsidizing the production or sale of its own goods.<sup>46</sup> The provision served its purpose well until the globalization and developed trade relations has changed the approach needed. Nowadays most of states conduct trading activities abroad or, at least, have strategic economic interests abroad. In this context it becomes crucial whether the phrase "within the territory" describes the public body or the location of the recipient of the financial contribution.

In 2020 the United States, the EU and Japan jointly issued a statement offering amendments to the existing subsidies system.<sup>47</sup> They outlined the necessity of extended list of prohibited subsidies, the reversal of the burden of proof in case of "excessively large subsidies", and tackling through litigation subsidies that contribute to overcapacity.<sup>48</sup> Such initiative appeared as a response to persistent policy of the Chinese government. Since 2013, China has been pushing for a new One Belt, One Road program, aiming to connect China with countries along the ancient Silk Road and a new Maritime Silk Road via infrastructure investment.<sup>49</sup> In conjunction with their general

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<sup>44</sup> *Id.*, art. 27.5.

<sup>45</sup> *Id.*, art. 1.1 (a) (1).

<sup>46</sup> The World Trade Organization, Expert Group Meeting on Trade Financing – Note by the Secretariat, General Council Working Group on Trade, Debt and Finance, 5. WT/GC/W/527 (2004).

<sup>47</sup> The United States and the European Union, Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan (2020), <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/joint-statement-trilateral-meeting-trade-ministers-japan-united-states-and-european-union> (last visited April 13, 2022).

<sup>48</sup> *Ibid.*

<sup>49</sup> *Supra* note 5.

“Go Out” policy it made a great deal in helping Chinese companies to be established abroad. As a result, Chinese state-owned banks such as China EXIM Bank, the Agricultural Development Bank of China, the Bank of China or SINOSURE have been providing financing in the forms of loans, export guarantees and export insurance to Chinese companies establishing themselves outside China.<sup>50</sup>

These two issues should be addressed together since China still invokes its status of developing state. To provide more clarity to the term “within the territory of a Member” it is possible to apply the Vienna Convention on the Law of Treaties (hereinafter the VCLT).<sup>51</sup> WTO Panels and the Appellate Body repeatedly applied articles 31 and 32 of the VCLT in their reports (for example, US – Gasoline,<sup>52</sup> US – Shrimp I<sup>53</sup>). Keeping in mind the general rule of interpretation it seems reasonable to conclude as follows. The term “within the territory of a Member” in Article 1.1 (a) (1) only refers to “a government or a public body” and does not concern the term “financial contribution”.<sup>54</sup> In other words, it does not indicate where the recipient of the financial contribution must be located. This is because the qualifier directly follows the term “a government or any public body” and because this term is not between commas. “This interpretation is further confirmed by the insertion immediately after the definition of “government” between brackets, which clarifies the term to mean “a government or any public body within the territory of a Member”.<sup>55</sup> Thus, although the ASCM does not include a specific definition of the “recipient” of a “benefit”, Article 1.1 (b) does not preclude from the definition of a subsidy, those subsidies that are given to benefit a recipient who is outside the territory of the subsidizing Member.<sup>56</sup>

## Conclusion

It is a reality that subsidies play a significant role in economic system of developing states. They are beneficial for producers and consumers (although not in long term). Additionally, some Member States need subsidies to maintain the proper functioning of their economies.

Different cultural and historical backgrounds surely cause some peculiarities in regulation of this matter on the national level. In the context of expanding international trade, it is necessary to harmonize the rules and provide the basis for the fair competition around the globe. The WTO system

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<sup>50</sup> Victor Crochet and Vineet Hegde, *China's 'Going Global' Policy: Transnational subsidies under the WTO SCM Agreement*, 23 *Journal of International Economic Law* 1, 6 (2020).

<sup>51</sup> See generally Vienna Convention on the Law of Treaties (1969).

<sup>52</sup> WTO, Report of the Panel, United States – Standards for Reformulated and Conventional Gasoline (1996).

<sup>53</sup> WTO, Report of the Panel, United States – Import Prohibition of Certain Shrimp and Shrimp Products (1998).

<sup>54</sup> Crochet and Hegde, *supra* note 50, 10.

<sup>55</sup> *Id.*, 11.

<sup>56</sup> *Id.*, 13.

contains crucial provisions in the ASCM and the GATT. These provisions create a framework in which the Member States apply subsidies and at the same time avoid disrupting the harmony of international trade. To ensure the balance between interests of international trade and strength of developing countries, the WTO system includes provisions that help to minimize the negative impact of the restricted subsidy regime. For example, there are extended transitional periods or special exclusions in the ASCM.

Nonetheless, evolved international relations and modernization of all economic activities raised several considerable issues that should be addressed. First, it is the status of a developing state. The right of self-proclamation might be abused and more strict rules on this matter will contribute to the fair competition. For example, this status can be discussed among all Member States and included in the WTO Agreements. Another issue is transnational subsidies that are initially were not covered by the ASCM but could be included in its scope using general rules of interpretation. Such measures could significantly improve the existing system.