



AN OVERVIEW OF THE REGULATORY FRAMEWORK FOR SUBSIDY USE UNDER WTO LAW: HISTORICAL EVOLUTION

Azizbek Toyirov

A senior lecturer of Tashkent

State University of Law,

azizbektoyirov7@gmail.com

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ABSTRACT

The regulation of subsidies under the framework of the World Trade Organization (WTO) has undergone significant evolution since the establishment of the General Agreement on Tariffs and Trade (GATT). Initially focused on tariff reductions, early GATT provisions regarding subsidies were limited in scope and clarity, leaving critical gaps in addressing the trade-distorting effects of government interventions. As global trade dynamics became increasingly complex, the need for a robust regulatory framework became evident, leading to the adoption of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) during the Uruguay Round.

This article provides a comprehensive exploration of the historical development and regulatory framework governing subsidies under WTO law, emphasizing the intricate balance between preventing trade distortions and allowing governments the flexibility to achieve legitimate social and economic objectives. By analyzing the evolution of legal norms—from the early provisions of GATT Articles VI and XVI to the establishment of the SCM Agreement—this study sheds light on how subsidy regulation has addressed the dual challenges of safeguarding market access and supporting domestic policy goals.

In the formative years of the General Agreement on Tariffs and Trade (GATT), trade negotiations primarily concentrated on reducing tariffs, which were widely recognized as the predominant tools of protectionism. Although subsidies and other protective measures were addressed, the regulatory framework governing subsidies remained underdeveloped and ambiguous. The provisions related to subsidies, articulated in Articles XVI and VI of the GATT, offered only rudimentary multilateral oversight. These provisions permitted Contracting Parties to impose countervailing duties as a means to neutralize the adverse effects of harmful



subsidies but lacked the precision and robustness needed to effectively manage subsidy-related distortions in international trade.

The Tokyo Round marked an initial attempt to strengthen subsidy regulations through the introduction of the Subsidies Code. However, the code's non-binding nature and limited scope restricted its effectiveness in addressing the challenges posed by subsidies. It was not until the Uruguay Round that meaningful progress was achieved with the establishment of the Agreement on Subsidies and Countervailing Measures (SCM Agreement). The SCM Agreement provided a comprehensive and enforceable framework for the regulation of subsidies and countervailing duties, laying the groundwork for a rules-based approach to managing these trade-distorting practices on a global scale.

Under the SCM Agreement, the concept of a "subsidy" is defined broadly, encompassing scenarios in which a government confers an economic benefit on a recipient, resulting in a financial transfer or advantage. This definition highlights the dual nature of subsidies as both economic instruments and regulatory concerns. Conceptually, a subsidy can be regarded as the inverse of taxation, reflecting a financial flow from the government to a private entity, as opposed to taxation, which involves financial flows in the opposite direction. Taxation and subsidization are thus complementary fiscal tools through which governments can influence market behavior and economic outcomes.

Unlike fiscal measures, such as taxes and subsidies, regulatory interventions—such as technical standards or safety regulations—do not involve direct financial transfers. These distinctions are critical for understanding the scope and applicability of the SCM Agreement, as its provisions are specifically tailored to address fiscal mechanisms that have direct trade implications. By establishing clear parameters for identifying and regulating subsidies, the SCM Agreement represents a significant step forward in ensuring transparency, predictability, and fairness in international trade.¹

The evolution of subsidy regulation from the GATT era to the establishment of the SCM Agreement underscores the international community's commitment to addressing the challenges posed by subsidies in a liberalized trade environment. By providing a structured framework for managing subsidies and their trade-distorting effects, the SCM Agreement serves as a cornerstone of the WTO's efforts to maintain a balanced and equitable global trading system. Nevertheless, as the dynamics of international trade continue to evolve, ongoing reforms and adaptations may be necessary to ensure that subsidy regulations remain effective and relevant in addressing contemporary trade challenges.

Subsidies, however, present a dual-edged challenge. While they can distort trade by providing economic advantages to domestic producers at the expense of foreign competitors, they are also instrumental in achieving a range of legitimate policy objectives, including promoting social welfare, fostering innovation, and addressing market failures. This dual nature complicates efforts to regulate subsidies, as they are not inherently protectionist in the same way tariffs are. For instance, subsidies aimed at supporting low-income households through food assistance programs may have minimal impact on trade while yielding significant social benefits.

¹ WTO Secretariat, *World Trade Report 2006: Exploring the Links between Subsidies, Trade and the WTO* (Geneva: WTO Publications, 2006) at 47.



*Samuelson*² and *Nordhaus* succinctly describe subsidies as "a payment by a government to a firm or household that provides or consumes a commodity," emphasizing their dual function. They highlight government food subsidies as an example, demonstrating how such measures can achieve socially desirable outcomes without substantially affecting trade dynamics.³ This distinction underscores the complexity of regulating subsidies, as policymakers must balance the need to mitigate their trade-distorting effects while preserving their utility as a tool for public policy.

The evolution of the World Trade Organization's (WTO) regulations on subsidies and subsidized trade finds its origins in the foundational provisions of Articles VI and XVI of the General Agreement on Tariffs and Trade (GATT) 1994.⁴ These early provisions, while serving as a starting point, lacked the depth and clarity required to effectively address the complexities of subsidies in international trade. This gap was substantially addressed with the introduction of the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), which provided a more comprehensive and enforceable framework.

Under the original GATT 1947, subsidies were acknowledged as an issue, but their treatment was rudimentary and incomplete. Article XVI, titled "Subsidies," stopped short of defining what constitutes a subsidy.⁵ Instead, it focused on procedural requirements, obligating Contracting Parties to notify the existence of subsidies that impacted trade and to engage in discussions aimed at mitigating the adverse effects of such subsidies. The absence of a clear definition left significant ambiguity, making it difficult to assess the nature and extent of a subsidy's impact on international trade.

Additionally, Article XVI addressed export subsidies with only a limited scope. It merely encouraged Contracting Parties to refrain from using export subsidies on primary product exports, falling short of outright prohibition or enforceable regulation. This provision reflected a minimalistic approach, primarily aimed at reducing trade distortions without imposing strict obligations. The lack of precision and enforceability in these early rules highlighted the nascent stage of international efforts to regulate subsidies effectively.

The limitations of the GATT 1947 framework underscored the need for a more robust and clearly defined approach to subsidy regulation. The weaknesses in addressing trade-distorting subsidies became more apparent as global trade expanded and governments increasingly used subsidies as tools for economic and industrial policy. These developments necessitated a more detailed legal framework, which would come with the establishment of the WTO in 1995 and the adoption of the SCM Agreement.

The SCM Agreement marked a significant advancement in the regulation of subsidies, providing precise definitions, categorizations, and disciplines for their use.⁶ It introduced a tripartite classification of subsidies—prohibited, actionable, and non-actionable—based on their potential to distort trade and harm other WTO members. Prohibited subsidies, such as

² Samuelson, P. "Interactions Between the Multiplier Analysis and Principle of Acceleration". *Review of Economic and Statistics* 21 (1939a): 75-78.

³ Nordhaus, W. "Samuelson's Economics at Fifty: Remarks on the Occasion of the Anniversary of Publication", *Journal of Economic Education* 30 (1999), p.356.

⁴ See the General Agreement on Tariffs and Trade (GATT) 1994.

⁵ See Article XVI of the GATT, 1947.

⁶ See Subsidies and Countervailing Measures Agreement.



those contingent upon export performance or the use of domestic over imported goods, were explicitly banned. Actionable subsidies, though not outright prohibited, were subject to challenge if they caused adverse effects on other members' interests. The agreement also laid out rules for countervailing measures, providing a structured process for addressing the adverse effects of subsidies through the imposition of duties.

This evolution from the rudimentary provisions of GATT 1947 to the sophisticated disciplines of the SCM Agreement reflects the growing recognition of the complexities and significance of subsidies in the global trading system. The SCM Agreement not only filled the gaps left by Articles VI and XVI of the GATT but also established a framework that balances the need to discipline trade-distorting subsidies with the flexibility for governments to pursue legitimate policy objectives. This transition highlights the WTO's pivotal role in adapting its regulatory mechanisms to meet the evolving challenges of international trade.

In 1962, Article XVI of the General Agreement on Tariffs and Trade (GATT) was amended to introduce a prohibition on export subsidies for non-primary products if these subsidies resulted in export prices falling below domestic sales prices. This amendment represented a significant step toward curbing trade-distorting practices, yet its scope was limited as it explicitly exempted developing countries from this prohibition. This exemption reflected the recognition of the unique economic challenges faced by developing nations, which often relied on subsidies as tools for fostering industrial growth and export competitiveness.

Additionally, Article VI of the GATT 1947 addressed the application of countervailing measures to counteract subsidies on imported products that caused, or posed a threat of causing, material injury to the domestic industry producing similar goods.⁷ This provision permitted the imposition of countervailing duties as a remedial measure to neutralize the adverse effects of such subsidies. However, the rules governing these measures lacked specificity and comprehensiveness, leading to ambiguities in their interpretation and application. The absence of detailed guidelines often left Contracting Parties with significant discretion, raising concerns about the potential misuse or overuse of countervailing duties.

These early amendments and provisions, while marking progress in addressing the trade-distorting impacts of subsidies, underscored the need for a more structured and uniform framework. The limitations of Articles XVI and VI in providing clear definitions, consistent standards, and enforceable rules paved the way for the later development of the WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement). The SCM Agreement would eventually establish a more comprehensive legal regime, offering precise disciplines on subsidies and the application of countervailing measures, thereby enhancing transparency, fairness, and predictability in the global trading system.

To address the regulatory gaps in subsidy and countervailing duty rules, GATT Contracting Parties negotiated and adopted the *Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement* during the Tokyo Round of trade negotiations (1973–1979).⁸ Commonly referred to as the Tokyo Round Subsidies Code, this plurilateral agreement aimed to enhance clarity and discipline regarding subsidies and the

⁷ See Article VI of the GATT 1947.

⁸ See the *Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement*



use of countervailing measures. However, its impact was limited, as it was accepted by no more than 25 Contracting Parties. Moreover, it failed to provide sufficient precision or enforceable guidelines on the regulation of subsidies and countervailing duties, leaving significant ambiguities unaddressed.

Throughout the 1980s, the absence of clear and detailed subsidy regulations exacerbated tensions among GATT Contracting Parties. Many disputes remained unresolved, further demonstrating the inadequacy of existing rules. Recognizing the need for comprehensive reform, the 1986 *Punta del Este Ministerial Declaration*, which launched the Uruguay Round of trade negotiations, explicitly called for a thorough review of Articles VI and XVI of the GATT 1947, along with the Tokyo Round Subsidies Code.⁹ The objective was to strengthen and improve the regulatory framework governing subsidies and countervailing measures, ensuring that they effectively addressed the trade distortions and economic harm caused by subsidy practices.

These shared insights laid the foundation for a compromise, culminating in 1994 with the successful conclusion of the Uruguay Round and the adoption of the multilateral *Agreement on Subsidies and Countervailing Measures* (SCM Agreement). This landmark agreement, binding on all members of the newly established World Trade Organization (WTO), represented a significant advancement in international trade regulation. Unlike previous efforts that focused narrowly on applying and interpreting Articles VI, XVI, and XXIII of the GATT, the SCM Agreement introduced a comprehensive framework for defining, classifying, and disciplining subsidies.

The SCM Agreement not only enhanced the clarity and enforceability of subsidy regulations but also marked a critical evolution in the multilateral trading system, addressing both trade distortions caused by subsidies and the need for equitable rules that account for diverse economic realities among WTO members. Its adoption signified a major milestone in global efforts to foster fair competition and ensure a more balanced and predictable international trade environment.

The evolution of the regulatory framework governing subsidies under WTO law demonstrates a gradual yet significant shift toward addressing the complexities of trade-distorting government interventions. From the early, limited provisions in GATT Articles VI and XVI to the comprehensive and binding rules established by the Agreement on Subsidies and Countervailing Measures (SCM Agreement), the journey reflects the international community's response to emerging challenges in global trade.

This regulatory evolution underscores the dual objectives of mitigating trade distortions caused by subsidies while preserving the policy space for governments to achieve legitimate socio-economic goals. The SCM Agreement's nuanced approach, as highlighted by WTO jurisprudence, reflects a "delicate balance" between these competing interests, ensuring that subsidies serve constructive purposes without undermining fair trade practices. Additionally, the development of sector-specific agreements, such as the Agreement on Agriculture, highlights the tailored efforts to address unique subsidy-related issues within specific economic sectors.

⁹ Kleinfeld, G. and Kaye, D. "Red Light, Green Light?" The 1994 Agreement on Subsidies and Countervailing Measures, Research and Development Assistance, and US Policy, 28:6 *Journal of World Trade* (1994), 43-63, at 43.



Nevertheless, the complexities of defining and regulating subsidies—particularly in a rapidly evolving global economy—indicate that further refinement of these rules may be necessary. The historical lessons drawn from the GATT era and the Uruguay Round negotiations provide valuable insights for future reforms aimed at fostering a more equitable and efficient international trading system.