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THE REGULATION AND SUPERVISION OF TARGETED SUBSIDIES WITHIN THE SCM AGREEMENT FRAMEWORK

Azizbek Toyirov,
A senior lecturer of Tashkent State University of Law,
azizbektoyirov7@gmail.com

ABSTRACT

The regulation of subsidies under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) is a cornerstone of the World Trade Organization's (WTO) efforts to ensure a fair and predictable multilateral trading system. Subsidies, while often employed by governments to promote economic growth and social welfare, can distort international trade when misused, undermining competition and creating imbalances in global markets. The SCM Agreement provides a structured framework for addressing these challenges, categorizing subsidies into prohibited, actionable, and non-actionable forms—a system commonly referred to as the "traffic light" approach. Among these, prohibited subsidies—such as export subsidies and domestic content subsidies—are of particular significance due to their inherently trade-distorting nature. Unlike actionable subsidies, which require evidence of adverse effects, prohibited subsidies are deemed impermissible based solely on their characteristics, reflecting the WTO's strict stance against practices that undermine fair competition.

This article explores the nuanced regulation and supervision of prohibited subsidies under the SCM Agreement, focusing on the intricate legal provisions outlined in Articles 3 and 4. It examines the conceptual foundations of export and domestic content subsidies, emphasizing their implications for global trade. By analyzing key provisions, case law, and interpretative guidance from WTO bodies, this study aims to elucidate the balance the SCM Agreement seeks to achieve between disciplining harmful trade practices and preserving the legitimate use of subsidies as policy tools.

Key words: *SCM Agreement, subsidy, prohibited, actionable, export, domestic, trade, distortion, WTO, rule.*

The Agreement on Subsidies and Countervailing Measures (SCM Agreement) establishes a robust and systematic framework for regulating subsidies that fall within its jurisdiction. This framework is structured around three primary categories: prohibited subsidies, actionable subsidies, and non-actionable subsidies. This classification is often referred to as the "traffic light" system due to its intuitive analogy with traffic signals.

Under this system, prohibited subsidies are met with a “red light”, signifying their universal prohibition as they inherently distort trade and competitiveness. These include subsidies contingent upon export performance or the use of domestic over imported goods. Actionable subsidies, on the other hand, are governed by a “yellow light”, indicating that while they are not outright forbidden, they are subject to scrutiny if they result in adverse trade effects such as material injury to a domestic industry, nullification of benefits, or serious prejudice. Finally, the category of non-actionable subsidies, symbolized by a “green light”, originally allowed certain subsidies considered to have minimal or no trade-distorting effects. However, these provisions were introduced on a temporary basis during the initial implementation of the WTO framework and have since lapsed, leaving this category effectively dormant.

This classification underscores the SCM Agreement's nuanced approach to subsidy regulation, balancing the need to discipline harmful trade practices with the recognition of subsidies' legitimate role in achieving economic and social objectives. By addressing the complexities of subsidy-related trade distortions, the Agreement aims to promote a predictable and equitable multilateral trading system.

Prohibited subsidies are comprehensively regulated under Part II of the SCM Agreement, and, as the term suggests, they are categorically forbidden. Article 3 delineates two specific types of subsidies that fall under this prohibition: export subsidies and subsidies contingent on the use of domestic goods over imported goods, commonly referred to as domestic content subsidies. These subsidies are explicitly outlawed under Article 3.2, which unequivocally precludes WTO Members from granting or maintaining such measures.[1]

The stricter treatment of these subsidies stems from their inherently trade-distorting nature. While all subsidies have the potential to distort trade, export and domestic content subsidies are uniquely disruptive. Export subsidies grant unfair advantages to domestic producers by undermining foreign competitors in international markets, effectively distorting global trade flows. Similarly, domestic content subsidies hinder the access of foreign producers to a Member’s domestic market, favoring local industries and creating artificial barriers to competition.

Significantly, the determination of prohibited subsidies does not require proof of actual adverse trade effects. Unlike actionable subsidies, where the complainant must demonstrate material harm, the classification of a subsidy as prohibited depends solely on whether the specific elements outlined in Article 1 of the SCM Agreement

[1] See article 3.2 of the SCM Agreement.

are established. This approach underscores the WTO's commitment to preventing practices that fundamentally distort trade, thereby fostering a fairer and more predictable global trading system.

Article 3.1(a) of the SCM Agreement explicitly prohibits export subsidies that are contingent—whether expressly stated in legal terms (*de jure*) or implied through factual circumstances (*de facto*)—on export performance. [2] This prohibition encompasses subsidies tied to export conditions, as detailed in the illustrative list provided in Annex I of the Agreement. The terms "in law" and "in fact" mirror the legal concepts of *de jure* and *de facto*, emphasizing both explicit and implicit forms of export dependency.

Footnote 4 of the SCM Agreement offers critical clarification, specifying that export contingency exists when factual evidence demonstrates a practical link between the granting of a subsidy and actual or anticipated exportation or export earnings, even in the absence of a formal legal requirement.[3] However, the footnote also ensures a nuanced interpretation, stating that subsidies provided to enterprises engaged in export activities are not automatically deemed export subsidies under this provision. Instead, the focus of Article 3.1(a) lies on the presence of "contingency," requiring a clear and identifiable relationship between the subsidy and export activities.[4]

This approach underscores the WTO's intent to prevent trade distortions by addressing subsidies that confer unfair advantages in global markets, while maintaining a balance by not overreaching into subsidies that may coincidentally benefit exporting entities without being explicitly tied to their export performance. The careful articulation of these rules reflects the SCM Agreement's broader objective of fostering a level playing field in international trade.

Article 3.1(b) of the SCM Agreement focuses on domestic content subsidies, commonly referred to as "local content" or "import substitution" subsidies. This provision explicitly prohibits subsidies that are contingent—whether solely or as one of several conditions—on the use of domestic goods over imported goods. These subsidies are deemed particularly harmful as they undermine the principle of non-discrimination in trade by favoring domestic products, thereby distorting competition and restricting market access for foreign producers.

The concept of "contingency," central to Article 3.1(a) on export subsidies, is equally applicable to Article 3.1(b). [5] However, while Article 3.1(a) explicitly

[2] See Article 3.1(a) of the SCM Agreement.
[3] See Footnote 4 of the SCM Agreement.
[4] See Article 3.1(a) of the SCM Agreement.
[5] See Article 3.1(b) of the SCM Agreement.

distinguishes between *de jure* (legal) and *de facto* (factual) contingencies, Article 3.1(b) does not include this textual clarification. Despite this omission, the WTO Appellate Body has unequivocally ruled that the prohibition in Article 3.1(b) covers both explicit legal requirements and implicit practices that effectively tie the subsidy to the use of domestic goods. This interpretation ensures that the rule is applied comprehensively, addressing both overt and covert forms of local content subsidies.

By encompassing all forms of contingency, Article 3.1(b) aligns with the SCM Agreement's broader objective of eliminating trade-distorting subsidies while promoting fair competition in global markets. This provision underscores the WTO's commitment to preventing protectionist practices that could erode the benefits of an open and rules-based trading system. The nuanced interpretation of "contingency" ensures that domestic content subsidies, even when subtly structured, are subject to scrutiny and discipline under WTO rules.

The Agreement on Subsidies and Countervailing Measures (SCM Agreement) provides a comprehensive framework for regulating subsidies, categorizing them into prohibited, actionable, and non-actionable types. Its "traffic light" system addresses trade-distorting subsidies while recognizing their legitimate role in economic and social development. The provisions on prohibited subsidies, including export and domestic content subsidies, highlight the WTO's commitment to maintaining fairness and predictability in the global trading system.

Key articles of the SCM Agreement, such as 3.1(a) on export subsidies and 3.1(b) on domestic content subsidies, emphasize the importance of preventing distortions in international trade. These rules extend to both explicit legal conditions (de jure) and implicit factual practices (de facto), ensuring comprehensive coverage of subsidy-related issues. By focusing on the principle of "contingency," the SCM Agreement effectively disciplines unfair trade practices without overreaching into policies not directly tied to trade distortion.

The analysis demonstrates the delicate balance maintained by the SCM Agreement between disciplining harmful trade practices and respecting the sovereign rights of States to implement domestic economic policies. Its nuanced and systematic approach supports the WTO's overarching goal of promoting a fair, rules-based global trading system, while addressing contemporary challenges in trade policy and international economic relations. This highlights the ongoing relevance and adaptability of the SCM Agreement in fostering equitable global trade practices.