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# CORRECTING MARKETS TO TACKLE GLOBAL CHALLENGES WHAT PRINCIPLES SHOULD GUIDE INTERNATIONAL SUBSIDY RULES?

A REPORT BY WWF'S TRADE AND INVESTMENT PROGRAMME

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"IT'S TIME TO CHANGE SOME OF THE RULES GOVERNING THE INTERNATIONAL ECONOMIC ORDER, TO THINK ONCE AGAIN ABOUT HOW DECISIONS GET MADE AT THE INTERNATIONAL LEVEL - AND IN WHOSE INTERESTS - AND TO PLACE LESS EMPHASIS ON IDEOLOGY AND TO LOOK MORE AT WHAT WORKS."

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## PREFACE

This report is part of WWF Trade and Investment Programme's attempts to initiate debates on key topics of international trade governance, looking beyond current negotiations and institutional frameworks. It does not intend to articulate policy positions with regard to ongoing international subsidy reform processes, whether at the WTO or elsewhere. The general principles articulated here are just that – general principles – and thus will necessarily require adaptation to specific policy circumstances. Nor is the paper intended to modify specific positions WWF may have articulated in any ongoing international negotiation or dialogue.

The report draws on a roundtable organised by WWF together with the Fundação Getúlio Vargas in São Paulo 12-14 June 2006 with experts from a range of constituencies – government, government advisors, international organisations, civil society and academics from both North and South (list of participants, background papers, presentations and proceedings are available on [www.panda.org/trade](http://www.panda.org/trade)). However, no opinions in this report should be attributed to participants unless otherwise specified.

## ACKNOWLEDGEMENTS

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## ABBREVIATIONS

AoA: WTO Agreement on Agriculture  
 ASCM: WTO Agreement on Subsidies and Countervailing Measures  
 CAP: EU Common Agricultural Policy  
 CBD: Convention on Biological Diversity  
 DSB: WTO Dispute Settlement Body  
 DSM: WTO Dispute Settlement Mechanism  
 GATT: General Agreement on Tariffs and Trade  
 GDP: Gross Domestic Product  
 IMF: International Monetary Fund  
 LDC: Least-Developed Country  
 MEA: Multilateral Environmental Agreement  
 MFN: Most-Favoured Nation  
 RTA: Regional Trade Agreement  
 SDT: Special and Differential Treatment  
 TRIPS Agreement: Agreement on Trade-Related Aspects of Intellectual Property Rights  
 UN: United Nations  
 UNFCCC: UN Framework Convention on Climate Change  
 WTO: World Trade Organization

# EXECUTIVE SUMMARY

There are a range of global challenges facing the world today, from poverty and climate change to biodiversity loss and security. These are increasingly interconnected. Subsidies are an important policy instrument that impacts on global challenges, for the better and for the worse. Today, effective international rules on subsidies are decided and enforced through the WTO. These rules focus on disciplining subsidies that distort trade. It means that they do not seek systematically to respond to the complex impacts subsidies have on global challenges. WWF believes this is a fundamental flaw that will need to be addressed. This report does not attempt to provide detailed proposals of what subsidy disciplines should look like. It does, however, suggest four principles which could inform the development of new subsidy disciplines and on which experts from different constituencies can agree. These principles are not new to international economic law, but they need to be mainstreamed into international subsidy rules:

**1) No sectoral carve-outs from international subsidy disciplines.** Any international disciplining of subsidies should apply the same principles across sectors. However, both political realities and substantive constraints may require specific disciplines on a sectoral or otherwise limited basis.

**2) Harm and benefit of subsidies should be balanced in a coherent manner.** International subsidy rules should address harm of international concern. This means that focus should be on harm done to other countries or to global commons. Still, subsidies may have a measurable impact only domestically yet be of international concern (for example impacts on human rights or biodiversity). The definition of such harm should ensue from international law. In all cases, however, international rules need to balance harm of international concern with any (domestic) benefit of a subsidy.

**3) Different rules for different countries.** Because different countries face different challenges and because different policy options are “reasonably available” to countries to deal with these challenges, special and differential treatment are crucial to balance harm and benefit of subsidies. This entails a need for more fine-grained differentiation among countries: Colombia, as long as it struggles with the growing of illicit crops, may need to use a broad range of incentives to stimulate farmers to grow other crops; while Chile, if such subsidies would have negative side effects, may not be in need of the same scope for subsidies.

**4) Compulsory transparency for subsidies.** The need for a subsidy and its final impacts depend on the context, which changes permanently with regulations, market structure, innovation etc. Currently, subsidies too often serve a vocal interest group and are kept outside public scrutiny. International rules to ensure transparency and periodic evaluations of subsidies’ impacts are therefore necessary not only from the point of view of the international community, but also – perhaps more importantly – such rules could help enlighten domestic debate and also optimise subsidies from a national point of view.

Operationalising these principles will require far greater co-operation among international bodies such as key MEAs, the WTO and UN specialised agencies. That is a vast topic that goes beyond the present report. In order to start preparing the ground for the above principles, WWF will continue to contribute to the broad range of transparency initiatives<sup>1</sup> on subsidies currently underway and document the complex impacts of subsidies – in particular in agriculture.<sup>2</sup> At the same time, WWF will engage with other stakeholders who agree that subsidies are too important globally to be judged, at the international level, on the basis of trade concerns only.

<sup>1</sup> See e.g. the German transparency initiative on agricultural subsidies: [www.wwf.de/unsere-themen/landwirtschaft/agrarpolitik/subventionen/wer-profitiert](http://www.wwf.de/unsere-themen/landwirtschaft/agrarpolitik/subventionen/wer-profitiert). Accessed 9 October 2006.

<sup>2</sup> For an overview of WWF activities on agriculture, see [www.panda.org/about\\_wwf/what\\_we\\_do/policy/agriculture\\_environment/index.cfm](http://www.panda.org/about_wwf/what_we_do/policy/agriculture_environment/index.cfm). Accessed 9 October 2006.

## I

# INTRODUCTION: SUBSIDIES AND GLOBAL CHALLENGES

## 1 ADDRESSING GLOBAL CHALLENGES

**This report does not attempt to provide detailed proposals of what subsidy disciplines should look like. It does, however, suggest a series of existing principles which could inform the development of new subsidy disciplines.**

There are a range of global challenges facing the world today, from poverty and climate change to biodiversity loss and security; from urbanisation and HIV/AIDS to water scarcity and debt.<sup>3</sup> These challenges are intimately interconnected. Consider, for example, the nexus between climate change, trade in oil, the economic fortunes of oil-rich developing countries, international conflict, and terrorism. Or the connections between demand for red meat, trade in fodder for beef-cattle, Brazil's export-led growth strategy, international debt and the deforestation of the Amazon.

Such interconnections make prioritisation difficult, and point to the need to formulate our responses on a case-specific basis through deliberative processes that reflect the full range of relevant expertise. International trade disciplines are of crucial importance in the course of engaging these challenges. But unless such disciplines are shaped to contribute to meeting global challenges, they will at best divert attention from the urgency of addressing them, and at worst undermine the development of other processes intended to do so.

In many circumstances, the pursuit of trade liberalisation – the dismantling of market access barriers or subsidy regimes – can lead to positive steps towards meeting these challenges. Equally, there are many instances where trade liberalisation undermines such progress. WWF is not interested in ideological arguments about whether liberalisation is “good” or “bad”.<sup>4</sup> It is, though, very concerned that the evolving international disciplines on trade should be shaped in a way that is responsive to the complexities of the interrelated challenges we face, with a view to helping develop sophisticated and strategic responses to these.

Subsidies represent just one policy instrument, the use of which has important implications for addressing global challenges, and which are today the

subject of trade rules. This report does not attempt to provide detailed proposals of what subsidy disciplines should look like. It does, however, suggest a series of existing principles which could inform the development of new subsidy disciplines. WWF does not expect that these principles will form the basis for negotiations on subsidy disciplines as these are currently construed – at the WTO, in particular. WWF does, however, anticipate a time when the imperative to rethink international trade rules, including subsidy disciplines, gathers compelling political momentum. This report is an attempt to foresee and rehearse some of the discussions that will then be needed, and to point to established precedents in global governance upon which the international community will need to build.

## 2 CHALLENGES OF SUBSIDIES

There are several dictionary, and even internationally agreed, definitions of a subsidy, but acceptance of one among all policy communities and academic disciplines remains elusive. “Subsidy” is often used as an antonym to taxes, meaning a government transfer of money to a private actor, whether producer or consumer. What then about tax concessions? These have the same effect for the beneficiary as a monetary transfer and can thus qualify as a subsidy. Furthermore, the provision by governments of certain goods or services (such as food or education) below market price can also be considered a subsidy. One may consider that much regulation has the equivalent effect of a subsidy, even if it does not involve government expenditure. One example is border protection that effectively involves a transfer of resources from consumers to domestic producers. Finally, inadequate regulation may imply a subsidy. Some environmental economists have argued that a company that is not held liable for the costs of its pollution, may be considered as receiving a benefit similar to a subsidy.

<sup>3</sup> States disagree about solutions, cf. the debates about climate change, poverty reduction or international security).

<sup>4</sup> See e.g. Trade and Consequences, WWF Macroeconomics Policy Office, Washington DC, 2006.

The common element of all these definitions is that a subsidy amounts to the difference between actual transfers between economic agents and what these transfers “ought to be” – were there only perfect markets.

As any economist will admit, there are no more perfect markets than there is an agreed definition of subsidies. Most markets are not perfectly competitive, and the definition of an “externality” – whether positive, such as public health, or negative, such as air pollution – all depends on our changing preferences, expressed through politics.<sup>5</sup>

In order to avoid being bogged down in interminable controversies, the international rules for subsidies suggested in this report do not address those subsidies considered as such merely because of negative externalities (such as greenhouse gas emissions). Still, the controversies surrounding externalities need resolution in the longer term. In this report, we adopt the definition of subsidies provided in Article 1.1 of the WTO Agreement on Subsidies and Countervailing Measures (ASCM): A subsidy is considered to be a financial contribution by a government or any public body whether it be in the form of direct transfers, guarantees, tax concessions or regulations setting the price of products, that confers a benefit.<sup>6</sup>

This is not a definition specific enough to permit the collection of comparable numbers from different countries. Estimates of global subsidies vary widely, even if they attempt to count relatively similar subsidies. According to some estimates, global subsidies (excluding externalities) may amount to more than a trillion US dollars per year, or 4 per cent of global GDP.<sup>7</sup> Subsidies respond to market failures and externalities as well as political balance of power. These vary greatly between countries, and subsidies' sectoral distribution will vary similarly. In most industrialised countries, agriculture represents the largest share (385 billion USD for the OECD countries in 2005<sup>8</sup>); this is also the case in some developing countries such as India. In other developing countries, such as Brazil

<sup>5</sup> Sowa, Nii, The Role of Subsidies as a Means to Increase Welfare, 2005, downloadable on [www.wwf.de/imperia/md/content/pdf/landwirtschaft/Subsidies\\_Increase\\_Welfare.pdf](http://www.wwf.de/imperia/md/content/pdf/landwirtschaft/Subsidies_Increase_Welfare.pdf). Accessed 9 October 2006.

<sup>6</sup> Economically speaking, custom duties could be interpreted as falling

or Colombia, most subsidies go to services. In many cases, however, the bulk of subsidies are not sector-specific and instead are provided broadly, such as to support research and development, or help small and medium-sized enterprises.

The common feature of all these subsidies is that they act as an incentive for greater production or consumption of goods and services that fulfill certain characteristics. Because they typically concentrate benefits on a few actors while distributing their costs among a great number of actors (taxpayers in general), there is a greater incentive for those who benefit from them to defend their subsidies, than for those who bear the costs to eliminate them. Hence, subsidies often outlive the achievement of their original aim. Consider, for example, food security in Europe. This is no longer of such concern as it was after the Second World War. Yet, in the OECD countries, 54% of total support to agricultural producers is provided in the form of market price support, payments based on output, and input subsidies. These measures drive intensification of agriculture to increase output. Their effect will often be environmental damage and lower world food prices (thus harming many developing countries that have a comparative advantage in agriculture).

Such influence of strong vested interests turning subsidies into permanent, perverse subsidies is not a rule. The Brazilian Proalcool programme, which subsidised ethanol production initially, contributed to making Brazilian ethanol a competitive transport fuel notably through tax concessions. However, it had a number of negative side effects, not in the least foregone government revenue, leading to phase-out of the subsidies. More positive examples include “reverse auctions” for subsidies to deliver public policy objectives at the lowest cost to the public purse. They have successfully been used to ensure universal phone access in Chile and Peru, and for paying Australian farmers to provide environmental services.

under this definition, but in order to limit the scope of the report and because of the very different way custom duties are dealt with by international rules, custom duties will not be addressed in this report.

<sup>7</sup> Agricultural Policies in OECD Countries – At a Glance, OECD, 2006.

**The common element of all these definitions is that a subsidy amounts to the difference between actual transfers between economic agents and what these transfers “ought to be” – were there only perfect markets.**

**Subsidies often outlive the achievement of their original aim.**

In many cases, however, it will be far from clear whether a subsidy has an overall positive effect or not – because the impacts are not comparable.

International rules should focus on harm done to other countries or to global commons. Still, there may be circumstances where they should address impacts that are purely domestic, yet of international concern.

a convergence of views on general principles that international subsidy disciplines ought to be based on began to emerge

In many cases, however, it will be far from clear whether a subsidy has an overall positive effect or not – because the impacts are not comparable. An example of this is subsidies to liquified petroleum gas (LPG) in Senegal. This has resulted in considerable savings of fuelwood and charcoal, relieving pressures on local forests and reducing air pollution. However, it has mainly benefited the better-off parts of society as the LPG is not distributed outside big cities. The subsidies come at a significant cost to the Senegalese treasury, thereby making fewer funds available for the rural poor.<sup>9</sup> Like many other subsidies, the Senegalese scheme could be improved to approach “Pareto-optimality”.<sup>10</sup> But even so, one has to decide on trade-offs between the subsidies’ impacts on deforestation, pollution and redistribution. These are incommensurable factors – “apples and pears” – that can only be weighed through processes of political deliberation.

## IC INTERNATIONAL DISCIPLINES FOR SUBSIDIES

As a general rule, international disciplines cannot and should not overrule national authorities in making those deliberative decisions that affect only their own citizens. International rules should focus on harm done to other countries or to global commons. Still, there may be circumstances where they should address impacts that are purely domestic, yet of international concern. This principle is already accepted in international law, for instance in regional human rights treaties, such as the African Charter on Human and Peoples’ Rights, or in multilateral environmental agreements (MEAs) such as the Convention on Biological Diversity (CBD), the preamble of which refers i.a. to biodiversity being a “common concern of humankind”.

An increasing number of global challenges mean that more and more impacts – seemingly domestic – may have transborder or even global impacts e.g. through trade flows, foreign direct investments or climate change. Shaping subsidy disciplines to help deal with such challenges raises some very delicate political questions about sovereignty. Such disciplines can only be justified under special circumstances, and have to be circumscribed by international agreements to which all parties voluntarily subscribe based on an adequate balance of rights and obligations. For instance, the CBD preamble affirms simultaneously States’ “sovereign rights over their own biological resources” and “their responsibility for conserving their biological diversity and for using their biological resources in a sustainable manner.”

Insofar as subsidy disciplines are enforced through trade sanctions, it is also essential to look at how sanctions in this respect contribute to meeting the range of global challenges we are facing, whether poverty, HIV/AIDS or water stress.

Addressing these questions was the challenge put to participants at a roundtable organised by WWF together with the Fundação Getulio Vargas in São Paulo 12-14 June 2006 with experts from a range of constituencies – government, government advisors, international organisations, civil society and academics from both North and South (list of participants, background papers, presentations and proceedings are available on [www.panda.org/trade](http://www.panda.org/trade)) This report represents WWF’s assessment of the discussions and should not in any way be attributed to roundtable participants.

WWF believes, however, that a convergence of views on general principles that international subsidy disciplines ought to be based on began to emerge at the roundtable (section II): Section II.A makes the case for the abolition of sectoral carve-outs. Section II.B argues that international subsidy disciplines need

to address and balance incommensurable harms and benefits that are of concern to the international community. A crucial application of this principle is to apply different rules to different countries in order to account for their varying capacities and needs (section II.C). Finally, because public knowledge of subsidy regimes is low and the impacts of subsidies are context-specific, procedural disciplines that focus on transparency and evaluations in order to know what is being paid to whom, for what reason and with what impact, are needed (section II.D).

The purpose of this report is to elaborate on these principles. They are well-established in international law – and reflected in WTO law – and experts from the broad range of constituencies present at the São Paulo roundtable were able to agree on them as general principles. They are often also reflected in WTO law and its current subsidy rules – although they often co-exist with, and are subordinated to, other principles, such as rules that focus narrowly on subsidies’ formal characteristics (cf. the rules contained in the Agreement on Agriculture – AoA) or impacts on export markets. This is why WWF believes that current WTO rules cannot ensure that the right balances are struck when assessing harm and benefit of a subsidy: Often, they turn a blind eye to harm of concern to the international community, while at other times they constrain unduly WTO Members’ possibility to use subsidies. Thus, the mainstreaming of the principles outlined in this report will require reform of WTO subsidy disciplines. On the other hand, the report does not seek to define a priori the respective roles that the WTO and other international bodies ought to play in a new international regime for subsidies.

The purpose of this report is to elaborate on these principles.

WWF believes that current WTO rules cannot ensure that the right balances are struck when assessing harm and benefit of a subsidy

<sup>9</sup> OECD estimate, available on [www.oecd.org/dataoecd/12/7/37002545.xls](http://www.oecd.org/dataoecd/12/7/37002545.xls). Accessed 9 October 2006.

<sup>9</sup> Energy Subsidies: Lessons Learned in Assessing their Impact and Designing Policy Reforms, UNEP/UN Foundation, 2004.

<sup>10</sup> An economic term for a situation where you can make no economic agent better-off without making another agent worse-off.

II

PRINCIPLES FOR  
INTERNATIONAL  
DISCIPLINES ON  
SUBSIDIES THAT  
PROMOTE  
SUSTAINABLE  
DEVELOPMENT

The four principles presented in this section are of a varied nature. The first tackles the basic architecture of disciplines; the second deals with the trade-offs between incommensurable objectives that

disciplines need to address; the third underlines the need for rules to differentiate between countries; the final principle is the need for procedural rules related to transparency and evaluation of subsidies.





II A

## NO SECTORAL CARVE-OUT

" A GOVERNMENT THAT ROBS PETER TO PAY PAUL  
CAN ALWAYS DEPEND ON THE SUPPORT OF PAUL."

GEORGE BERNHARD SHAW



## II A 1 THE PRINCIPLE: THERE SHOULD BE NO SECTORAL CARVE-OUT FROM INTERNATIONAL SUBSIDY DISCIPLINES

any international disciplining of subsidies should apply the same principles across sectors.

The present international disciplines on subsidies make distinctions between different sectors through the derogation for agricultural subsidies from the general WTO rules (GATT Article XVI and the ASCM): The AoA includes a whole set of different rules and principles. Most importantly, the AoA disciplines subsidies based on the criteria used in their disbursement (e.g. guaranteed prices vs. payments for extensive agriculture), not on their impact on exports. While it is fairly easy to understand the historical and political reasons for this, it does not make much sense to make a priori sectoral carve-outs if the aim of international disciplines is to enable a case-by-case balancing of different benefits and harms, based on a range of principles. This is not, of course, tantamount to saying that the current general WTO subsidy rules should simply be extended to apply to agricultural subsidies.

The São Paulo roundtable participants were apparently unanimous that any international disciplining of subsidies should apply the same principles across sectors. However, any operationalisation of these principles through rules and judgments would require a balancing between different benefits and harms that would obviously vary according to the issues at stake. In other words, while the general principles governing subsidy disciplines should be applied as universally as possible, it is understood that both political realities and substantive constraints may require specific disciplines on a sectoral or otherwise limited basis. Indeed, as the debate today is construed, improvements of subsidy rules may be most feasible through sectoral approaches – as exemplified by the negotiations on fishing subsidies in the WTO Doha Round.

There are also pragmatic reasons as to why the world might be well advised to abandon sectoral carve-outs. The case of biofuels illustrates this. Most people would agree that in the case of an integrated agricultural system, simultaneously producing, for example, sugar for biofuel, pig-meat for food consumption and wood-products for bio-energy, it would be hard to determine whether this was part of the energy or agricultural sector. In fact the demand for fossil-free energy and its possible provision through the growing of energy crops may be co-opted by vested interests as an argument against the dismantlement of the enormous subsidy regimes sustaining many rich countries' agriculture, most of which were originally created to secure food supply.

## II A 2 QUESTIONS THAT ARISE

The overall question relating to this principle is how the specific rules should be elaborated in order to operationalise general principles. Should they be sector-specific? Should they relate to the different impacts of subsidies (trade, pollution etc.)? And how much discretion should be left to international bodies in applying these principles and rules to specific cases?

## II A 3 HOW CAN THIS PRINCIPLE BE APPLIED?

### II A 3 A EXISTING APPLICATION OF THIS PRINCIPLE

The principle of general subsidy disciplines is already applied, with substantive exceptions for agricultural subsidies, through the ASCM. Indeed, even for agricultural subsidies the ASCM applies to the extent that the AoA does not contain specific rules.<sup>11</sup>

### II A 3 B HOW TO GATHER POLITICAL ACCEPTANCE FOR THE MAINSTREAMING OF THE PRINCIPLE?

At present, this principle runs right into one of the – if not the – greatest source of political tension in trade negotiations between North and South and within Northern societies themselves: the special treatment of the agricultural sector mainly created to permit the US, the EU, Japan and other Northern countries to maintain high levels of protection and subsidisation of their agricultural sectors. The current round of WTO negotiations has shown just how sensitive this area is. For example, the US proposed at the June 2006 ministerial meeting in Geneva to reintroduce the so-called “peace clause” in the AoA whereby WTO Members would agree not to challenge each other’s agricultural policies through WTO dispute settlement. The US proposed this in a situation where developing countries already felt there was very little on offer for them in the agricultural part of the negotiations. Thus, the US suggested not only maintaining different and much more permissive rules for agriculture, but furthermore exempting possible flaws of these permissive rules from dispute settlement. On the EU side in the run-up to and during the December 2005 WTO ministerial conference in Hong Kong, a strong coalition of 10-14 Member States again and again pushed the European Commission not to make any further compromise on agriculture. Thus, the current political situation in major developed countries would not allow disciplines based on impacts on other countries

to also cover agricultural subsidies. Today, such an approach to agricultural subsidies would require that the new disciplines or other international rules (e.g. tariff bindings) result in effective protection of their farmers. This would clearly be unsatisfactory from the point of view of agricultural exporters. It would be preferable that the political economy within Northern countries shifts. The latter could happen as a result of increased transparency regarding subsidies. The recent disclosure by a number of EU Member States of the gross inequity of payments under the EU Common Agricultural Policy (CAP) has given a big boost to those who want to reform the CAP. Campaigns for transparency are gaining momentum in the EU, so far crowned with a proposal by the European Commission to publish who receives which EU funds.<sup>12</sup> Combined with increased pressure on public finances in many rich countries, there is indeed a potential for medium-term changes to the political economy of agricultural subsidies at least in the EU.

### II A 3 C EXISTING OPPORTUNITIES

There is some potential to take small steps towards minimising sectoral carve-outs in the suspended WTO round of negotiations. Any further restriction of “amber box” agricultural subsidies (i.e. linked to production factors) would be a small step in this direction, given that the “amber box” permits perverse subsidies for agriculture that would otherwise be prohibited by the WTO. Furthermore, stricter rules on the use of “blue box” (linked to production factors but simultaneously limiting output) and “green box” (not linked to production factors) subsidies – as suggested notably by the G20 – would diminish the use of current perverse agricultural subsidies and thus help pave the way for acceptance of equal treatment across sectors. This is not to say, of course, that any stricter rules on subsidies – whether linked to production factors or not – would necessarily diminish the use of perverse agricultural subsidies: The point is that there is ample evidence of harm caused by agricultural subsidies in all “boxes”; stricter rules are needed. The next section discusses what should guide the further constraining of these rules.

Campaigns for transparency are gaining momentum.

There is ample evidence of harm caused by agricultural subsidies in all “boxes”; stricter rules are needed.

<sup>11</sup> Cf. AoA Art. 13

<sup>12</sup> European Commission, Green Paper on European Transparency Initiative, COM(2006)0194 final, 3 May 2006 (ec.europa.eu/commission\_barroso/kallas/transparency\_en.htm - accessed 9 October 2006).





II B

## BALANCING HARM AND BENEFIT OF SUBSIDIES IN A COHERENT MANNER

"NOT EVERYTHING THAT COUNTS CAN BE  
COUNTED, AND NOT EVERYTHING THAT CAN  
BE COUNTED COUNTS."

ALBERT EINSTEIN



This section first outlines how subsidies can have impacts – often negative – far beyond their recipients. International law – including trade law – recognises that some of these impacts are the legitimate concern of the international community, and should therefore be addressed by international subsidy rules (II.B.1). The São Paulo roundtable seemed to concur with this as a matter of principle, but a number of questions were raised about how to achieve it in a coherent manner, in particular because the harms and benefits that need to be balanced will often be incommensurable (II.B.2). However, international economic law, including GATT/WTO law, contains a number of precedents for applying the different elements of this principle and we explore in II.B.3 how it can be mainstreamed in international subsidy rules.

II B 1  
THE PRINCIPLE:  
INTERNATIONAL  
DISCIPLINES SHOULD  
REFLECT HARM OF  
CONCERN TO THE  
INTERNATIONAL  
COMMUNITY AND  
BALANCE THIS WITH  
SUBSIDIES' BENEFITS

International disciplines should deal with impacts of concern to the international community.

**US and EU subsidies to cotton farmers:** These contributed to a sharp drop in world cotton prices. Consequently, the revenues of some of the poorest countries in the world – which happen to be cotton exporters, such as Burkina Faso, Mali, Chad and Benin – fell. These are all LDCs whose development has been made a priority of the international community e.g. through the WTO agreements, the UN Millennium Declaration<sup>13</sup> or their inclusion in the World Bank/IMF Highly Indebted Poor Country (HIPC) initiative for debt

relief. In other words, US and EU subsidies, indirectly, cause harm to the objectives that they, in other fora, have committed themselves to.

**US fossil fuel subsidies:** Estimates of US subsidies to fossil fuels vary widely – the lowest estimate is 18.1 billion USD.<sup>14</sup> For instance, oil and gas companies can deduct before taxes a higher share of sales revenues than other companies, representing an annual subsidy of 600 million USD. Another example is the “Non-Conventional Fuel Production Credit” – a tax credit for certain types of fuel extracted from “non-conventional” sources – originally intended to provide incentives for alternatives to traditional petroleum, but that has mostly benefited oil and gas production (e.g. from tar sands); this represents 1.3 billion USD per year.<sup>15</sup> This happens at the same time as the US has taken on no commitments to reduce its greenhouse gas emissions despite its being the world’s largest emitter – and also the largest per capita emitter of CO2 amongst non-oil or gas exporting countries.<sup>16</sup> Still, the US has ratified the UN Framework Convention on Climate Change (UNFCCC), which commits its Parties to combat climate change. In this case, one could easily argue that, in the absence of credible carbon sequestration or other ways to avoid greenhouse gas emissions from the increased production due to the US fossil fuel subsidies, they cause harm to the international community even though it is not possible to identify or quantify precisely that harm.

It is well-recognised that subsidies may cause significant impacts not only for those targeted by the subsidy. International disciplines should deal with impacts of concern to the international community. Unavoidably, international political economy determines what is the scope of such concerns; it should be kept in mind that these concerns are subjective and constantly evolving.

At present, however, the following three types of potential harm caused by subsidies and recognised by various international instruments can be distinguished:

1. Transboundary harm:

This is the “easiest” type of harm for international rules to deal with. Subsidies can cause transboundary harm for instance through job losses (and thus increase poverty) or tax revenue shortfalls (thus constraining social policies) in other countries. It would generally be subsidies affecting trade or investment that would cause such harm. Today, WTO rules merely address harm to exports. If one were to focus on harm caused to internationally recognised global challenges, one could point to world leaders’ commitments through e.g. the Millennium Declaration to reduce extreme poverty and hunger, achieve universal primary education, combat HIV/AIDS, malaria and tuberculosis etc.<sup>17</sup> In other words, if harm to employment or government revenue were caused to a poor country, there would be a presumption of violation of the Millennium Declaration. Addressing such harm raises questions about which countries should have recourse to such claims against other countries. For instance, when does the loss of employment in a country become a concern to the international community? Presumably, the magnitude of job losses, the overall unemployment challenge of the affected country and its development level all need to be taken into account. This is already implicitly recognised by WTO rules through provisions on special and differential treatment (SDT). Other transboundary harm caused by subsidies recognised by international treaties includes all sorts of pollution (of environmental media such as shared watercourses, air or sea) and depletion of migratory species (including fish and birds). For instance, when discussing its work on incentive measures (Article 11 of the CBD), the Conference of the Parties to the CBD has stressed in a number of cases that “these incentives and mitigation measures should not adversely affect biodiversity and livelihoods of other communities, and should be applied in a manner consistent with international law”.<sup>18</sup>

2. Harm to global commons:

Certain elements of the planet are beyond national jurisdiction, either as distinguishable geographical entities (such as the high seas, the resources of the

deep sea bed or Antarctica), or because they resemble public goods – countries cannot be excluded from benefiting from them (cf. the ozone layer or the atmosphere’s climate regulation). Because of the fundamental dependence of humanity on some of these global commons, these are the natural resources for which international disciplines are often the strictest (cf. the penalty procedure under the Kyoto protocol). Yet subsidies still cause great harm to global commons, considering in particular subsidies for fossil fuels or for high-sea fishing.

3. Domestic harm:

As noted in the introduction to this report, increased global interconnectedness and the emergence of new global challenges mean that harm may be of concern to the international community even if the harm does not cross any border. An example of this is human rights, a field where international bodies increasingly interfere with domestic matters. Furthermore, States have been given an international responsibility for preserving their domestic biodiversity<sup>19</sup> – thereby putting a limit (so far untested) to their sovereignty over species inhabiting their territory. Still, subsidies may be detrimental to human rights or biodiversity, e.g. through infrastructure development or certain economic activities. Interestingly, human rights and biodiversity concerns may overlap in such cases.<sup>20</sup> Clearly, this is politically the most sensitive category of harm, and international disciplines have to be circumscribed by international agreements to which all parties voluntarily subscribe based on an adequate balance of rights and obligations.

Today, these different types of harm caused by subsidies are dealt with in a dispersed manner: either through the proxy of trade (according to WTO rules) or through the final impact on natural resources or human rights. An integrated set of subsidy disciplines would require a “network” with cross-references between different international hard or soft law and (an) enforcement mechanism(s) with traction.

<sup>13</sup> www.un.org/millennium/declaration/ares552e.htm - accessed 9 October 2006

<sup>14</sup> earthtrack.net/earthtrack/index.asp?page\_id=201&catid=73 - accessed 9 October 2006

<sup>15</sup> www.taxpayer.net/TCS/energy/coal.htm - accessed 9 October 2006

<sup>16</sup> Carbon Dioxide Information Analysis Center website cdciac.ornl.gov (an exception is Luxembourg which due to its location, size and low taxes has inflated fuels sales). Accessed 9 October 2006.

<sup>17</sup> UN General Assembly Resolution 55/2, 8 September 2000 (www.un.org/millennium/declaration/ares552e.htm – accessed 9 October 2006)

<sup>18</sup> See e.g. 1992 UN Convention on Biological Diversity CoP decision VII/18, second preambular paragraph; decision VII/4, paragraph 7

footnote and decision VII/27, paragraph 1 footnote.

<sup>19</sup> 1992 UN Convention on Biological Diversity (www.biodiv.org)

<sup>20</sup> See for instance Inter-American Commission on Human Rights, Resolution 12/85, Yanomani (Case 7615 – Brazil) (www.cidh.org)

The harm of international concern would need to be weighed against the domestic benefit of the subsidy before disciplines were enforced.

Assessments both of harm and benefit should be based upon international agreements and objectives.

Finally, and very importantly, given that subsidies are generally designed to produce certain domestic benefits, the harm of international concern would need to be weighed against the domestic benefit of the subsidy before disciplines were enforced. This becomes particularly important with regard to developing countries (cf. II.C).

## II B 2 QUESTIONS THAT ARISE

- **How to weigh harm of international concern against domestic benefit or necessity of the subsidy?**

Accommodating such incommensurable concerns is a challenge, but one at which all political process is ultimately directed. Applying a necessity test for subsidies causing harm of international concern will reduce the instances where a subsidy is applied for domestic benefit yet causes international harm. Yet, it will not eliminate such contradictions. Assessments both of harm and benefit should be based upon international agreements and objectives.

- **How to establish criteria to judge causalities?**

It is cumbersome to establish causalities between a subsidy regime in one country and impact on the ground, such as deforestation or job losses, in another country. Under the current trade regime, the proxy for harm is whether or not a given subsidy regime compromises the export potential of another country. That is in itself not always easy to establish in a rigorous manner. It is even harder when it comes to concrete impact on the ground. It was pointed out at the São Paulo roundtable that jobs have been lost in the Indian cotton industry and at the same time some developed countries apply huge amounts of subsidies to their cotton producers. It is easy on a conceptual basis to establish a link between such subsidies and job losses in India, but it is surely not the only cause – it might not even be the most important cause: The

Indian government imposes export taxes on their cotton producers, which alongside other government policies may be a far more important cause for these job losses. How can these causalities be established? And how large a portion of the cause of harm should a given subsidy regime exert before being subject to disciplines?

- **How to distinguish internationally recognised agreements or objectives?**

References to international agreements and objectives are a good principle, but there is no definition of what these agreements might be. It takes us to the long-running debate about what constitutes customary international law, i.e. what law is applicable without explicit obligations taken on by States. Firstly, despite numerous proposals on minimum thresholds for the number and importance of parties to a treaty, there is no agreed definition of how to distinguish an obligation that all States have to respect from an obligation applicable to a small number of States. Secondly, it is often difficult to separate hortatory from binding language in international agreements and objectives; a clearer distinction would make them easier to use as reference points.

- **What sanctions should be applied under such an international subsidy regime?**

Economic sanctions are considered as the international peaceful sanctions with the greatest traction. Trade sanctions may be the most easily available, although they are effective only when used by large trading nations against smaller ones. There are also other possible tools such as freezing of assets or fines. The real question, though, is how to impose sanctions based on harm that is not measurable in monetary terms: What is the harm caused by subsidies to coal-firing? What is the harm caused by subsidies driving irresponsible fishing in the high seas? A non-economic way of sanctioning such harm could be by denying the offending state certain rights in international bodies, such as the right to vote or the right to benefit from their facilities (technical assistance, lending facilities etc.<sup>21</sup>).

<sup>21</sup> See for instance the analysis of Ibrahim Shihata, "Implementation, Enforcement, and Compliance With International Environmental Agreements – Practical Suggestions in Light of the World Bank's Experience", Georgetown International Environmental Law Review volume 9 (1996-1997), pp. 37-51.

- **What bodies should enforce subsidy disciplines?**
- WTO dispute settlement is impressively effective amongst international courts and tribunals because 1) it cannot be blocked by a party to a dispute, 2) it is relatively rapid, and 3) the sanctions it authorises (trade retaliation) are easily available to complaining parties. Therefore, many want to avail of it to defend their interests (cf. the Agreement on Trade-Related Aspects of Intellectual Property Rights – TRIPS – that was negotiated in the WTO to enhance the enforcement of pre-existing international conventions on intellectual property rights). Although the WTO Dispute Settlement Body is unlikely to relinquish the priority given to trade concerns in its rulings, it has shown an increasing willingness to defer to evaluations made by other international bodies – whether that be specifically mandated by the WTO agreements (cf. India-Quantitative Restrictions<sup>22</sup>) or not (cf. US-Shrimp<sup>23</sup>).

## II B 3 HOW CAN THIS PRINCIPLE BE APPLIED TO SUBSIDY DISCIPLINES?

**II A 3 A EXISTING APPLICATIONS OF THIS SAME PRINCIPLE IN GATT/WTO PRACTICE**  
The principle of balancing domestic and international harms and benefits and using trade rules to achieve the “optimal mix” consists of several elements, all of which have become well-established in GATT/WTO practice:

**Flexibility for political objectives:** Since its inception the GATT has acknowledged that its rules should be made flexible enough to provide leeway for Members for the achievement of legitimate political objectives. This was the basis for providing so-called “special and differential treatment” to developing countries as the GATT acknowledged that priority should be given to the economic development

of these countries. Similarly, it was the basis for the GATT exceptions articles XX and XXI.

**Sanctions for political objectives:** Using trade and other economic sanctions against a country to further international non-economic objectives is also a well-established principle in trade law. In many cases this has happened without any objective cross-border impact of the policies pursued by the targeted country. Although countries have resorted to unilateral measures without any international blessing (cf. the US suspension of MFN treatment of Czechoslovakia after its 1948 political regime change), the UN Security Council has also increasingly called on economic sanctions against countries pursuing certain domestic policies. The first example was the unilateral declaration of independence of the white settler regime in Southern Rhodesia: Even though there was no evidence of Rhodesian intent of external aggression, its racist constitution triggered a determination of the Security Council that it constituted a threat to international peace and security, and thus made mandatory for all UN Members to cease economic relations with Southern Rhodesia. According to the UN Charter, it is clear that UN obligations take precedence over other international obligations – such as WTO rules – of Members. This has never been contested when action was taken pursuant to Security Council resolutions. Weighing benefits and harms: Weighing domestic benefits with international harm is a recurrent theme in GATT/WTO law. The Appellate Body has explicitly stated that, in order to allow an exception under GATT Art. XX from that agreement’s disciplines, a weighing and balancing of a series of factors has to take place. This includes the contribution made by the trade measure to the objective of the domestic regulation, the importance of the common interests or values protected by the regulation, and the accompanying impact of the measure on imports or exports – in other words its indirect harm to other WTO Members. There are also several WTO examples of automatically applicable rules for this balancing, such as the derogation from AoA subsidy disciplines for domestic support to combat illegal crops.

<sup>22</sup> WT/DS90/AB/R (www.wto.org/english/tratop\_e/dispu\_e/cases\_e/ds90\_e.htm – accessed 9 October 2006)

<sup>23</sup> WT/DS58/AB/R (www.wto.org/english/tratop\_e/dispu\_e/cases\_e/ds58\_e.htm – accessed 9 October 2006)

there are plenty of precedents to build a networked set of international rules with cross-references between treaties and institutions.

Ultimately, the coverage of the WTO dispute settlement is a political decision, as demonstrated by the TRIPS Agreement.

**Deference to judgments by other international bodies:**

Neither is there any theoretical difficulty in making use of one international agreement to enforce disciplines defined by other agreements or bodies:

- GATT Art. XV:2 defers to the International Monetary Fund (IMF) assessments of questions on monetary reserves, balance-of-payments or foreign exchange arrangements. For instance, if the IMF deems a country to be in balance-of-payments problems, that country can restrict imports even if that is otherwise prohibited by GATT.
- The WTO agreements relax a number of obligations for, and provide special rights to, least-developed countries (LDCs). As the UN defines the criteria for LDCs<sup>24</sup>, the WTO effectively defers to another organisation the decision on which countries are in need of these special rules.
- GATT Art. XX(h) allows, under certain criteria, for otherwise GATT-incompatible measures taken under international commodity agreements.<sup>25</sup>
- The TRIPS Agreement defers to the Berne and Paris conventions the definition of intellectual property rights to be enforced through the WTO. In other words, there are plenty of precedents to build a networked set of international rules with cross-references between treaties and institutions. However, applying this to a new area such as subsidies will necessarily be ad hoc and the result of political bargains as long as there is no coherent structure for public international law. The NAFTA listing of specific environmental agreements that take priority over NAFTA provisions – regrettably without any criteria for this listing nor any process for its evolution – is an example of this. The work of the UN International Law Commission to remedy the fragmentation of international law may therefore be essential if this principle of coherence of subsidy rules is to be operationalised.

<sup>24</sup> The UN definition of LDCs contains three criteria (cf. [www.unctad.org](http://www.unctad.org)):

- a low income, as measured by the Gross Domestic Product (GDP) per capita;
- weak human resources, as measured by a composite index (Augmented Physical Quality of Life Index) based on indicators of life expectancy at birth, per capita calorie intake, combined primary and

**II A 3 B HOW TO GATHER POLITICAL ACCEPTANCE FOR THE EXTENSION OF THE PRINCIPLE TO NEW GLOBAL CHALLENGES?**

As explained above, tackling harms and benefits of subsidies in a coherent manner would presumably need to rely on a networked model of international governance with a well-functioning enforcement mechanism. This is not likely to appear under the UN Charter in the foreseeable future. The WTO Dispute Settlement Body (DSB) thus presents itself as a politically opportune body to enforce international disciplines defined, or assessments made, outside the WTO. As noted above, the WTO's deference to, for instance, the IMF or the Paris and Berne conventions demonstrates the feasibility of this. At the same time, enforcement through non-WTO mechanisms may improve in the future. MEAs might gather crucial political momentum for effective enforcement if all major countries become parties to MEAs (the Kyoto protocol and the CBD have quasi-universal membership, yet their effectiveness is diminished by the absence of the US) and, in particular, if they are given the authority to impose penalties, such as under the Kyoto protocol, or even fines. Ultimately, the coverage of the WTO dispute settlement is a political decision, as demonstrated by the TRIPS Agreement. Subsidies very often cause harm to other countries that is measurable in economic terms. On this basis, it was possible to start negotiations in the Doha round on specific disciplines for fishing subsidies that were not based on trade distortion, but on “production distortion”. Harnessing political support for such a broadening of the scope of WTO-enforced disciplines will largely depend on allaying fears that it will provide a smokescreen for protecting current subsidies in rich countries. Clearly, concessions by developed countries of greatest interest (e.g. agriculture) or concern (e.g. TRIPS) to developing countries would be important in this respect.

“Pooling” current subsidy disciplines that target direct trade effects together with disciplines addressing other global challenges is currently conceivable only if the latter harm acquires direct economic importance (as is the case of fishing subsidies). So, realistically,

secondary school enrolment, and adult literacy; • a low level of economic diversification, as measured by a composite index (Economic Diversification Index) based on the share of manufacturing in GDP, the share of the labour force in industry, annual per capita commercial energy consumption, and UNCTAD's merchandise export concentration index.

various global challenges – such as climate change – may be added incrementally to the list of concerns that subsidy disciplines address as they acquire economic importance.

**II A 3 C EXISTING OPPORTUNITIES**

Traditionally, the definition of “trade-related” harm in the WTO has been narrowly restricted to mean “related to direct distortions of competition in export markets”. In the recent Doha round, there has been a certain willingness to go beyond this in discussions about ASCM reform:

- As noted above, the fishing subsidy negotiations have focussed on “production enhancing” subsidies that lead to fish stock depletion and thus to distortion of global economic activities in the fisheries sector – rather than on trade distortion.
- The US has proposed to prohibit all subsidies causing “intrusive government interference in the marketplace” (such as subsidies covering operating losses etc.): This demonstrates that trade distortion is not considered a sacrosanct principle constraining WTO disciplines.

Conversely, when it comes to acknowledging domestic benefits of subsidies, many WTO Members have suggested resurrecting a category of “non-actionable subsidies” (that elapsed in 2000) under which subsidies with “legitimate development goals” such as “regional growth, technology research and development, production diversification, and development and implementation of environmentally sound methods of production”<sup>27</sup> would fall. Obviously, there is great

<sup>25</sup> UNCTAD has taken the initiative to a number of such commodity-specific agreements. See <http://www.unctad.org/Templates/Page.asp?intItemID=1532&lang=1> for further details (accessed 3 November 2006).

<sup>26</sup> For an assessment of the WTO negotiations on fishing subsidies immediately before the July 2006 suspension of the talks, see The Best of Texts, The Worst of Texts, WWF, June 2006. For a detailed outline of WWF suggestions on disciplines for fishing subsidies, see David K. Schorr, Healthy Fisheries, Sustainable Trade – crafting new rules on fishing subsidies in the World Trade Organization, WWF, June 2004. These and other reports are downloadable from [www.panda.org/about\\_wwf/what\\_we\\_do/policy/trade\\_and\\_investment/our\\_solutions/fishing\\_subsidies/index.cfm](http://www.panda.org/about_wwf/what_we_do/policy/trade_and_investment/our_solutions/fishing_subsidies/index.cfm). Accessed 9 October 2006.

controversy about what such “legitimate development goals” comprise, and the WTO may not be the most constructive forum to discuss this.

There is also an interest in subsidy rules from MEAs: The Kyoto protocol specifically establishes a general obligation to take measures to phase out market imperfections, such as “subsidies in all greenhouse gas emitting sectors that run counter to the objective of the Convention”.<sup>28</sup> The importance of this was further stressed at the 2002 World Summit for Sustainable Development in Johannesburg, which in its Plan of Implementation reiterated the need for reforming energy subsidies for sustainable development.<sup>29</sup>

In 2004, the 7<sup>th</sup> meeting of the Conference of the Parties (COP-7) to the CBD adopted a decision encouraging parties and other governments to use, as voluntary interim guidance, draft proposals for the application of ways and means to remove or mitigate perverse incentives. Conversely, COP-8 called for more in-depth study of how “positive incentive measures” could be used to protect biodiversity.<sup>30</sup>

The FAO has already created “soft law” on fishing subsidies through its 1999 International Plan of Action on the Management of Fishing Capacity.<sup>31</sup>

Although the importance of subsidy reform is acknowledged by several international treaties, there are no disciplines that can rival the enforceability of WTO rules. There might therefore be just as much a need for MEA parties to adopt clearer rules on subsidies as a need for the WTO to broaden the scope of subsidy impacts that its dispute settlement mechanism can deal with.

<sup>27</sup> Decision on Implementation-Related Issues and Concerns, WT/MIN(01)/17, 14 November 2001

<sup>28</sup> Art. 2.1(a)

<sup>29</sup> Cf. Art. 19 of the Plan of Implementation ([www.un.org/jsummit/html/documents/summit\\_docs/2309\\_planfinal.htm](http://www.un.org/jsummit/html/documents/summit_docs/2309_planfinal.htm) – accessed 9 October 2006)

<sup>30</sup> COP Decision VII/18 and VIII/26 respectively ([www.biodiv.org](http://www.biodiv.org))

<sup>31</sup> International Plan of Action for the Management of Fishing Capacity, FAO, 1999 ([www.fao.org/docrep/006/x3170e/x3170e04.htm](http://www.fao.org/docrep/006/x3170e/x3170e04.htm) – accessed 9 October 2006)

realistically, various global challenges – such as climate change – may be added incrementally to the list of concerns that subsidy disciplines address as they acquire economic importance.

There might therefore be just as much a need for MEA parties to adopt clearer rules on subsidies as a need for the WTO to broaden the scope of subsidy impacts that its dispute settlement mechanism can deal with.



The image is a composite of two distinct microscopic views. The left half shows a dense field of cells, likely from a tissue section, with various shapes and sizes, some containing prominent nuclei. The right half shows a large, complex virus particle with a textured, spiky surface, possibly a coronavirus, set against a dark background.

II C

DIFFERENT  
DISCIPLINES FOR  
DIFFERENT  
COUNTRIES

"SOCIETY IS A MARVELLOUS MACHINE THAT  
ALLOWS GOOD PEOPLE TO BE CRUEL WITHOUT  
KNOWING IT."

ALAIN



Many of the global challenges that need to be “balanced” as discussed in section II.B. need to differentiate between countries. Countries face different challenges when it comes to poverty, HIV/AIDS, illegal narcotic crops or water stress. A recurrent theme at the São Paulo roundtable was therefore the need to base the weighing of harms and benefits on different categories of countries to which different rules should be applied (II.C.1), which in turn raises intricate questions pertaining to any classification (II.C.2). This section ends by reflecting on both the existing acceptance of this principle and how its application can be further improved (II.C.3).

## II C 1 THE PRINCIPLE: ADAPTING RULES TO COUNTRIES

In the course of balancing the harms and benefits described in II.B, the function of SDT is to assign different rights and obligations to different countries

A necessary corollary to international disciplines on subsidies based on how subsidies help or prevent the world from tackling global challenges, is to differentiate these rules between countries. SDT for developing countries, as it currently exists, is simply a well-established expression of the need to ensure that trade rules help deal with the development challenge – one of the most important and commonly agreed global challenges.

In the course of balancing the harms and benefits described in II.B, the function of SDT is to assign different rights and obligations to different countries in recognition of the fact that they have different capabilities and needs.

SDT, seen through the lens of this report, is not about giving free rein to developing countries’ use of subsidies, but rather, about enabling developing countries to use subsidies to tackle their specific challenges and those of the global community, where appropriate to their development needs.

SDT provisions need to be based on criteria linked to agreed objectives (whether economic diversification or combating malaria); this requires clear rules for differentiation between countries and graduation from SDT provisions – and should exclude time-bound privileges.

In Brazil, the government has started a pilot project subsidising companies that contract previously landless people to grow castor plants for bio-diesel. The previously public land was given to Brasil Ecodiesel under the guarantee that the land would be shared with small farmers who would produce castor seeds for the production of biodiesel. The families signed a contract in which they guarantee to plant castor plants for a period of ten years on parts of the nine hectare plot of land that each one receives. The farmers also receive a brick house to live in, with electricity and plumbing. In ten years, if they comply with the contract they have with the company, the residents will receive the title deeds for the piece of land. The federal government program supports this by fiscal incentive policies for industries that process castor and palm oil in the poorest regions of the country – the North and Northeast – and support family farming.<sup>32</sup>

These subsidies are clearly linked to production factors, but also provide an efficient way to improve the development prospects of landless people and make use of Brazil’s vast unproductive, arid areas in its Northeastern States. Even if one day a large-scale version of this scheme leads to higher Brazilian biodiesel exports than would have been the case otherwise, the principle of SDT would mean that such economic implications would be given less weight than analogous impacts of a similar scheme for the production of biodiesel, say, in Europe – where other tools are available to deal with challenges of unemployment and poverty.

<sup>32</sup> Arab-Brazil News Agency, Biodiesel, the social fuel, 11 November 2005 (www.anba.com.br/ingles/especial.php?id=250 – accessed 9 October 2006)

## II C 2 QUESTIONS THAT ARISE

- As a specific example of the issue of balancing harms and benefits discussed in section II.B, SDT raises the question of how to balance not only, e.g., job losses against deforestation, but also how to value the two differently with reference to different developing country situations. Should SDT be applied based on countries’ relative levels of development? That would for example mean that Brazil should be able to defend itself based on SDT provisions if challenged by Belgium but not if challenged by Belize.

- The above point relates to the question of graduation of developing countries, which in any case becomes a very central issue to SDT: How to actually differentiate between developing countries? Which criteria to use? Is a simple GDP proxy sufficient, or is it necessary to use more complex proxies like, for example, the Human Development Index? Graduation should ideally be linked to specific needs or objectives (e.g. graduation from SDT for agriculture could happen whilst retaining SDT for manufacturing as a country’s development advances or as the need for diversification of agriculture away from illicit crops decreases<sup>33</sup>). Finally, the proxies chosen should not make it possible for countries to avoid graduation based on more or less arbitrary indicators. Like any classification, the criteria and differentiation will necessarily be imperfect. But that is not a reason to retreat from attempts to develop such classification.

- Which form should SDT take? Should developing countries be subject to laxer rules or should SDT be expressed through stricter rules on impacts of developed countries’ subsidies on poorer countries? Should SDT be expressed mainly through substantively different rules or should there be a reversal of burden of proof for developed vs. developing countries when asses-

ing the legitimacy of a subsidy? If a necessity test of subsidies were applied, it might need to take into account the different administrative capacities of countries.

## II C 3 HOW CAN THIS PRINCIPLE BE IMPROVED IN SUBSIDY DISCIPLINES?

### II C 3 A EXISTING APPLICATIONS OF THIS PRINCIPLE IN GATT/WTO PRACTICE

The principle of SDT is generally accepted in international law and applied in different manners across international agreements. With regard to current subsidy disciplines, the principle is already accepted in the ASCM and the AoA through a variety of provisions: According to ASCM Art. 27.1 “Members recognize that subsidies may play an important role in economic development programmes of developing country Members.” This article goes on to list various exemptions, transitional periods and reversals of presumptions for the benefit of developing countries.

The AoA also contains various provisions giving greater margin of manoeuvre to developing countries for using agricultural subsidies, for instance on export subsidies (article 9) and the de minimis threshold for domestic support commitments (article 6).

The “hardest” SDT provision on subsidies is perhaps the exemption from the ASCM ban on export subsidies. Graduation from this exemption is already well-defined according to two criteria: Countries are graduated when they no longer qualify as LDCs or when their GDP/capita surpasses a certain level. Alternatively, graduation takes place for specific products when a country’s exports of a product reaches a certain share of world trade.

Should SDT be applied based on countries’ relative levels of development?

Graduation should ideally be linked to specific needs or objectives

<sup>33</sup> For more detailed suggestions see Manuel Tortora, Special and differential treatment and development issues in the multilateral trade negotiations. The skeleton in the closet, 2003. UNCTAD document reference WEB/CDP/BKGD/16.



The dual principles of SDT and graduation are already accepted and co-exist in the WTO when SDT gives developing countries tangible rights.

If the developing countries were to change their approach to graduation, that would probably require a change in the politically most sensitive areas of multilateral trade negotiations.

This illustrates that the dual principles of SDT and graduation are already accepted and co-exist in the WTO when SDT gives developing countries tangible rights. As mentioned in II.B, the AoA subsidy rules also contain SDT rules not only based on levels of development, but also in terms of specific challenges faced by developing countries: Under AoA article 6, domestic support in developing countries to promote diversification from growing illicit narcotic crops is exempted from the AoA disciplines.

II C 3 B HOW TO GATHER POLITICAL ACCEPTANCE FOR THE IMPROVEMENT OF HOW THE SDT PRINCIPLE IS APPLIED?

When it comes to differentiation and graduation, there is resistance both among developed and developing countries.

SDT in the WTO tends to focus on time-bound concessions, such as longer implementation periods for developing countries, regardless of actual development. One of the stronger motivations for that is rooted in the almost exclusive bias towards facilitating trade as the over-arching goal. Even though the neo-liberal “Washington consensus” has been abandoned by the World Bank, the IMF and the vast majority of academics, there remains a fairly dogmatic assumption amongst those who deal hands-on with trade negotiations that liberalised trade nearly always underpins development. Another motivation is the traditional mercantilist approach taken by trade diplomats – both in the North and in the South – with little regard to anything else than access to foreign markets. On the other hand, developing countries have for a long time shown a strong resistance to any further differentiation amongst themselves. They fear that it might divide them, diluting the bargaining power they have, as a group, built up in the course of recent years of negotiations. Some of the relatively well-off and faster growing developing countries clearly resist out of self-interest.

If the developing countries were to change their approach to graduation, that would probably require a change in the politically most sensitive areas of multilateral trade negotiations, in particular agriculture. If the WTO groupings G20 and G77 obtained what they had expected the Doha round to deliver (namely a significantly increased market access for agricultural products in the large Northern markets), they might open up for discussing differentiation and graduation.

II C 3 C EXISTING OPPORTUNITIES

The launch of the “Doha Development Round” testified to an acknowledgement by the trade community of the importance of the development challenge. SDT has indeed featured centrally in the Doha round, and one of the few decisions made at the December 2005 Hong Kong Ministerial Conference was to grant additional concessions to LDCs.<sup>34</sup> When it comes to subsidy negotiations, the need for SDT received substantial and concrete attention in the negotiations on fishing subsidies, and has been identified as a core issue in AoA negotiations on “green box” reform. At least according to the rhetoric widely employed within the Doha talks, the need for “pro-development” rules has been amongst the most consensual points in the negotiations. Generally, there has been an increase in the quantity of SDT provisions applied in the WTO.

At the same time, the quality of SDT has not improved much: Most SDT provisions remain hortatory, not binding. Conversely, there has been no progress on graduation. With this in mind, it is hardly surprising that the “Doha Development Round” was suspended. It indicates also an inability of negotiators within the current WTO framework to deal with one of the most important global challenges, namely economic underdevelopment. There might therefore be a willingness to discuss, amongst other things, international subsidy rules through other lenses than their impact on trade.

<sup>34</sup> WT/MIN(05)/DEC, 18 December 2005 ([www.wto.org/english/thewto\\_e/minist\\_e/min05\\_e/final\\_text\\_e.htm#sd\\_treat](http://www.wto.org/english/thewto_e/minist_e/min05_e/final_text_e.htm#sd_treat) – accessed 9 October 2006)



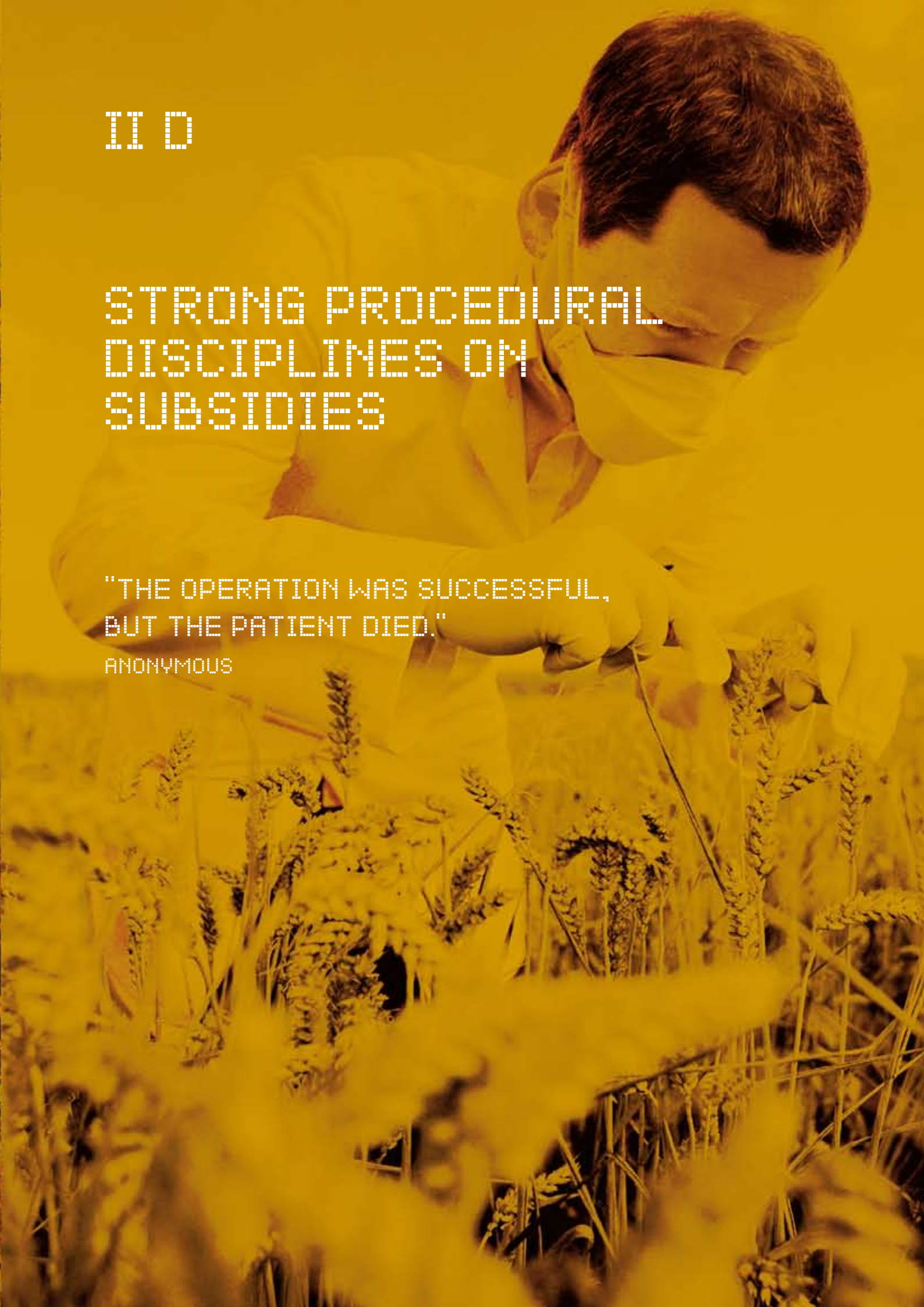


II D

## STRONG PROCEDURAL DISCIPLINES ON SUBSIDIES

"THE OPERATION WAS SUCCESSFUL,  
BUT THE PATIENT DIED."

ANONYMOUS





Because of the need for case-by-case balancing of harms and benefits, both according to conflicting objectives (cf. II.B) and different domestic situations (cf. II.C), participants at the São Paulo roundtable concurred that procedural rules for subsidies are essential. This section discusses what such procedural rules might look like (II.D.1 and II.D.2), precedents in GATT/WTO law and the prospects for more comprehensive rules (II.D.3).

## II D 1 THE PRINCIPLE: THE DEVIL IS IN THE DETAILS

Well-intended subsidies too often turn into perverse subsidies a few years down the road.

Well-intended subsidies too often turn into perverse subsidies a few years down the road. It is often forgotten that the externalities or market failures that subsidies respond to are continuously changing with innovation, political preferences, human capital etc. Furthermore, subsidies may have very different effects in slightly different contexts, depending on competition in the market, regulation, technology, consumer preferences and so forth.

Strong procedural disciplines are thus needed for all subsidies that cause harm of international concern. These should include:

1. **Transparency:** Too often, it is far from clear what is being paid to whom and based on what criteria. International disciplines requiring notification of this would not only make it easier to avoid harm of international concern; it would also be a tool for domestic constituencies that are negatively affected by a subsidy.
2. **Evaluation:** What are the overall impacts of a subsidy – in particular, is the aim of the subsidy achieved to a degree that justifies its use? Does it

target the underlying cause of the specific externality or market failure (rather than a particular technology)? How does it address equity? What alternative measures have been considered and why have they been dismissed? This amounts to a necessity test.

3. **Periodic review:** If a subsidy causes international harm that is outweighed by other, greater benefits, a “waiver” should in all cases be time-bound.

Even though a subsidy may be introduced to address a market failure and meet a certain human need, say for shelter or nutrition, governments have a tendency not to subsidise this need, but instead certain things that can meet this need – such as the construction of high-rise apartment buildings or domestic agricultural production. Due to politically powerful producer interests (e.g. construction companies or the agro-business industry), these things are misconstrued as merit goods – goods that would be under-consumed if the market were left to its own devices. This happens notably because of the political economy inherent to subsidies. Recipients usually have better information about their subsidies than do governments, enabling them to exaggerate the need for subsidies. Subsidies can create excess profits, which in turn can be used to reward politicians, creating a closed circle. To avoid such capture of well-intended subsidy schemes, Ronald Steenblik, research director of the Global Subsidies Initiative<sup>35</sup> advocates the following features for any subsidy:

1. The period during which a subsidy is offered is no longer than the duration of the problem. These time limits should be credible.
2. It addresses the underlying cause of the externality or market failure.
3. It is linked directly to the specific externality or market failure – not to any particular technology or production method.

<sup>35</sup> www.globalsubsidies.org

4. It is not trying to correct damage caused by another subsidy.
5. It is the least economically distorting policy among alternatives.
6. It includes, if necessary, flanking measures to address equity impacts.

Even though it might be preferable if all the above conditions were respected, it does not follow that each of them should be pursued at any cost. For instance, WWF would argue that there might be trade-offs between the minimisation of economic distortions (cf. item 5 above) and the maximisation of equity of a given measure (cf. item 6). It is important that all the likely impacts of a subsidy are considered and that their prioritisation is made through transparent political deliberations.

## II D 2 QUESTIONS THAT ARISE

- **Should there be a presumption of non-compliance in the absence of providing the information above?**  
A dispute settlement body could draw “adverse inferences” from incomplete information on a given subsidy. It is more difficult, however, to imagine sanctions for “hidden” subsidies that no one is aware of in the absence of notification. Domestic law can be helpful to increase their visibility: In Germany, the Ministry of Finance publishes an annual subsidy report, which includes all forms of federal support through both direct expenditure and tax expenditures.<sup>36</sup>
- **How to make notification requirements feasible for developing countries? I.e. how to apply SDT to development levels and administrative capacity of countries?**  
Many international agreements acknowledge developing countries’ limited reporting capacity: LDC

WTO Members may be granted longer time periods between their Trade Policy Reviews than the ordinary six years for minor trading countries. Under the UNFCCC, Annex II (developing) countries are not required to submit full greenhouse gas inventories, and even submission of the less comprehensive “national communications” on steps taken is subject to availability of financial resources. Considering that these notifications would be of great use, not in the least domestically, technical assistance for fulfilling these disciplines might be more desirable than full-fledged derogations for developing countries.

- **Above what threshold of impacts should subsidy notifications be required?**  
Notifications should clearly be required where impacts of international concern could trigger sanctions. In many cases, affected countries will be able to identify these subsidies themselves. However, in many other cases, it will be unclear what harm is due to a specific subsidy. Moreover, there might also be subsidies causing harm solely inside borders that still are of international concern. In such cases, which are likely to become more frequent with time, the international community needs to reflect on how to establish clear criteria for when the procedural subsidy disciplines kick in.

Strong procedural disciplines are thus needed for all subsidies that cause harm of international concern.

<sup>36</sup> Bundesministerium der Finanzen (BMF) der Bundesrepublik Deutschland, Bericht der Bundesregierung über die Entwicklung der Finanzhilfen des Bundes und der Steuervergünstigungen für die Jahre 2003-2006, Bundesministerium der Finanzen (BMF) der Bundesrepublik Deutschland, Berlin, 2006

(www.bundesregierung.de/nn\_774/Content/DE/PeriodischerBericht/Berichte-der-Bundesregierung/2006/03/2006-03-15-zwanzigster-subventionsbericht.html – accessed 9 October 2006)

This principle ought to be attractive to negotiators of subsidy disciplines as it can help them counter the arguments of vocal interest groups, notably in the field of agriculture.

In many countries, international negotiations on procedural disciplines would be facilitated by domestic pressure for increased transparency.

II D 3

HOW CAN THIS PRINCIPLE BE APPLIED BETTER IN SUBSIDY DISCIPLINES?

II D 3 A EXISTING APPLICATIONS OF THIS PRINCIPLE IN GATT/WTO PRACTICE

Compulsory reporting or notification is a common feature in international agreements including current WTO subsidy disciplines, where ASCM art. 25 instructs Members to regularly notify their subsidies. Compliance with this obligation, however, is deficient. There may be different reasons for this, but for many developing countries, lack of administrative capacity is an important explanation. In international agreements, there is therefore often a provision that technical assistance is required to help developing countries fulfill their reporting obligations (see e.g. UNFCCC art. 4).

II D 3 B HOW TO GATHER POLITICAL ACCEPTANCE FOR THE IMPROVEMENT OF THE APPLICATION OF THIS PRINCIPLE?

Procedural disciplines will be politically controversial primarily at the domestic level, as it will make the real impacts of subsidies within a country (which, in general, are the most prominent) clearer. Conversely, this principle ought to be attractive to negotiators of subsidy disciplines as it can help them counter the arguments of vocal interest groups, notably in the field of agriculture.

II D 3 C EXISTING OPPORTUNITIES

A standardised notification format for subsidies is clearly a necessary starting point for any procedural disciplines. The Global Subsidies Initiative, involving a broad range of subsidy experts, is working on a proposal, which is expected by the end of 2006 (see [www.globalsubsidies.org](http://www.globalsubsidies.org) for updates).

In many countries, international negotiations on procedural disciplines would be facilitated by domestic pressure for increased transparency. As noted above, this pressure has rapidly been building up in the EU, with several EU Member States publishing who receives what from the CAP (e.g. Denmark, the Netherlands, Sweden and the UK<sup>37</sup> ) and the European Commission’s proposal to make such transparency compulsory for all EU funds.<sup>38</sup>

The European Commission proposed at the beginning of the Doha round, in 2002, “to explore the possibility of penalising partial or non-notifications. A mechanism would have to be devised through which the quality and scope of notifications could be scrutinised and if failings were found or suspected a review procedure could be generated through an expedited WTO dispute settlement procedure similar to the one envisaged for spurious initiations or by referring the matter to an empowered Permanent Group of Experts.”<sup>39</sup> Unfortunately, this has not been the topic of further discussions.

III

CONCLUSION:  
GOING BEYOND  
THE WTO AGENDA  
ON SUBSIDIES

<sup>37</sup> An overview is available on [www.farmssubsidy.org](http://www.farmssubsidy.org). Accessed 9 October 2006.

<sup>38</sup> European Commission, Green Paper on European Transparency Initiative, COM(2006)0194 final, 3 May 2006 ([ec.europa.eu/commission\\_barroso/kallas/transparency\\_en.htm](http://ec.europa.eu/commission_barroso/kallas/transparency_en.htm) – accessed 9 October 2006)+

<sup>39</sup> European Commission, EC submission in DDA negotiations: Agreement on Subsidies and Countervailing Measures, Ref. 492/02 – Rev3, Brussels, 19 November 2002 ([trade.ec.europa.eu/doclib/docs/2004/july/tradoc\\_112234.pdf](http://trade.ec.europa.eu/doclib/docs/2004/july/tradoc_112234.pdf) – accessed 9 October 2006)

International disciplines will never ensure that subsidies are used in an optimal way. Of course, it would be administratively unworkable if international organisations were to map out, evaluate and judge subsidies in such a fine-grained manner as to prescribe the “right” disciplines on subsidies to a country, under any set of circumstances. More importantly, decisions on subsidies ultimately contain a degree of arbitrariness in the sense that they involve political interference in markets. Only States have the legitimacy to make such arbitrations for their own countries. Participants at the São Paulo roundtable seemed to agree that international disciplines ought instead to focus on serious harm of concern to the international community. Because of their massive impacts on people and nature across the globe, stronger and more coherent international disciplines than those we already have – or even those that have been discussed – are needed.

In negotiating the GATT sixty years ago, negotiators quite properly focussed on development challenges. Today, these challenges are still of utmost importance, but awareness about a series of other

problems has also grown – from climate change to HIV/AIDS. Much as GATT rules were shaped in response to post-World War II development challenges, we should now pursue opportunities for shaping WTO rules to support the approaches that the international community is taking to meet these other challenges.

This report has discussed some suggested principles upon which such disciplines could be based. Operationalising these principles will require far greater co-operation among international bodies such as key MEAs and the WTO. This is not subsidy-specific: Such co-operation will increasingly be required to deal with global challenges also on other fronts. This view is reflected, for instance, in recent negotiations on the relationship of the TRIPS Agreement with the CBD, and in proposals under the WTO Doha declaration paragraph 31(iii) on liberalisation of trade in environmental goods and services based on assessments by MEAs.<sup>40</sup> Also, an arrangement between e.g., on the one hand, a future protocol under the UNFCCC obliging parties to eliminate certain subsidies and, on the other hand, the WTO accepting the use of its dispute settlement and suspension of WTO concessions for

<sup>40</sup> See for instance the Colombian proposal JOB(06)/149 of 19 May 2006, discussed in BRIDGES, Developing countries present views on environmental goods, 16 June 2006 ([www.ictsd.org/biores/06-06-16/story1.htm](http://www.ictsd.org/biores/06-06-16/story1.htm) – accessed on 9 October 2006)

breaches of these obligations, will most likely be just one part of a broader arrangement between UNFCCC instruments and the WTO (e.g. with regard to border-tax adjustments).

To break the stalemate of current negotiations on subsidy disciplines, one needs to tackle the considerable political economy challenges inherent to subsidy reform.<sup>41</sup> Increased transparency and improved reporting, as discussed above, will be crucial in this respect. Such changes could presumably enable a broader representation of views in the public debate – between both winners and losers, in both the subsidising country and elsewhere. Representation of differing views within a country also in a formal international process of assessing the impacts of subsidies would both make this process more dynamic and legitimate. The impacts of subsidies are far more complex than the impression given by current discussions. These are pitting States against States, while the differences of interests more often cut through nations. This points in the direction of more general – and radical – proposals for networked international governance suggested by seasoned observers of international

relations, such as the idea of “Global Issue Networks” of World Bank vice-president for Europe, Jean-Francois Rischard.<sup>42</sup>

As in most matters of international law, the balancing of harms and benefits of subsidies through an international process will require case-by-case arbitrations. The WTO dispute settlement system is an example of how this can work if politicians establish detailed rules that give an independent quasi-court sufficient guidance to rule on claims brought before it through a weighing of harms and benefits. However, WWF believes that international subsidy rules – i.e. WTO rules at present – need to be reformed along the lines outlined in this report in order to ensure that this balancing act deliberately targets global challenges. This will not only require modification of WTO agreements’ substantive provisions, it will also necessitate involvement of a broader range of expertise when assessing harms and benefits of subsidies. Subsidies are meant to correct markets. International rules should help them do just that.

<sup>41</sup> Environmentally Harmful Subsidies: Challenges for Reform, OECD, 2005

<sup>42</sup> Jean-Francois Rischard, High Noon, Basic Books, 2002

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