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ISSUE BRIEF

This issue brief is launched in January 2024 as part of the **Atlantic Council GeoEconomics Center's Bretton Woods 2.0 Fellowship**. This Fellowship aims to cultivate a new generation of economists to help reimagine the shape of the international financial system.

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Navigating Subsidy Reform at the WTO

Toward Improved Trade Governance in a Fragmented Geoeconomic Terrain

JANUARY 2024

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Introduction

The World Trade Organization (WTO), founded in 1948, and regulating trade among its 164 member countries, has been a powerful engine for overall economic expansion, at the forefront of the international rules-based system. It has generated economic gains by promoting freer and fairer trade; increasing competition, efficiencies, and innovation; protecting consumers; and providing a platform for rules enforcement and dispute resolution to enhance stability and predictability in the global trading system. It also has supported the integration of developing countries into the world economy by fostering growth, development, and poverty reduction. Since its founding, the global economy has evolved largely in line with the ideals the WTO prescribed, as exports in 2019 were 250 times the level of 1948, reflecting widespread economic growth and interconnected trade.[i]

However, the WTO has now become almost infamously ineffective at settling disputes and holding countries accountable for unfair trade practices. Global trade has grown increasingly fragmented since the global financial crisis of 2007–2009, the COVID-19 pandemic, and Russia's 2022 invasion of Ukraine, all of which accelerated the trend against free trade and globalization. In all major economies, trade policy is increasingly used as a strategic instrument to address geopolitical competition. While US policymakers fixate on China's unfair trade practices, US export controls against China and the US Inflation Reduction Act are prime examples of trade-distorting policies. Moreover, US hindrance of the appointment of new members to the WTO Appellate Body, which lacks a quorum, has raised questions about its intentions.[ii]

The legitimacy and relevance of the WTO is in question, and it faces many challenges. However, the WTO retains unique characteristics that grant it an important role in international trade policy problem-solving: a set of core principles, a forum for negotiating and monitoring, and membership representing 96.7 percent of global gross domestic product (GDP).[iii] **This report aims to provide recommendations for how the United States and its allies, and leaders in the organization, can better wield its potential to address global issues, specifically to reduce inefficiencies from fragmentation caused by subsidies.** By first outlining and explaining the obstacles preventing an effective WTO, this report will ultimately provide recommendations for how the organization can provide guidance on subsidies for global public goods by facilitating discussions within multilateral trade agreements. It also provides suggestions for how the WTO can work with other Bretton Woods institutions to ensure that less-developed countries (LDCs) gain access to green financing, technology, and resources.

Section 1: The WTO, the Doha Round, and the Pursuit of Free Trade

A Legacy of Unfinished Business

The Doha Round holds substantial significance in the realm of international trade negotiations and the global economic landscape, perhaps not for what it accomplished, but for the discordance it revealed. Initiated in 2001, the Doha Development Agenda was launched under the World Trade Organization with a strong emphasis on development and the needs and concerns of developing countries. The agenda pursued greater flexibility for developing countries' compliance with trade agreements and sought to promote global trade liberalization by reducing trade barriers and tariffs and facilitating multilateral negotiations. Despite best efforts, the Doha Round encountered substantial challenges and ultimately failed to produce a comprehensive agreement. The negotiations were marred by disagreements on key issues, including agricultural subsidies, market access for industrial goods, and services trade. This impasse highlighted the difficulties in reconciling diverse national interests and led to a perception of stalled progress—leaving behind a legacy of discussions, commitments, and areas of partial agreement.

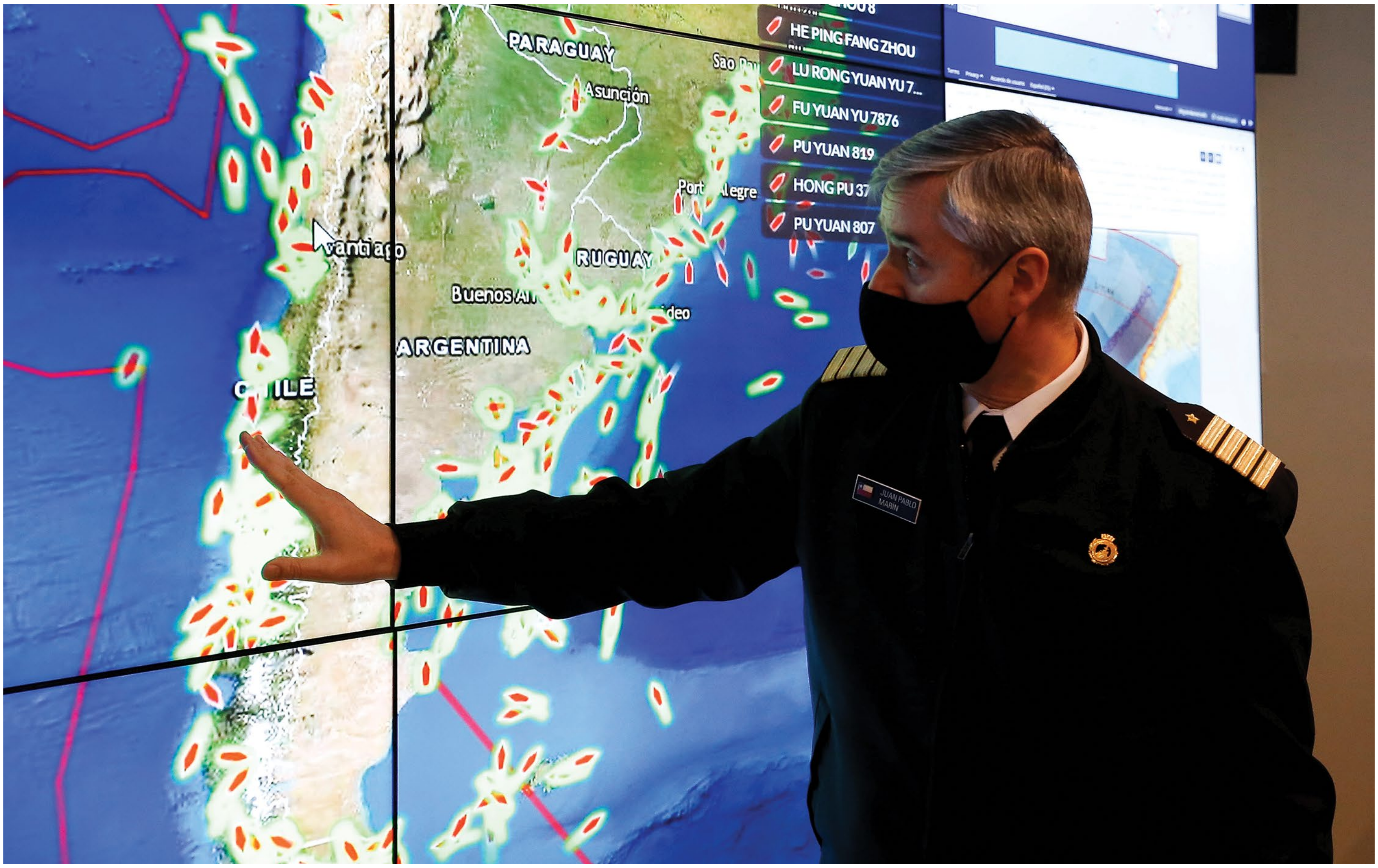
The Doha Round's inability to reach a conclusive agreement prompted many countries to pivot toward bilateral and plurilateral trade agreements.[iv] These alternative agreements, like the Trans-Pacific Partnership (TPP), Transatlantic Trade and Investment Partnership (TTIP) and the Regional Comprehensive Economic Partnership (RCEP), gained prominence as countries sought to advance their trade agendas outside of the multilateral framework and in the absence of formal WTO engagement.

Since June 2016, all members of the WTO have officially participated in some kind of regional trade agreement.[v] Some argue that this compromise may inadvertently lead to trade barriers and a fragmented trade landscape. International Monetary Fund Executive Director Kristalina Georgieva has highlighted the impacts of trade fragmentation, and the IMF has estimated that the long-term cost in terms of global output could range between 0.2 percent and 7 percent, depending on the severity.[vi] A global trading system that is increasingly divided into blocs will likely improve trade openness *within* blocs; but without multilateral agreements, the division will increase barriers *between* them.[vii] As long as regional trade blocs are organized around hegemons, like the United States, the European Union, and China, each with differing economic standards and practices, the regional agreements they create will tend toward incompatibility.

When we look at regional flashpoints involving trade, like Brexit, the WTO's role has been notably minimal, aside from occasional references to the potential outcome of "crashing out" in the early stages of negotiations. This isn't to say that the WTO needs to be the locus of all trade discussions—far from it—but the WTO's role is to serve as a trade body safety net and a domain of last resort. In other areas, the WTO's attempts to be that safety net have faltered or not played a pivotal role. During the pandemic, for example, the WTO was minimally involved in addressing breaches to export restrictions related to vaccines. This was exemplified in disputes between the United Kingdom and the EU, as competing claims on the prohibition of vaccine imports caused heightened geopolitical tension.[viii]

Yet some issues that were part of the Doha negotiations, such as intellectual property rights and trade facilitation, were later addressed through separate agreements within the WTO.[ix] While many have proclaimed the Doha Round as stalled, the WTO continues to engage in discussions within its thematic categories and has not officially concluded it, though eight ministerial conferences have been held.

An example of a critical trade issue that has gone through rough patches outside of the Doha context is the protracted struggle to reach agreement on a range of subsidies. In particular, this includes issues such as fishing subsidies, observed in the initial stages of the Twelfth Ministerial Conference in 2022. However, it's noteworthy that an ac-



Chile's Commander Juan Pablo Marin, Chief of Security and Maritime Operations, shows the areas where the Chilean government is keeping tabs on a large fleet of Chinese fishing vessels fishing along the Pacific Coast of South America, in Valparaiso, Chile October 8, 2020. REUTERS/ Rodrigo Garrido

cord was eventually reached at the close of that year.[x] The realm of trade policy and the pursuit of "freer trade" as it stands looks like a landscape where the Doha Round's status remains in flux—and where policy issues may stay on ice. Despite such challenges, the WTO may still represent the best hope for easing trade tensions between competing states, and the sticky issues from the Doha Round remain worthy of our attention.

Free Trade: A Casualty of Geopolitical Tensions

Trade has now become a battleground beyond borders. As countries increasingly adopt friend-shoring policies and utilize nontariff measures such as quotas or embargoes, the pervasive discourse holds that the era of free trade is over.

In a hyperglobalized economy, the idea of "free trade" has been a constituent part of the international rules-based order and represents a belief in many quarters which transcends even economic beliefs and discourse—reaching the level of identity, nationhood, and constitutional status. In recent decades, many parts of the global economy sought to slowly unpick areas of unfair advantage and break down trade barriers. It seemed that governments were stowing their checkbooks and stepping back to allow markets to determine economic outcomes on their own, with trade in goods and services being pushed in the direction of a more level playing field.

The great financial crisis created a backlash against globalization, with undercurrents of nationalism and populism burgeoning, and governments tended to increase barriers to free trade and movement.[xi] The COVID-19 pandemic has since posed unprecedented challenges to the world trade system, causing a sharp decline in trade volumes and disrupting global supply chains.[xii] An impartial spectator might have looked at this period in history and thought the pandemic would result in a rekindling of the principles of free movement of goods and services, and a recommitment to a leveling of the playing field. Yet the opposite seems to be true. Russia's February 2022 invasion of Ukraine further fragmented the global trade order as Western governments slapped unprecedented rounds of sanctions on the Russian Federation, followed by the suspension of the most favored nation (MFN) treatment of Russia in March 2022,[xiii] accompanied by massive exits of Western businesses from the country.

Trade policy has often been the tool of choice in responding to other geopolitical realities, even before the invasion. For example, the Trump administration imposed a 25 percent tariff on $50 billion of Chinese exports in 2018 with the goal of forcing Beijing to make changes to what the United States says are long-standing unfair trade practices and intellectual property theft.[xiv] The WTO later ruled that these tariffs were not justified.[xv]

Fast-forward to our present day: the US Inflation Reduction Act (colloquially referred to as IRA) recently celebrated its legislative first birthday. IRA consists of industrial policies, green subsidies, and made-in-America provisions. It constitutes perhaps one of the most dramatic examples of this reorientation away from free-trade rules, buttressed by "security-first" political discourse. Some of the language deployed around this illustrates the muddying waters: US Secretary of the Treasury Janet Yellen, in a talk on US-China relations, highlighted consideration of a program to "restrict certain US outbound investments in specific sensitive technologies with significant national security implications." She further clarified that those actions are "not designed for [the United States] to gain a competitive economic advantage or to stifle China's economic and technological modernization [but are] driven by straightforward national security considerations."[xvi] This kind of sentiment is now closer to the norm than the exception.

These events, past and present, paint the global economy as drifting silently into a world where domestic and national security interests dominate. These interests and shared values seem to take precedence over the old consensus on leveling the economic playing field, efficiency gains due to global integration, and the WTO's core mission of pursuing freer trade. Centering national interest in international economic relations is not an entirely new model, however. It resembles the post-1945 Bretton Woods regime, when governments maintained substantial autonomy in managing their industrial, regulatory, and financial affairs, many placing emphasis on safeguarding their domestic interests, and maintaining various forms of interventions such as subsidies, state ownership, currency management, and capital controls rather than pursuing extensive global integration.[xvii] As such, this may represent more of a retrenchment than a paradigmatic shift. Against this backdrop, our attention turns back toward the WTO, the variables and trends it is battling, and what can be done to reform it for the betterment of all.

Section 2: The Increasing Global Trend of Subsidization and the WTO

The WTO defines subsidies broadly as financial contributions provided by governments or public entities that confer a benefit to specific industries or enterprises. These benefits can take various forms, such as grants, loans, equity infusions, tax breaks, or the provision of goods and services.

The Rise of Subsidization Globally

The global rise of state subsidization is statistically evident (see Fig.1), **and is acknowledged and often denounced by institutions such as the WTO.** For example, the IMF notes:

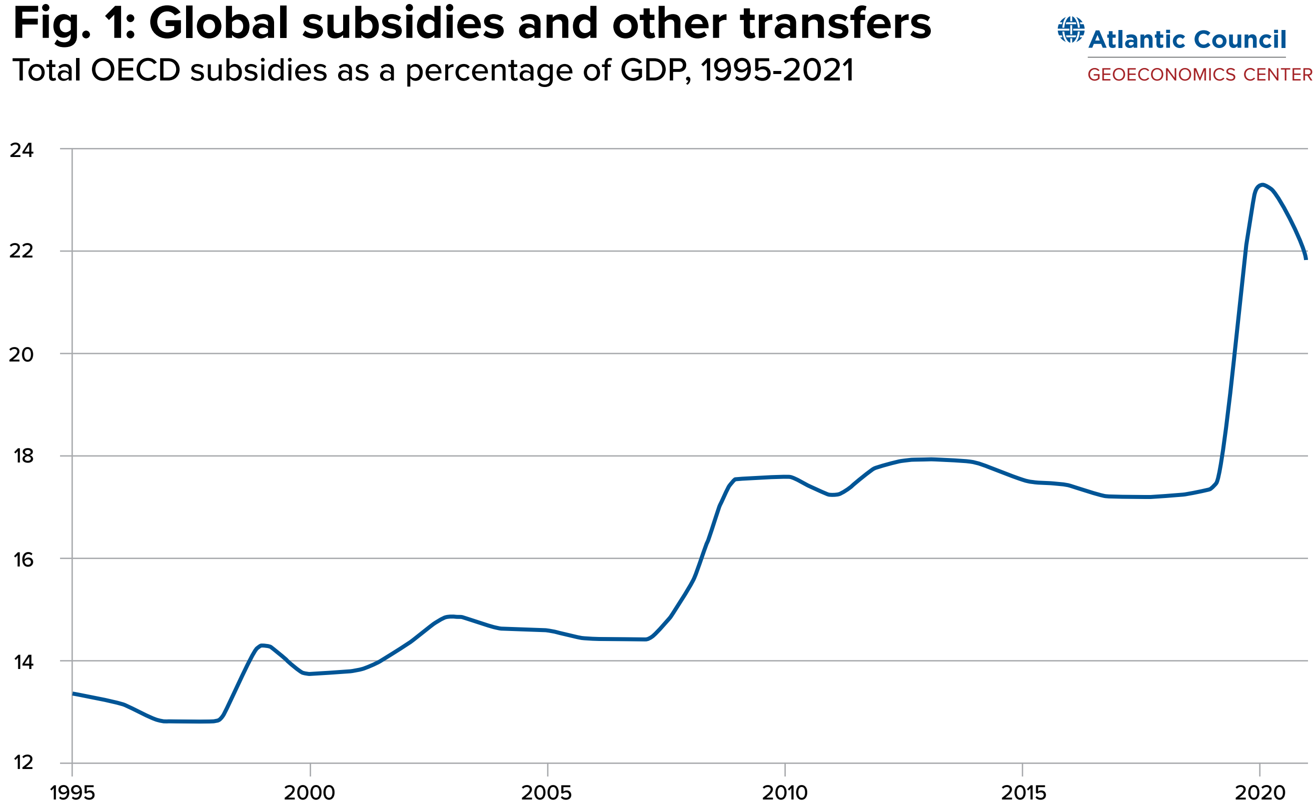
> A ramping up of subsidies by some of the world's largest economies has contributed to a significant increase in global trade tensions. New subsidies, countervailing duties, and legislation such as the US Inflation Reduction Act, the EU Green Deal Industrial Plan, and the Made in China 2025 strategy have raised concerns about the potential for subsidy wars—subsidy competition that leads to a race to the bottom.[xviii]

At large, subsidies take up a substantial portion of the government and economy. Among Organisation for Economic Co-operation and Development (OECD) countries in 2020, the median of subsidies and other transfers such as social benefits and nonrepayable transfers to private and public enterprises was 56.3 percent of total government expenses, which was 34.9 percent (weighted average) of GDP in the same year.[xix] Yet the number of subsidy measures in force has been rapidly increasing since 2008.[xx] Given the trend of rising subsidization, problems with mapping subsidies worldwide and the current WTO rules are outlined in this section.

Taking a sectoral lens, we can observe that large subsidization is prevalent in critical sectors worldwide, including

Fig. 1: Global subsidies and other transfers

Total OECD subsidies as a percentage of GDP, 1995-2021



Source: Word Bank data on subsidies and nominal GDP; Atlantic Council calculations.
Note: Subsidies, grants, and other social benefits include all unrequited, nonrepayable transfers on current account to private and public enterprises; grants to foreign governments, international organizations, and other government units; and social security, social assistance benefits, and employer social benefits in cash and in kind.

fishing, agriculture, and energy.[xxi] Beyond the core datasets, including sectoral datasets on subsidies and those on high-level expense reports, there is evidence of subsidization and noncompetitive trade policy in other datasets, too. In a comprehensive 2023 Trade Policy Factbook (prepared ahead of the Group of Twenty Bali summit), Global Trade Alert's team showed several figures that reinforce the general trend—with a focus on the world's most developed states. When looking at the total number of policy interventions by G20 members that impaired the competitive position of firms located abroad, they were able to show that harmful interventions outnumber liberalizing interventions on a scale of three to one.[xxii]

However, as noted by the OECD in 2022, transparent, accurate, and up-to-date reporting on subsidies is woefully inadequate worldwide.[xxiii] Although it is evident that the utilization of subsidies has been on the rise, our comprehensive grasp of their scale and significance remains uneven and incomplete due to governments' opacity concerning their assistance to businesses.

The Problem with Subsidies

For decades now the public discourse among countries, national governments, political actors, and international institutions has held (rightly or wrongly) that their lodestar was trade liberalization. Indeed, belief in this kind of liberalization is neither just a technocratic nor trade-only issue, but has often spilled over into the social and identity politics of nation-states who self-describe as champions of free trade. Whether these actors view the existing WTO rules as not stringent enough to avoid subsidy wars or trade conflicts, or argue that the rules are inflexible and limit governments' abilities to address pressing domestic policy issues, they may be right. **This is why one of the WTO's critical roles may be to help its members draw a line between protectionist measures and sensible industrial policies,**[xxiv]

Active pumpjacks from oil wells are pictured at the Inglewood Oil Field, the largest urban oil field in the United States, from the Baldwin Hills Scenic Overlook in Culver City, California, U.S., March 10, 2022. Picture taken March 10, 2022. REUTERS/Bing Guan

and thereby foster a more balanced and equitable global trading system.

Subsidies are a source of concern because of their potentially negative effects on both domestic and international markets. *Domestically,* they may create a gap between prices and production costs and distortion in relative prices between different goods and services. This leads to inefficient allocation of resources, corruption, reduced innovation, and increased rent-seeking, while simultaneously encouraging practices that harm the environment and public health.[xxv] *Internationally,* subsidies tend to distort trade and investment decisions in foreign markets, especially when they favor domestic producers or products over foreign ones, leading to side effects such as supply chain disruptions, relocation of production, and consumer bias.[xxvi] Furthermore, subsidies can erode the benefits of previous trade agreements that lowered tariffs and increased market access,[xxvii] creating a sense of unfairness and weakened public support for trade. Crucially, subsidies can provoke trade disputes and retaliation from trading partners who feel disadvantaged by subsidized imports or exports, leading to a spiral of countermeasures and escalating tensions.[xxviii]

As such, widespread subsidization contradicts the WTO mission and principles in a number of ways: distorting trade, conferring unfair advantages upon certain producers, and undermining the fundamental principle of non-discrimination. Crowding out innovation and productivity growth works against the WTO aim to improve living standards, while increased disputes buttressed by subsidization work opposite to the trust- and cooperation-building goals at the organization's heart.

This is why the use of subsidies for trade in goods has been underpinned by the WTO Agreement on Subsidies and

Countervailing Measures (the SCM), which spells out conditions under which *governments are allowed to* "support their industries for legitimate policy objectives," notably, under the least-developed countries (LDCs) self-designation, to promote low-income nations' economic development; *and outright prohibits some subsidies*, such as those that are contingent upon export performance or requiring local content.[xxix] *The third category is not prohibited but can be challenged*, should a WTO member believe it has been injured by another member's subsidy. This injury to the domestic market can take various forms, such as lost sales, price depression, or a decline in market share, and a member can initiate a dispute settlement process and seek remedies to offset the adverse effects.[xxx]

Members also are required to notify the WTO of their subsidy programs to enhance transparency, monitoring, and compliance with the rules and address potential disputes via the embedded consultations and dispute settlement arm. In reality, many members frequently ignore the notification requirement. As of October 27, 2023, 101 members had not made their 2023 notifications, which were due by June 30, 2023; eighty-five members have yet to make their 2021 notifications, which were due more than two years ago; and seventy-three members still have not submitted their 2019 notifications, now overdue by more than four years.[xxxi]

Moreover, some forms of state intervention under SCM, notably, those to and provided by state-owned enterprises (SOEs), do not count as "subsidies" under the current WTO definition, providing favorable treatment (e.g., in terms of financing for land or equipment) to exporting SOEs. Some concerned members have built additional measures into recent trade agreements (e.g., the Comprehensive and Progressive Agreement for Trans-Pacific Partnership) to limit the resulting market distortions. Finally, the quality of data and analysis on the use of subsidies is frequently cited as inadequate.

As WTO members discern the surge in subsidies, subsidy disputes, and countervailing duty investigations, they harbor different views on how to reform the WTO rules on subsidies. Some leaders of advanced economies want to update the SCM agreement to capture more subsidy practices that they think cause overcapacity, distort competition, and harm other countries—advocating a stepping up of disciplines, including sanctions on failed notification. Other leaders in developing economies wish to broaden the list of subsidies that would be exempt from challenge.

Section 3 offers priorities for action and reform.

Section 3: Priorities for Action

Trade is now held hostage by geopolitical disputes being fought by proxy. Given the diminishing backing for trade liberalization, it is imperative for the WTO to undergo a transformation and rethink its purpose and goals to align with the changing global economic landscape. Specifically, we believe it is crucial to concentrate on subsidies because they underlie many of these geopolitical tensions and are central to the WTO's mission of promoting free trade. In light of this, we suggest directing future reform efforts toward the following key areas:

1. Building a framework on subsidies

As noted by Clete Willems in 2020, forging like-minded alliances—such as improving cooperation and coordination between the United States and the EU—may be a necessary start in forging meaningful WTO reform, in any reform area.[xxxii] As one of the world's most outward-oriented economic areas, moreover, the EU has an important scrutiny role to play on international trade policy and modernizing WTO rules in the milieu of new global challenges. Moreover, over three-fifths of the global goods trade competes with at least one subsidized US, EU, or Chinese firm. If US-China cooperation on subsidies is unlikely in the near future, US-EU cooperation might be the most realistic step toward making significant progress on a global scale.[xxxiii] Especially against the backdrop of a multipolar geopolitical order, propped up by Russia's 2022 invasion of Ukraine, the reform efforts pertaining to subsidies might be spearheaded by a like-minded US-EU partnership around shared interests. If China is to be left out of the coordination process, and maintain its subsidies, the US and EU will realistically only make progress to remove subsidies on goods for which there is limited Chinese competition.

The US-EU Trade and Technology Council (TTC) may be the place to start, as it established a mechanism to prevent subsidy races in May 2023.[xxxiv] If, and how, this will work in practice has yet to be seen. Progress within the TTC has been slow, and US-EU trade disputes, for example on steel and aluminium, have polluted TTC discussion. Furthermore, the United States and the EU have distinct approaches to the WTO, as Brussels maintains some faith in the system, and Washington slightly less so. A transatlantic effort toward building a framework on subsidies would be an onerous but necessary undertaking. A successful transatlantic collaboration on developing a subsidies framework would ideally catalyze and encourage a broader global effort. The ultimate goal would be to develop a truly global

U.S. Secretary of State Antony Blinken, U.S. Secretary of Commerce Gina Raimondo, European Commission Executive Vice-President Margrethe Vestager and European Commission Executive Vice-President Valdis Dombrovskis participate in a US - EU Stakeholder Dialogue during the Trade and Technology Council (TTC) Ministerial Meeting at the University of Maryland in College Park, Maryland, U.S., December 5, 2022. Saul Loeb/ Pool via REUTERS

framework around subsidies that would address concerns among LDCs.

2. Improving the delineation, distinction, and categorization between "good" and "bad" subsidies

Recognizing that some subsidies are appropriate, insofar as they can address market failures or promote competition in a concentrated industry, is important, and it should be easy to distinguish them from harmful subsidies. The WTO should focus on helping its members draw a sensible line between protectionist measures and sensible industrial policies.[xxxv] Some existing provisions under the WTO offer time-tested principles that could underlie the revisions. In line with the Agreement on Agriculture (AoA), SCM could be reformed to limit the amount of financial support for trade-distorting subsidies, while industrial subsidies geared toward social ends and global public goods could remain unregulated.[xxxvi] The OECD is well positioned to help with measurement and calculations, and developed nations may be entitled to lower caps than developing regions.

3. Incentivizing increased transparency, monitoring, and notification

Encouraging members to disclose their subsidies and enforcing penalties for those that consistently fail to make timely notifications of their subsidies may be an important means to prevent disputes. Strengthening penalties for notification noncompliance may additionally disincentivize late subsidy notifications. To this end, proposals have focused on barring of a delinquent member to preside over WTO bodies and access WTO information resources; and requiring specific reporting at the General Council or applying the designation of an "inactive member," as proposed by the US delegation in October 2017.[xxxvii] In particular, choosing to focus on penalties for any non-LDC member that consistently fails to follow transparency requirements may be a sensible starting point in promoting transparency. Further research may be needed to explore to what degree such punitive measures are successful in incentivizing timely notifications.

4. Intensified support in less developed regions

Low-income countries with limited public resources and capacity constraints may find it hard to navigate the existing framework, not to mention changes ensuing from any potential reform this paper might propose. To this effect, the WTO Secretariat should continue improving its ability to grant day-to-day provision of technical assistance to developing regions, designed to enhance understanding and streamline the notification process, bringing together officials from developing and LDC members to share experiences and expertise. To this end, recent experience corroborates the value of tailored approaches in aiding members' compliance with transparency obligations.[xxxviii] The WTO also could step up targeted capacity programs where it notes the willingness of members to improve compliance over time.

5. Funds for North-South subsidies

Beyond providing technical assistance, the WTO should work to level the playing field by encouraging global resource mobilization toward building capacity, resources, and infrastructure within LDCs to deal with the fallout of subsidies.

The difficult part is determining where this capacity-building knowledge and resources could realistically come from. Countries subsidizing domestic industries have the opposite incentive; they want to improve the competitiveness of their own industries and shorten supply chains. Private companies that develop new technologies will do so at a high price, even if receiving subsidies: they won't freely offer the results of their R&D to companies in low-income countries. Therefore, the WTO and other global organizations would need to fill the gap to provide an incentive.

One suggestion for capacity-building in LDCs, especially for the clean energy transition and pandemic preparedness, would be to mobilize the IMF's special drawing rights (SDRs) through multilateral development banks, and especially the World Bank.[xxxix] The WTO's mandate does not include leveraging funding to assist developing regions, but multilateral development banks (MDBs) are well suited to do so. If the WTO evolves to allow subsidies on global public goods, it might counter the resulting trade distortions and inequalities by coordinating with MDBs to ensure that low-income countries without subsidies might qualify for funding.

6. Enhanced focus on subsidy reform can buttress the pursuit of sustainable development goals

Implicit and explicit subsidies allocated to fossil fuels, agriculture, and fisheries surpassed $7 trillion in 2022, or 8 percent of global GDP,[xl] often fueling degradation of environmental assets critical to human health and nutrition underlying the global economy. For example, fossil fuel usage—incentivized by subsidies—is a culprit behind some seven million premature deaths each year due to air contamination.[xli] Cutting environmentally harmful subsidies, on the other hand, could help redirect sizable resources to fostering sustainable development, especially when accompanied by clean alternatives that are made both available and affordable, and propped up by information campaigns to tackle social biases.[xlii]

This paper argues that the SCM agreement lies at the core of the WTO reform and should be an area of focus for action. In particular, SCM reform should revolve around increasing transparency and notification on subsidies as means to reduce trade tensions, and pursuing time-tested approaches to delineate harmful subsidies from the rest. The authors encourage transatlantic leaders to pursue this reform agenda through these steps, as the most realistic ones for making meaningful progress possible in a fragmented global economic landscape, and to include specific measures for LDC-capacity building to level the playing field. Finally, this paper highlights the potential of repurposing environmentally harmful subsidies for global public goods, such as preservation of natural assets and the global health imperative. Building public acceptance, fostering transparency, effective agenda communication, and building in social protections to support those unevenly affected by the reform will be imperative to reform success and the resurgence of a more modern and effective WTO.

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Acknowledgments

The authors wish to thank Bretton Woods 2.0 Next Gen Fellows for their research assistance. The authors also thank James Gardiner.

This report is written and published in accordance with the Atlantic Council Policy on Intellectual Independence. The authors are solely responsible for its analysis and recommendations.

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