

*Public Law Research Institute Report:*

## **NAFTA's Relationship to State Support of Industries and Export Subsidies**

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### Question Presented

*California has a variety of programs to stimulate exports including trade offices, export financing, trade shows, etc. This paper addresses the issue of whether any of these programs prohibited under NAFTA as improper subsidies.*

### Short Answer

*The text of the North American Free Trade Agreement (NAFTA) itself is largely silent on the issues of domestic support of industries and export subsidies. NAFTA contains no explicit requirements that export subsidies or state programs designed to support specific industries be eliminated. NAFTA does, however, require that all parties to the agreement accord "National Treatment" to the goods of any other party to the agreement. This essentially means that a signatory country may not give preferential treatment to goods produced in its country.*

*This "National Treatment" requirement would seem to preclude direct domestic support of industry. NAFTA's "National Treatment" obligation, however, is interpreted in accordance with the General Agreement on Tariffs and Trade (GATT), which excludes direct subsidy to industries before the export stage. The main exception to NAFTA's "silence" on domestic support and export subsidies is the extensive discussion and*



*explicit allowance of such domestic support in the agricultural sector.*

*Beyond this skeletal framework, there is little discussion of the affect of NAFTA on state support and subsidy in NAFTA itself, the Administrative Action Statement, or secondary sources. The federal-state consultation process is intended to sort out any grey areas where the legitimacy of state action is in dispute.*

### *I. National Treatment*

*NAFTA requires that each party to the agreement accords "national treatment" to the goods of another party to the agreement. [No. 1] National treatment means that "with respect to a state or province, treatment [is to be] no less favorable than the most favorable treatment accorded by such state or province to any like, directly competitive or substitutable goods, as the case may be, of the Party of which it forms a part." [No. 2]*

*The parties to NAFTA agree to define national treatment in accordance with Article III of the General Agreement on Tariffs and Trade (GATT) and its interpretive notes. [No. 3] Article III of GATT essentially prohibits any differential taxation of foreign products in excess of the taxation applied "directly or indirectly to like products of national origin . . ." [No. 4] The "no less favorable treatment" language applies to all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use." [No. 5]*

*This GATT language implies that domestic subsidization of industry and products before the export stage is permissible. However, each signatory must treat domestic and imported products in a similar fashion in the import stage.*

### *II. Domestic Support*

*Even though the national treatment requirement does not seem to prohibit domestic support of industries as differential treatment of goods, NAFTA and the Administrative Action Statement explicitly discuss and allow support of domestic agricultural enterprises. [No. 6]*

#### *A. Export Subsidies in the Agricultural Sector*

*NAFTA parties may utilize export subsidies against competition from non-NAFTA countries. NAFTA parties may introduce an export subsidy on exports of an agricultural good to another NAFTA country following three day's notice and consultations with that country. Each party maintains its right to apply countervailing duties to subsidized agricultural imports from any source, including NAFTA parties. A trilateral NAFTA Working Group on Agricultural Subsidies is established to meet at least semi-annually to review subsidy issues. [citation omitted] While no changes in domestic agricultural subsidies are required of any of the NAFTA countries, the Agreement does require participants to endeavor to move toward domestic policies that have "minimum or no trade distorting or production effects." [No. 7]*

*The Administrative Action Statement notes that "NAFTA governments . . . recognize that commitments to reduce domestic support in the agricultural sector may be undertaken in multilateral trade negotiations. Accordingly, Article 704 encourages NAFTA countries to work toward domestic support measures in the agricultural sector that minimize or cause no trade distorting or production effects, and that do not conflict with any applicable*

*commitments to reduce domestic support measures that may be negotiated under the GATT." [No. 8]*

*NAFTA incorporates, as between the United States and Canada, the Canada Free Trade Agreement (CFTA) Article 701 prohibition on introducing or maintaining export subsidies on agricultural goods exported between these two countries. [No. 9] NAFTA Article 705 does not extend this prohibition to agricultural trade with Mexico, but instead affirms that export subsidies on agricultural goods exported to another NAFTA country are inappropriate where there are no other subsidized imports of that good into that NAFTA country. [No. 10] The Administrative Action Statement endorses the use of export subsidies in the agricultural sector to counter the impact of other countries' subsidization programs:*

*Agricultural Export subsidy programs have provided an important tool to maintain and expand exports of U.S. agricultural commodities. Currently, there are export subsidy programs to promote exports to Mexico of many U.S. agricultural commodities, including the export enhancement program, the dairy export incentive program and the cottonseed oil and sunflower seed oil assistance programs.*

*The Secretary of Agriculture will aggressively use the agricultural export subsidy programs with respect to exports to Mexico as appropriate to help U.S. producers compete against subsidized products from other countries, such as dairy products, vegetable oil, and wheat and to maintain U.S. markets in the face of subsidized imports from other countries. [No. 11]*

*But while agricultural subsidies are allowed under NAFTA, under the circumstances discussed above, they seem to be strongly disfavored. NAFTA countries will be establishing a working group to work toward the "elimination of all export subsidies affecting agricultural trade between them." [No. 12] The Parties to NAFTA agree that "their primary goal with respect to agricultural subsidies is to achieve, on a global basis, the elimination of all subsidies which distort agricultural trade, and the Parties agree to work together to achieve this goal, including through multilateral trade negotiations such as the Uruguay Round." [No. 13] Article 701 of NAFTA provides that:*

*2. Neither Party shall introduce or maintain any export subsidy on any agricultural goods originating in, or shipped from, its territory that are exported directly or indirectly to the territory of another Party.*

*3. Neither party, including any public entity that it establishes or maintains, shall sell agricultural goods for export to the territory of the other Party at a price below the acquisition price of the goods plus any storage, handling or other costs incurred by it with respect to those goods.*

*4. Each party shall take into account the export increases of the other Party in the use of any export subsidy on any agricultural good exported to third countries, recognizing that such subsidies may have prejudicial effects on the export interests of the other Party. [No. 14]*

*In Chapter 19 of the Administrative Action Statement, entitled "Dispute Settlement in Antidumping and Countervailing Duty Cases," there is a section which deals with subsidies negotiations. The statement notes that section 406 "sets forth certain objectives for the United States in any future trade negotiations over subsidies, convened*

*under NAFTA Article 1907, with a NAFTA country." [No. 15] These objectives include "the achievement of increased disciplines on domestic subsidies; export subsidies, particularly with respect to agricultural products; and maintenance of effective remedies against subsidized imports, including, where appropriate, countervailing duties." [No. 16]*

*Furthermore, the Report of The Agriculture Policy Advisory Committee (APAC) of the Uruguay Round of Multilateral Trade Negotiations (under GATT), more precisely outlines those practices in contention. As far as internal support mechanisms are concerned, the members of the GATT Committee reaffirmed that they seek to "discipline those internal support mechanisms which have created distortions in trade . . . [while maintaining] . . . the ability of member countries to provide support to their agriculture through non-trade distorting policies." [No. 17] The report listed permitted and prohibited policies as follows:*

*Policies subject to reduction include:*

*Price Supports*

*Deficiency Payments*

*Marketing Loans*

*Acreage Payments*

*Import Subsidies*

*Subsidized loan programs*

*Permitted policies include:*

*General Services (research, inspection, marketing, and promotion, etc.)*

*Food Security and Domestic Food Aid*

*Decoupled income support*

*Crop insurance or income safety net programs*

*Structural adjustment assistance*

*Environmental or conservation programs [No. 18]*

*The report noted that while export subsidies had been virtually eliminated for industrial goods, the Uruguay Round was "designed to begin the reduction of these subsidies in the agriculture sector." [No. 19] All direct export subsidies, according to the report, are "intended to be disciplined. This includes direct export subsidies, producer financed subsidies, marketing transportation and freight subsidies and subsidies to further processing for export." [No. 20]*

*GATT signatories agreed to reduce their Aggregate Measure of Support (AMS) (for internal support) from the 1986-88 base period during the 1995-2000 period. [No. 21] They also agreed to reduce member country budgetary outlays for export subsidies by 36 percent.*

*Domestic Industries at Risk*

Section 407 of NAFTA provides a process for the identification of domestic industries that are likely to face: "(1) increased competition from Canada or Mexico or other countries with which the United States concludes a trade liberalizing agreement; and (2) a deteriorating competitive position before a more effective discipline on subsidies is developed with respect to the country concerned." [No. 22] The United States Trade Representative (USTR) is responsible for identifying those domestic industries that are at risk. [No. 23] Section 407 allows an identified industry to request the gathering of information pursuant to other law and authorities monitoring and review of evidence related to subsidies. [No. 24]

### Conclusion

NAFTA, the Administrative Action Statement, and secondary sources give little guidance in answering this question. Perhaps because NAFTA is little more than year old, issues have not yet arisen that have required the states or the federal government to start focusing energy and resources to delineating permitted and prohibited state action after NAFTA. Until more specific, authoritative guidelines are developed, the federal-state consultation process is the main method to determine the legitimacy of state actions.

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### Notes

[No. 1] The North American Free Trade Agreement, art. 301(1) [hereinafter NAFTA].

[No. 2] NAFTA, art. 301(2). See also The North American Free Trade Agreement Implementation Act, ch. 3(A)(1)[hereinafter Administrative Action Statement].

[No. 3] NAFTA, art. 301(1).

[No. 4] General Agreement on Tariffs and Trade, art. III [hereinafter GATT].

[No. 5] Id.

[No. 6] NAFTA, art. 704; Administrative Action Statement, ch. 7(B)(2). NAFTA also exempts certain export promotion and foreign aid programs in the investment sector. Gary C. Hufbauer & Jeffrey J. Schott, NAFTA: An Assessment (Institute for International Economics, Washington DC, 1993).

[No. 7] Bert R. Pena & Amy Henderson, U.S.-Mexico Agricultural Trade and Investment After NAFTA, 1 U.S.-Mex. L.J. 259, 271-72 (1993). Pena & Henderson's article contains a significantly more detailed discussion of U.S.-Mexico agricultural trade issues, including a detailed analysis of the NAFTA schedules and appendices.

[No. 8] Administrative Action Statement, ch. 7(B)(2). There is some skepticism, however, concerning the commitment of NAFTA signatories to elimination of export subsidies. See Key NAFTA Provisions Affecting Agricultural Sectors, 3 NO.8 Mex. Trade & L. Rep. 8, 10 (1993) [hereinafter Key NAFTA Provisions] ("Given the limited commitment to the elimination of agricultural export subsidies as a result of NAFTA, this provision is not likely to have a significant effect on the agricultural sector.").

[No. 9] Administrative Action Statement, ch. 7(B)(3).

[No. 10] *Id.* Article 705(4) requires an exporting country to give the importing country advance written notice before adopting an export subsidy of an agriculture sector good and provides for consultations between the importing and exporting countries with a view to eliminating the export subsidy or minimizing or countering any adverse impact of the subsidy on the market of the importing country.

[No. 11] *Administrative Action Statement*, ch. 7(C)(3)(d).

[No. 12] *Id.* But see Key NAFTA Provisions, *supra* note 6, at 10.

[No. 13] *Administrative Action Statement*, ch. 7(A)(attachment).

[No. 14] *Id.*

[No. 15] *Id.* at ch. 19(B)(1)(c).

[No. 16] *Id.* The *Administrative Action Statement* makes reference here to section 1101(b)(8) of the Omnibus Trade and Competitiveness Act, bolstering the discussion of the high priority the United States attaches to "improving rules on unfair trade practices, including government subsidies and effective rules and remedies to address unfair transborder pricing practices." But see Key NAFTA Provisions, *supra* note 6, at 10.

[No. 17] *Agriculture Policy Advisory Committee, Report on the Uruguay Round of Multilateral Trade Negotiations* 3.

[No. 18] *Id.* at 4.

[No. 19] *Id.* at 5.

[No. 20] *Id.*

[No. 21] *Id.* The United States is already more than 20 percent below the 1986-88 base AMS level. Therefore, no further reductions will be necessary.

[No. 22] *Administrative Action Statement*, ch. 19(B)(1)(d).

[No. 23] *Id.*

[No. 24] *Id.* The procedures and scope of section 407 are virtually identical to section 409(b) of the CFTA Implementation Act.