FINANCIAL TIMES

Global economy: Tricks of the trade law

By Alan Beattie - October 28, 2012 4:56 pm

Countries that have spurned 1930s-style protectionism are finding new ways to back their struggling industries

When doom-mongers predicted that the Great Recession would lead to the vampire of 1930s protectionism rising from the dead, they may have been watching the wrong graveyard.

Since the global financial crisis struck in 2008, worldwide increases in import tariffs of the type seen during the Depression have been largely absent. But governments, richer with cash and regulatory power than in the 1930s, have found other ways to back their struggling producers at a time of deficient global demand. Disputes over state subsidies are spreading, the trade law to constrain them is not easy to use, and few governments can throw stones without worrying about the glass in their own houses.

Some interventions have been crisis-related, like the many bailouts of car and financial services industries – France continues to proffer aid to the troubled carmaker PSA Peugeot Citroën – but others predate the global recession. China, in particular, has for more than a decade raised hackles with an aggressive state-led growth model, supporting export industries with measures including direct subsidies, tax breaks, export credits, cheap land and electricity, and subsidised loans from state banks.

An EU official says: "The subsidies issue is nothing less than a question of how to address state capitalism within a liberal global trading order."

Litigation has escalated along with official rhetoric. Although still covering only a small proportion of total trade, the number of new cases seeking "countervailing duties" (CVDs) – which are levied on imports deemed to be subsidised by foreign governments – doubled between 2004-07 and 2008-11. Several emerging markets have in recent years passed CVD legislation to enable future cases. Governments have started 16 subsidy-related cases at the World Trade Organisation since 2008.

In a recent paper for the Cato Institute, a US libertarian think-tank, Scott Lincicome, a trade lawyer at White & Case in Washington, states: "The world is awash in trade-distorting subsidies."

Familiar battlegrounds such as agriculture, fisheries and passenger aircraft have been joined by new energy industries: biofuels, solar and wind power. US solar cell manufacturers this year persuaded the International Trade Commission, an independent quasi-judicial federal agency, to impose CVDs on imports from China. A coalition of EU solar companies is seeking the same from Brussels.

Subsidies in global biofuels and renewable energy have followed a similar trajectory to those of industries such as coal, steel and shipbuilding in earlier decades. Initially justifying handouts by reference to big start-up costs and increasing returns to scale, such sectors went on to become symbols of national economic virility and self-sufficiency but frequently ended up with global overcapacity, production gluts, falling output prices and trade disputes.

True, there may be a strong economic case for subsidising the use of solar and wind power if it cuts carbon emissions relative to fossil fuel – a sector that has also traditionally received handouts. But many interventions are producer subsidies designed to build up domestic industries, potentially distorting competition and leading to waste.

Since 2009, for example, the US has greatly expanded existing programmes of grants and loan guarantees to energy equipment manufacturers. The bankruptcies of two such businesses – the solar company Solyndra and the battery maker A123 Systems – have become a cause célèbre among critics of Barack Obama's administration.

Though governments with high deficits have slashed renewables subsidies in the past year, several have sought to skew interventions further to domestic companies. France has tendered a series of contracts for offshore wind generation including clauses that critics say favour its own producers. In China, although Beijing has become more sceptical about subsidies for solar producers, city-level authorities fear the unemployment caused by factory closures. Last week the solar panel manufacturer LDK, which had already received financial help from local government, gained breathing space from financial difficulties by selling a 20 per cent stake to a city-related fund.

Subsidy programmes that discriminate between local and foreign producers invite WTO litigation. According to a leaked copy of a ruling obtained by the International Centre for Trade and Sustainable Development, a Geneva-based think-tank, the WTO will uphold a complaint brought by Japan and the EU against a power generation scheme in the Canadian province of Ontario that gives preferential treatment to locally manufactured solar and wind equipment.

If that ruling is confirmed, it could provoke a flurry of subsidy-related litigation, with Europe itself vulnerable. Spain recently introduced a "local content" rule favouring domestic biodiesel producers, prompting Argentina to threaten a WTO case against the EU claiming unfair treatment.

Yet while international trade law can restrain the use of trade-distorting support, it would be optimistic to imagine that WTO litigation or the widespread use of CVDs will bring the subsidy wars to a neat and rapid end. Applying WTO rules is neither simple nor straightforward. First, there are difficulties in assembling information. Second, governments encounter conflicts of interest in their own industries. Third, many countries are vulnerable to counteraccusations.

Finding reliable data on subsidies, particularly in an opaque, multilayered state such as China, is a big challenge in itself. Last year the US, complaining that Beijing and New Delhi had failed to notify the WTO of their subsidies, took the unusual step of "counter-notifying", submitting its own estimates of state support. A US trade official notes that the administration has increased its number of Mandarin-speaking trade lawyers from one to six and is aggressively conducting its own investigations. "We are piercing the Chinese veil ourselves," the official says. "We are not relying on them to tell us what is going on."

Even with good information, companies may be unwilling to submit a CVD petition or support a government bringing a WTO case. Many industries have internal conflicts. In the EU and the US, for example, cheap Chinese solar cell imports infuriate manufacturers but are welcomed by solar panel installers.

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Moreover, multinationals with Chinese operations may benefit from state subsidies, either directly or through cheaper component supplies, and might fear reprisals by Beijing if they put their names to a complaint.

This year Karel De Gucht, the EU trade commissioner, took the unprecedented step of threatening to "self-initiate" a CVD case against imports of telecommunications equipment from the Chinese manufacturers Huawei and ZTE. The big European producers – Ericsson, Nokia Siemens and Alcatel-Lucent – stayed studiously neutral. With Beijing threatening retaliation, the European Commission last month decided to delay the case, saying it needed stronger evidence.

The EU's prospective CVD action against Chinese solar cells was also thrown into doubt in August when Angela Merkel, German chancellor, said on a trip to Beijing the matter might be better settled through negotiation. Although the case has been spearheaded by a company based in Germany, SolarWorld, Berlin has been careful not to upset one of the country's biggest export customers.

So far, the EU's flagship CVD case against China is in the low-margin sector of "coated paper". Hosuk Lee-Makiyama, director of the European Centre for International Political Economy, a Brussels-based think-tank, says: "The EU has learnt that it can't rely on the right industries to bring a case at the right time".

In 2010, when the threat of a WTO case from Washington caused China to abandon a wind power subsidy programme, the complaint originated not from US companies but from the United Steelworkers union. The White House this year set up the Interagency Trade Enforcement Center to increase co-ordination and resources in pursuing complaints. The US trade official says: "One of the reasons the president created Itec is so we don't have to rely on an industry [that] is not necessarily happy about a situation but is conflicted."

Even when evidence and a legal standing can be assembled, filing WTO complaints and blocking imports can tempt retaliation. The long-running dispute over the aerospace groups Boeing and Airbus shows the potential for deadlock in a sector where many states subsidise producers. The WTO has found both the US and the EU, which have brought cases against each other, in breach of subsidy rules. Mr Lee-Makiyama says: "Rather than a Start [Strategic Arms Reduction Treaty] on subsidies and CVDs, we could end up instead with mutually assured destruction."

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In the US, there were hollow laughs from Mr Obama's critics when the president launched a WTO case against export subsidies to Chinese car parts last month while simultaneously lauding the success of his Detroit bailout. Mr Lincicome says: "US subsidy policy reflects a 'do as I say, not as I do' approach."

Washington insists its bailout was a temporary response to a crisis rather than sustained industrial policy, though Mr Lincicome notes that, in the course of litigation with China, the administration has not contested the idea that it could be a trade-distorting subsidy.

America's use of anti-subsidy measures is under criticism from its own courts and from the WTO, too. A federal-district court last year ruled that the US was wrong to impose both countervailing and "antidumping" duties (levied on goods priced unfairly low) on the same imports from China – though Congress scrambled to pass a bill to override this decision. The WTO last year also declared aspects of the US double-duty regime illegal.

China has leapt on the decisions, claiming the US is being hypocritical, calling it "protectionist" and starting WTO litigation against the new law. Though the likely outcome of that case is unclear, Washington has undoubtedly handed Beijing a public relations weapon and undermined its standing as a global subsidies sheriff.

Even if subsidies to sectors such as renewable energy are cut further, the issue of trade-distorting interventions is not likely to go away. As cross-border commerce shifts away from goods to services, the ability to use regulation subtly to back domestic companies will only grow.

“Services ... tend to be a very heavily regulated sector in all markets, which opens the door to misuse of that governmental function,” says the US trade official. “We see that in one place now but I think we are going to see it in others.”

Additional reporting by Leslie Hook