Do we need new rules on subsidies in the age of industrial policy?

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Government support is not new

Producer Support Estimates by country, percentage of gross farm receipts, 2000-02 and 2017-19

Source: OECD Agriculture Monitoring and Evaluation Report 2020
But it is set to increase following COVID-19

• Government support was a growth industry before COVID-19
  – Concerns over state capitalism
  – Digital markets (first mover advantage winner-take-most)
  – Trade tensions

• Governments extending significant support in the face of COVID-19.
  – This is necessary, and equity can be a good tool

• Two considerations:
  – Rescue design matters – how you go in affects how/if you come out
  – Some support linked to re-shoring and industrial strategies

• Against this background, what are the challenges for effective rules?
Why do we care?

• Level playing field and **distortions to competition** (beggar-thy-neighbour)

• Encourages **investment in capacity that not otherwise built**, or keeps uneconomic capacity alive (with effects on prices, jobs)

• **Other spillovers** (governance, environment)

• Increased pressure in **severe demand downturn** and different speeds of recovery

• **Undermines faith in global markets and the fair global economy**
UNDERSTANDING GOVERNMENT SUPPORT
### Government support takes many forms

<table>
<thead>
<tr>
<th>Statutory or Formal Incidence (to whom and what a transfer is first given)</th>
<th>A: Output returns</th>
<th>B: Enterprise income</th>
<th>C: Cost of intermediate inputs</th>
<th>D: Labour</th>
<th>E: Land and natural resources</th>
<th>F: Capital</th>
<th>G: Knowledge</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1: Direct transfer of funds</strong></td>
<td>Output bounty or deficiency payment</td>
<td>Operating grant</td>
<td>Input-price subsidy</td>
<td>Wage subsidy</td>
<td>Capital grant linked to acquisition of land</td>
<td>Grant tied to the acquisition of assets</td>
<td>Government R&amp;D</td>
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<td><strong>2: Tax revenue foregone</strong></td>
<td>Production tax credit</td>
<td>Reduced rate of income tax</td>
<td>Reduction in excise tax on input</td>
<td>Reduction in social charges (payroll taxes)</td>
<td>Property-tax reduction or exemption</td>
<td>Investment tax credit</td>
<td>Tax credit for private R&amp;D</td>
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<td><strong>3: Other government revenue foregone</strong></td>
<td>Waiving of administrative fees or charges</td>
<td>Under-pricing of a government good or service</td>
<td>Under-pricing of access to government land or natural resources</td>
<td>Loan guarantee; non-market debt-equity swaps and equity injections</td>
<td>Government transfer of intellectual property rights</td>
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<td><strong>4: Transfer of risk to government</strong></td>
<td>Government buffer stock</td>
<td>Third-party liability limit for producers</td>
<td>Assumption of occupational health and accident liabilities</td>
<td>Credit guarantee linked to acquisition of land</td>
<td>Deviations from standard IPR rules</td>
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<tr>
<td><strong>5: Induced transfers</strong></td>
<td>Import tariff or export subsidy; LCRs</td>
<td>Monopoly concession</td>
<td>Monopsony concession; export restriction</td>
<td>Wage control</td>
<td>Land-use control</td>
<td>Credit control (sector-specific); non-market M&amp;As</td>
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Understanding support in industrial sectors

• **Work to date**
  – Commodity (aluminium)
  – High-tech sector (semiconductors)
  – Ongoing horizontal work

• To assess government support in industrial sectors, we looked at **individual firms:**
  – Necessary given lack of policy transparency;
  – Enables greater granularity (e.g., of subnational measures)
  – Enables identification of support beyond traditional forms (e.g., support provided through the financial sector)
What did we learn? Aluminium

• **Support upstream** can have sizable **effects downstream**.
  – Need to take a **value chain approach**

• Support mostly takes the form of **energy subsidies** and **below-market financing**.
  - Below-market financing is hard to measure but even conservative estimates suggest it is significant. (USD 7-56 billion)
  - Aluminium multinationals obtain support in the different countries in which they operate, but large SOEs get most support from their home countries.

• There is **strong involvement of the state** in the aluminium value chain, and SOEs are both recipients and providers of support:
  - SOEs account for almost half of all smelting capacity
  - Cheap finance (debt) is often delivered through state-owned financial institutions
  - Issues for transparency

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[Diagram showing support for energy and other intermediates, financial subsidies (Tier 1, 2, 3), and other non-financial support for various aluminium companies.]

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What did we learn? Semiconductors

- R&D subsidies are significant
  - But do they work in high-tech sectors?

- How to treat government ownership in firms?
  - SOEs vs government invested firms

- Below market finance significant: loans (debt), but also equity
  - Hard to measure equity
  - Not just one off benefit
Support provided through the financial system

Support measures:

- **Below-market finance**
  - Grants
  - Tax concessions
  - Below-market inputs
  - Below-market energy
  - ...

- Below-market borrowings
- Below-market equity
- Below-market equity infusion
- Below-market equity returns
Support estimates differ in precision and complexity

Grants
Tax concessions
Below-market borrowings
Below-market equity

More precise, less complex
Less precise, more complex

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IMPLICATIONS FOR TRADE RULES
1. Transparency, transparency, transparency

- No information available from governments
  - WTO notification gaps on support
- But also, lack of transparency in particular on below-market finance
  - The need for agreed market benchmarks
  - Insufficient information on government ownership of companies
2. Capturing support provided through the financial system

- Government
  - Ownership stake (e.g., 40%)
  - Not necessarily a ‘public body’ under WTO rules

- State-owned enterprise (e.g., state bank)
  - Not covered by most FTAs

- Industrial producer (state-owned or private)
  - Direct support
  - Indirect support (e.g., below-market loan)

- Disciplined by the WTO SCM
3. Enabling the right support

• International co-operation needed for ground rules on how to provide support measures that
  – Are beneficial to society
  – Are necessary for fixing market failures
  – Enable markets to play their role in boosting productivity and living standards

• Some challenges require public support.
  – E.g., mitigate environmental harm, R&D efforts that may otherwise be under-supplied by markets

• Design matters.
Moving ahead on government support

• Government support needs to be **addressed multilaterally**
  – Transparency (what’s going on)
  – Predictability (lock in)
  – Reduction (starting with the most egregious)
  – Prevention (tomorrow’s subsidisers in tomorrow’s sectors)

• But need to **make the domestic case for global policy reform**
  – Is support achieving its claimed objectives – or doing so efficiently?
    • USD 700B/year in support to agriculture: USD 536B in support to producers vs general services (+ consumers) USD 172B
  – **Opportunity costs of scarce public resources**
    • Necessary investments for the public interest (education, digital infrastructure, health systems!)
Thank you

We look forward to answering any questions you may have!

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