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COSTA RICAN EXPORT INCENTIVES AND THE TRADE LAWS OF THE UNITED STATES

A Report Prepared For
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TABLE OF CONTENTS

EXECUTIVE SUMMARY:

COSTA RICAN EXPORT INCENTIVES AND THE FOREIGN TRADE LAWS OF THE UNITED STATES

INTRODUCTION

Costa Rica has several fiscal and other incentives to nontraditional exports, and is giving consideration to establishing others. These incentives are intended to stimulate exports, attract investment capital and create new jobs.

While these goals are laudable, it is also true that export incentives -- if they are not established carefully -- may run afoul of national and international trade laws. If Costa Rican export incentives are judged to be unfair trade practices by the United States or other members of the world trade community, the nation may be subject to retaliatory measures such as countervailing duties, orderly marketing arrangements or quantitative restrictions.

The existing Costa Rican export incentives have not yet been the cause of any serious difficulties abroad.* This should be no reason for complacency; if the Caribbean Basin Initiative is successful in stimulating new exports to the United States, these laws are likely to come under greater scrutiny by protectionist interests. This scrutiny will only increase if Costa Rica decides to create even more incentives programs.

I. SCOPE OF WORK

The purpose of this study is to assess the impact of domestic United States and international trade laws on the current Costa Rican efforts to promote exports. If the existing and proposed laws are consistent with the fair trade principles embodied in U.S. law and the GATT, then Costa Rica should be able to continue these

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* : After the submission of the body of this report to the Government of Costa Rica, a countervailing duty suit was lodged against allegedly subsidized Costa Rican cement exports to Puerto Rico.

programs without fear of disruption. If, however, there is reason to believe that these programs may encounter opposition which can close off markets to Costa Rican exports, then the country would be well advised to consider modifications in its laws, policies and practices which will minimize the likelihood of retaliation abroad. The following Costa Rican incentive laws are described and analyzed in this paper:

The Law for the Development and Protection of Industry (No. 2426 of 1959);

The Central American Agreement on Fiscal Incentives to Industrial Production (No. 3142 of 1963);

The Export Promotion Law (No. 5162 of 1972); and

The Emergency Law (No. 6955 of 1984).

In addition to these laws, there are also other laws and practices under consideration by the Government of Costa Rica which could imply export incentives (e.g., special exchange rates, subsidized financing, etc.). This paper does not analyze these proposals because no details are yet available. The general principles on U.S. and international laws that are laid out in subsequent sections, however, could serve as useful guides in drafting any such laws.

II. REVIEW OF INTERNATIONAL AND U.S. LAWS ON SUBSIDIES

A. Introduction

Subsidies are government programs which have the direct effect of stimulating the production or sale of a good. Subsidies are not illegal *per se*, but rather are permitted in some instances and subject to retaliation in others. The legality of a subsidy depends not only on the nature itself, but also on the legal standards by which the subsidy is being scrutinized.

There are four principal international and domestic U.S. laws which deal with subsidies, their legality, and appropriate countermeasures when they are prohibited. These are outlined in the sections to follow.

B. The General Agreement on Tariffs and Trade (GATT)

The GATT is the chief instrument of international trade law. There are four sections of it which are of concern to the topic at hand: Article VI (Countervailing Duties), Article XVI (Subsidies), Article XXIII (Dispute Settlement) and Part IV (Developing Countries).

Despite the GATT's substantial legal corpus and experience in these matters, however, its rules have not proven to be an effective means of curtailing the abuse of subsidies or governing the application of countervailing practices. There are numerous inconsistencies within the legislation, and there are no measures which effectively provide more favorable treatment for the exports of developing countries.

C. The Code on Subsidies and Countervailing Duty Measures

The Subsidies Code was negotiated at the Multilateral Trade Negotiations (MTN) held in 1979, and represents a synthesis of previously unilateral U.S. practices and international procedures. In exchange for greater global discipline, the United States agreed henceforth to apply the so-called "injury test" when seeking to countervail against other signatories' subsidized exports. The injury test makes it mandatory for the retaliating nation to establish that the subsidy in question is actually doing material injury to domestic workers or industries.

The Subsidy Code bans subsidies on the export of manufactured and mineral products, but there are exceptions. The prohibition on subsidies for manufactured goods does not apply to developing countries such as Costa Rica (although the developing countries must use these with restraint), and the Code does allow some subsidies on the export of agricultural products. These agricultural export subsidies are allowable as long as they do not lead to the exporting nation gaining more than an equitable share of the world market.

Purely domestic subsidies (also known as production subsidies) are not illegal, but GATT members must seek to avoid causing disruptions in other nations' economies through the use of these subsidies. There is no clearly binding and enforceable standard in this area.

D. U.S. Domestic Law on Countervailing Duties

U.S. trade law is generally more strict on subsidies than are the GATT or the subsidies Code. It does not make distinctions between types of subsidies (e.g., export vs. domestic subsidies); provided that material injury to U.S. workers or industry can be shown, the foreign subsidy is subject to countervailing action.

The executive branch is allowed very little discretion in administering these laws. The Congress has made the laws tough and binding on the administration, and has left little room for the consideration of the special needs of developing countries. The injury test is only granted when the U.S. is absolutely required to do so under its international obligations (i.e., in cases involving duty-free imports for GATT members, for all products in cases involving signatories to the Subsidies Code or countries which enter into a substantially similar agreement, and for other nations to which the U.S. has a binding commitment).* Once a subsidy is found to be doing material injury, the administration must either offset the subsidy with a countervailing duty, or else negotiate a solution with the offending nation.

III. ANALYSIS OF THE CURRENT AND PROPOSED COSTA RICAN LAWS

A. General Principles

In general terms, Costa Rican export subsidies are not inconsistent with the Subsidies Code as long as they abide by the following rules:

(1) They are consistent with the Costa Rica's competitive and development needs.

(2) They do not prejudice the trade or production interests of other countries.

(3) Subsidies on non-mineral primary products do not result in Costa Rica receiving more than an equitable share of the world market.

These rules do not apply to U.S. trade law. Most foreign subsidies are potentially subject to U.S. retaliation, provided that they result in material injury to U.S. workers or industry. Because Costa Rica does not meet any of the conditions outlined above, it is not entitled to the injury test and thus is less protected against countervailing actions.

B. Consequences of Costa Rican Practices for CBI Eligibility

The Caribbean Basin Economic Recovery Act (CBERA) provides that the President will take into account the subsidy practices of beneficiary countries before he grants their eligibility for the CBI benefits. The Costa Rican export subsidies could conceivably become construed as an obstacle to continued CBI designation, although this point may have been rendered moot when President Reagan granted eligibility for Costa Rica.

Nevertheless, the Government of Costa Rica has promised the U.S. Government that it will avoid creating distortions in

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* : El Salvador and Honduras are the only Central American countries which have such an agreement with the United States.

international trade, and will discuss and consult with the United States in those cases in which the U.S. believes that Costa Rican practices are distorting trade.

C. The Possible Consequences of Certain Costa Rican Practices

(1) Income Tax Rebates

Costa Rican tax law exempts income generated by export sales of nontraditional products from income taxes. This practice is inconsistent with both the Subsidy Code and U.S. trade laws, and ispotentially subject to countervailing actions. In order for there to be retaliation, however, it must be shown that the beneficiary taxpayers actually had an income which benefited from the deduction.

There are steps Costa Rica could take to protect this tax provision from retaliation while still preserving its basic function. The country could elect to defer rather than exempt the tax liabilities, or it could allow the establishment of tax-exempt export sales facilities in foreign countries.

(2) Rebates on Import Duties for Raw Materials and Capital Equipment

Costa Rica has a duty rebate program for raw materials and capital equipment used to manufacture export products. Under U.S. trade laws, the rebate for imported raw materials is allowable, but the rebate for capital equipment is not.

(3) Reduced Rates for Export Services

The new export contract law provides a framework by which lower charges may be assessed for certain export services (e.g., port charges). This may constitute a subsidy, and be subject to countervailing action.

(4) Export Financing

Export financing below commercial rates is a considered an export subsidy, and can be subject to countervailing action.

IV. IMPLICATIONS FOR COSTA RICA

A. Joining the Subsidy Code and the GATT

Costa Rica is put in an unfavorable position by the combination of (a) its export incentives program and (b) the fact that it is not a member of the GATT or the Subsidy Code. By utilizing the former without the protection of the latter, Costa Rica is left in a vulnerable position vis-a-vis countervailing actions.

Countries which are members of the GATT receive the injury test on all duty-free goods; countries which adhere to the Subsidies Code receive this test for <u>all</u> products. The CBI could put Costa Rica in an advantageous situation, because nearly all Costa Rican exports to the United States will receive duty-free treatment. This means that if Costa Rica were to become a GATT member, it would be entitled to the injury test in nearly all cases. The only products which would not receive an injury test would be (a) those which are ineligible for the CBI because of statutory restrictions (e.g., textiles), and (b) those which do not meet the rule of origin requirements. Even these products would be entitled to the injury test if Costa Rica were to adhere to the Subsidies Code.

Costa Rica indicated in its CBI designation letter that it intends to seek entry into the GATT. Consideration of this entry should be expedited. Costa Rica should also consider joining the Code and/or entering into a bilateral commitment with the United States which includes an injury test provision, so that those products which do not qualify for duty-free entry will also be entitled to an injury test.

B. Current Laws Should be Reviewed

Current Costa Rican practices should be analyzed in the light of international and U.S. trade law. The study should include a review of the current legislation to determine if modification in the laws would reduce the possibilities of countervailing actions.

C. Implement Practices Which Are Not Subject to Retaliation

Export incentives can be developed which are both effective and unlikely to provoke retaliation from other countries. In order to ensure that these actions are not subject to countervailing action, however, they should be applied throughout the economy rather than only to the export sector.

D. Macroeconomic Measures

A number of proposals have been made for alterations in Costa Rican economic policy, including reductions in public expenditures and the adoption of a more realistic exchange rate system. Without assessing the overall advisability of these measures, we would note that they are generally not subject to countervailing actions.

INTRODUCTION: WHY AN ANALYSIS OF COMPENSATORY MEASURES?

A retrospective analysis of the trade relations between Costa Rica and the United States indicates that the United States has not applied this type of measure to Costa Rican export subsidies. There could be several reasons for this failure to react against subsidies. The most easily distinguished include:

(a) the low impact of Costa Rican exports in the United States market; and

(b) the type of products exported, which generally do not compete with sensitive local production.

Nevertheless, Costa Rica has been attempting to modify its export production schemes for the U.S. market with a view towards substantially increasing its export levels. As part of this effort, legislation has been modified establishing new levels of export incentives.

At the same time, without leaving aside geopolitical considerations which could permit the United States to favor such efforts on the part of Costa Rica, we cannot fail to warn that certain influential factors could prejudice the application of this sort of measure by Costa Rica.

This year the United States faces a record imbalance in its trade. This deficit is perhaps the principal distorting element in its economy, and has produced important reactions in the public and private sectors of the United States. The domestic private sector is in greater difficulties every day in its attempts to compete with imports. As will be analyzed later, private sector requests to the United States Government for the application of compensatory measures are relatively easy to present, and the rules that govern these applications are clearly designed to permit an easy decision in favor of the petitioners by the United States Government. Since 1978, the United States has been modifiying its legislation to make these determinations easier, and to apply countervailing measures.

Finally, we think the Costa Rican private and public sectors should understand the basic rules that govern these types of measures before altering the fundamental structure of the Costa Rican trade regime. It must be noted that these countervailing measures, which are very harmful for the exports of the country, are especially difficult for new export industries which have not yet been consolidated. The total negative affect is multiplied by the psychological effect which the measures have on the local producers in the critical moment of starting up their export efforts.

This is a difficult topic to define, as it involves speculating about possibilities. Nevertheless, we believe that a responsible effort to increase Costa Rican production and exports must necessarily take into account those themes which we will develop in this paper.

I. SCOPE OF WORK

A. Purpose of the Study

The purpose of this paper is to examine Costa Rican export incentive legislation, and to point out certain incentives that could result in countervailing actions on the part of industrialized nations. Because the United States of America is the principal market for Costa Rican export products, especially non-traditional exports, the statements within this study will refer principally to the regime of the United States. Subsidies and countervailing actions have been the subject of a great many international negotiations, and standards have gradually been set for the determination of subsidies and the establishment of countervailing actions on the part of the great majority of developed countries. This permits us to predict with reasonable certainty that the statements made concerning the United States are valid with respect to other developed countries.

We have been requested to study and analyze the existing Costa Rican legislation concerning subsidies for exports and exportable production. Since the existing incentives are generally well-known, we will not restrict our analysis to the identification of these incentives but rather will look to the effect of these incentives on foreign markets. We must note that our investigation is restricted to those incentives which directly affect foreign trade, and does not take into account those practices which could be considered indirectly related to export or production incentives.

B. The Laws to be Analyzed

The laws which we will take into account, then, are the following:

Law for the Development and Protection of Industry (No. 2426 of 1959)

This law was approved when the country first began its industrial development at the end of of the 1950s. Its use was suspended a short while later, when Costa Rica signed the Central American Agreement for Fiscal Incentives to Industrial Development, and later with the establishment of the Law for Export Promotion of 1972. Nevertheless, we will define the principal incentives that are established in that law. As far as we are concerned, several sectors of the Costa Rican economy (including services and exports outside of Central America) could theoretically still benefit from this law. The incentives include:

(a) technical assistance given by the government;

(b) establishment of industrial training schools;

(c) up to 99 percent duty free entry for construction materials which are needed to construct factories;

(d) up to 99 percent duty-free import for motors, machinery, equipment, etc.

(e) up to 99 percent duty-free import for fuels and lubricants other than gasoline, raw materials, semi-elaborated products, packaging and containers; and

(f) A five year tax holiday which also applies to municipal taxes, fiscal taxes on capital and utilities, export taxes, and income taxes for profits which a firm reinvests in industrial improvements or in worker housing.

<u>The Central American Agreement on Fiscal Incentives to Industrial Production (No. 3142 of 1963)</u>

This agreement was signed with the objective of establishing incentives for the promotion of industrial enterprises within the Central American Common Market (CACM). It has been in operation for the last two decades. Because the Agreement is close to terminating, our commentary will be brief.

The Agreement established the following basic incentives:

(a) duty-free imports for machinery, equipment, raw materials, semi-elaborated materials, packaging, etc.

(b) duty-free import for fuels other than gasoline which are strictly used in industrial processes;

(c) income tax holidays; and

(d) tax holidays for the activities and net value of the firm.

<u>Export Promotion Law (NO. 5162 of 1972)</u>

This law for the promotion of investment and exports is ample and well-structured, and establishes a variety of incentives and tax exemptions for imports. Its principal benefits are:

a) Duty-free import:

qualifying firms which meet the prerequisites included in the law are allowed to import duty-free raw materials, semi-elaborated goods, packaging, machinery, equipment, accessories, spare parts, etc., as long as these goods are not produced locally in price competitive conditions and the finished goods are exported outside of Central America.

b) Tax Credit Certificates (CATs):

The CATs are emitted by the Central Bank to exporters of non-traditional products, these being defined by means of a negative list of about 18 products. The product must include a minimum of 35 percent national value-added. At the present time, the value of the CAT is 15 percent of the FOB export value. They are only emitted -- and we believe this is vital for purposes of this study -- when it can be demonstrated by means of economic studies that the benefit is indispensable for the product in order to compete in the international market.

c) Export Increment Certificates (CIEX):

This CIEX certificates were first incorporated in the CAT legislation when it was reformed in 1976. They are additional incentives to exporters which are granted by means of a certificate worth between one and ten percent of the increase in exports to markets outside of Central America. This increase is measured by comparing one year's export with those of the previous year.

The Emergency Law (No. 6955 of 1984)

With the advice of private and public sector consultants, the Government of Costa Rica approved the Law for the Financial Equilibrium of the Public Sector, commonly known has the Emergency Law. This law includes a section related to exports and investments which creates incentives and eliminates disincentives for both areas.

The law reforms the Income Tax Law, establishing a tax exemption for profits which are earned from non-traditional products exported outside of Central America. It also establishes the possibility for duty-free import of those materials which are incorporated in non-traditional exports sold outside of Central America, whenever they do not compete with existing national production.

It is also creates an entirely new mechanism: the export contract. This contract will be used as a medium for the coordination of advantages and benefits which are given to export companies by the government such as special port rates, simplication of red tape and procedures, bank credits and preferential interest rates, tax reductions, accelerated depreciation, and CAT and CIEX certificates. We would note here that these incentives are not created by the law, but rather the export contract establishes a mechanism by which they may be implemented.

The law also creates a new system for maquila or drawback industries, which eliminates the disadvantages of a previous system contained in the law for the Promotion and Development of Exports. One example of the changes between the two laws would be the elimination of the guarantee system which was used in the previous law, and its replacement by a more flexible guarantee which is called the "customs pledge."

The Emergency Law also establishes the possibility of deducting up to 50 percent of the amount paid in a stock exchange for the purchase of stock in local export industries or in exports for 100 percent of its production.

There are some disincentives to investment and exports which have not been resolved by the Emergency Law. Among these are the following:

(a) scrutiny of foreign exchange; and

(b) excessive paperwork involved in the export process.

There also apparently exists certain backsliding in the system contained in this law. For example, we cite the rules which allow government officials to decide what may and may not be imported duty-free as components for exports, rather than leaving it for the private sector to decide.

C. New Ideas for the Modification of the Foreign Trade Regime of Costa Rica

Besides the modifications contained in the legislation described above, the Government of Costa Rica has received other measures for study and consideration. These could imply export incentives.

These ideas include special official exchange rates for exporters, subsidized financing, establishment of "export platforms" in foreign markets, etc. Some of these ideas are considered in this paper. Nevertheless, a deep and detailed analysis concerning the implications of these laws vis-a-vis the possible countervailing actions and policies of the Commerce Department of the United States is not possible at this time. These ideas are not yet fully formed. We cannot comment on them further in this paper until they have been fleshed out.

Although monetary policy does not fall within the scope of this study, we would nevertheless note that multiple or subsidized exchange rates could be the object of compensatory actions on the part of the United States.

II. REVIEW OF INTERNATIONAL AND U.S. LAWS ON SUBSIDIES

A. The Principal Laws

The following are the principal international and U.S. subsidy laws of interest to Costa Rica:

(1) The General Agreement on Tariffs and Trade, particularly Articles VI (countervailing duties), XIV (subsidies), XXIII (dispute settlement) and Part IV (developing countries).

(2) The Subsidies Code, technically known as "the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT," negotiated during the Multilateral Trade Negotiations (MTN) concluded in Geneva in 1979.

(3) U.S. law, principally the Trade Act of 1974 and the Trade Agreements Act of 1979.

(4) The requirements for CBI eligibility contained in the Caribbean Basin Economic Recovery Act (CBERA) and the recent exchange of letters between Costa Rica and the United States.*

B. Definitions

1. Subsidies:

The instrument we will discuss are based on certain concepts of subsidies. Under U.S. countervailing duty law, a <u>subsidy</u> is a government program which has the direct effect of stimulating the production or sale of a good. Typically, the program would operate through a government on quasi-government agency.

Subsidies can be subdivided into two categories -- export subsidies, and domestic or production subsidies.

Export subsidization occurs when the subsidy itself or the amount of the subsidy is conditioned upon the export of a product, and is usually calculated in relation to the value or amount of the export. There are usually different international rules for export subsidies on manufactured goods and raw materials such as minerals and non-mineral primary goods (henceforth referred to as primary agricultural products), although U.S. CVD law does not differentiate.

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* We do not discuss the Generalized System of Preferences (GSP) at length in this paper. It should be noted, however, that if for whatever reason Costa Rica were to lose its CBI benefits, the GSP duty-free entry privileges would still be available to most products.

Export subsidies on primary agriculture products are generally subsidies conditioned on the export of any product of farm, forest or fishery in its natural form, or which has undergone only the minimal processing which is customarily required to prepare it for marketing in substantial volumes in international trade; further processing for reasons of consumer preference makes the product a manufactured good. For example, assistance for the export of frozen fish or fish placed in oil as preparation for export would be considered an export subsidy on a primary agricultural product. Assistance for frozen or canned fruits and vegetables, when the freezing or canning is done for reasons of consumer preference and not for perishability, is an export subsidy on manufactured products.

Domestic or production subsidies are usually granted for the production, as opposed to the exportation, of a product. They usually are not generalized thoughout the economy but are limited to certain groups of producers, sectors, regions, etc.

2. <u>Countervailing Duties:</u>

A countervailing duty is a levy assessed by the government of an importing country on a subsidized import in order to offset the subsidy. Its level is based upon an importing country's review of the subsidy policy of the exporting country. For any product where subsidies are found, it can be levied either on all imports or only on imports from particular enterprises which are benefitting from the subsidy.

C. <u>The General Agreement on Tariffs and Trade (GATT)</u>

Articles VI, XVI and XXIII of the GATT cover subsidies and countervailing duties. Part IV covers subsidies and countervailing duties for developing countries. GATT rules are not effective in practice for controlling either subsidy or countervailing practices or in providing more favorable treatment for the exports of developing countries.

1. <u>Article VI - Countervailing Duties.</u>

Article VI defines countervailing duties and sets out the circumstances under which these duties may be levied. The provision is straightforward and provides that:

(a) countervailing duties may only be imposed if the effect of the subsidy is to "cause or threaten material injury" to, or to "retard materially the establishment of," a competing domestic industry;

(b) countervailing duties should not exceed that level needed to offset the amount of subsidy found to exist;

(c) countervailing duties and dumping duties should not be imposed together to compensate for the same situation;

(d) in special circumstances (which virtually never occur), a country may impose countervailing duties where subsidized imports cause "material injury" to an industry in a third country;

(e) if specified conditions are met, programs designed to support or stabilize the prices of, or income derived from, primary products are presumed not to result in "material injury"; and

(f) countervailing duties may not be levied against any exemption from, or refund of, duties or taxes borne by a like product when destined for consumption in the home market.

U.S. countervailing duty law is embodied in a statute dating from 1897. This law is recognized by the Protocol of Provisional Application (PPA) to the GATT. The PPA allows countries to apply domestic legislation inconsistent with the GATT, which means that the United States does not have to apply any provisions of this GATT article which were inconsistent with its 1897 law. Specifically, the 1897 law did not require a finding of material injury in deciding whether to countervail against dutiable imports.

2. Article XVI - Subsidies.

Article XVI imposes obligations upon any contracting party granting or maintaining a subsidy that operates, directly or indirectly, to increase exports from or decrease imports into its territory. These obligations are: (a) to notify the GATT of the subsidy and its effects; and (b) upon a determination that the subsidy causes or threatens "serious prejudice" to the interests of another contracting party, to discuss, upon request, the possibility of limiting the subsidy.

Not surprisingly, this self-notification/consultation provision has been something less than an effective brake on the use of subsidies. As far as we are aware, there is no record of any country ever having limited a subsidizing practice as a result of consultations under Article XVI, paragraph 1. At a 1955 session of the GATT Contracting Parties to review the operation of the GATT articles, Section B was added to GATT Article XVI. This Section B -- paragraph 2-5 of Article XVI -- adds some limitations on the use of subsidies but deals only with direct export subsidies and applies only to those 17 developed countries that have accepted them. The rules themselves have yet to be well developed. Those countries that have accepted Section B have agreed to:

(a) cease to grant export subsidies, directly or indirectly, on nonprimary products where the subsidies result "in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market," and

(b) not to apply export subsidies on primary products in a manner that results in the subsidizing country having "more than an equitable share of world export trade in that product," taking into account trade shares of the contracting parties during a previous representative period and any special factors that may have been involved.

In 1960 the rules for export subsidies on nonprimary products were refined with the development of an illustrative "List of Export Subsidies." This illustrative list, although not exhaustive, sets out a number of specific practices considered to be export subsidies for purposes of Article XVI, paragraph 4.

The weaknesses in these export subsidy "prohibitions" are apparent. For primary products, in fact, there is no meaningful prohibition at all. Export subsidies are allowed as long as they do not give the subsidizing country more than an equitable share of the world market, and there is no guidance as to what is and what is not an "equitable" world market share.

On the nonprimary or industrial side, there is a flat prohibition on export subsidies, provided that the export subsidy results in dual pricing (i.e., a lower price in the export market than in the home market). While the requirement that an export subsidy result in dual pricing appears to have been an effort to distinguish between domestic and export subsidies, it made little economic sense and was at best difficult to prove. Dual pricing frequently arises from causes other than export subsidies. Tax breaks for export earnings stimulate exports without any dual pricing effect at all. Moreover, it was uncertain what constituted a "subsidy on export." Finally, the obligation of Article XVI, paragraph 4 had been assumed by only 17 countries, all of which were developed countries.

Except for the notification/consultation provisions of Article XVI, Paragraph 1, the Article itself does not deal with the question of domestic or internal subsidies. A 1955 Working Party report recommended, however, and the contracting parties approved, an understanding that:

> a contracting party which has negotiated a concession under [GATT] Article II may assume, for the purpose of Article XXIII, to have a reasonable expectation, failing evidence to the contrary, that the value of the concession will not be nullified

or impaired by the contracting party which granted the concession by the subsequent introduction or increase of a domestic subsidy on the product concerned.

This 1955 Working Party Report, while not making domestic subsidies actionable under the GATT per se, gave contracting parties a right of redress in cases where a domestic subsidy operated to undercut the value of a negotiated or bound tariff rate* concession even though the use of the subsidy was not itself prohibited.

While domestic subsidies were not prohibited then, this concept did link domestic subsidies and protection of trade interests.

Articles VI and XVI of the GATT are conceptually unrelated. For the purposes of applying countervailing duties, the rules of Article XVI are irrelevant. In a countervailing duty action, it makes little difference whether the subsidy in question is legal or illegal under the terms of Article XVI. All that matters is whether the subsidy, whatever its nature, is causing or threatening to cause "material injury."**

Conversely, the provisions of GATT Article VI are irrelevant to the enforcement of the subsidy rules of GATT Article XVI. If a subsidy is "illegal," the subsidizing country should stop the practice whether or not it causes "material injury." The subsidy rules are enforceable under the procedures of GATT Article XXIII. Under Article XXIII, the failure of a contracting party to carry out its GATT obligations is <u>prima facie</u> evidence of nullification or impairment of the benefits accruing to the affected party under the GATT. If, after consultation, the "nullification or impairment" is not resolved (i.e., the dispute is not settled), the party invoking the Article XXIII procedures may be authorized to take such offsetting measures as may be appropriate in the circumstances.

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* Bound rates are most-favored-nation (MFN) tariff rates resulting from GATT negotiations and thereafter incorporated as integral provisions of a country's schedule of concessions. The bound rate may represent either a reduced rate or a commitment not to raise the existing rate of a binding ceiling.

** Material injury is defined in U.S. trade law as that injury which is not inconsequential or unimportant. It is easier to demonstrate than the "serious injury" required in escape clause cases, where the petitioner claims he is injured by domestic subsidies.

3. Article XXIII - Dispute Settlement.

Article XXIII itself does not set out specific procedures under which the Contracting Parties hear disputes and arrive at their "recommendations" or "ruling." A fairly elaborate practice which centered around procedures for the establishment of impartial panels of experts was developed in the early GATT years. The procedures worked quite well until the late 1960s. The GATT panels were generally composed of government officials acting in an independent capacity. They established a tradition of objectivity and, as a rule, delivered clearly reasoned opinions of GATT "law" on the rights and obligations of the parties to the dispute. Political considerations were not ignored, but neither did they dominate the deliberations.

In the late 1960s, the panel procedure began to break down. The reasons for this are complex. It reflected both a breakdown of consensus over the GATT rules and the emergence of conflicting "bloc" interests. The principal "blocs" were the European Community, the United States and the developing countries. Whatever the cause, the result was a serious deterioration of the GATT legal system. The objectivity of panels was questioned, the proceedings tended to drag on, the opinions delivered were often vague and the results of the process were frequently resisted. GATT Article XXII procedures had become more an occasion for politics and conciliation than for objective dispute settlement. And, as is inevitable when enforcement procedures decline, defects in the substantive GATT rules began to loom larger than ever.

4. Developing Countries.

No special treatment was provided for developing countries in GATT Article IV and XVI of the GATT.

D. The Code on Subsidies and Countervailing Duty Measures

1. Introduction

The Code on Subsidies and Countervailing Duty Measures was considered the principal outcome of the Multilateral Trade Negotiations (MTN) which concluded in Geneva in 1979. For the United States, it represented the first international success in disciplining the subsidy practices of a large group of countries, and internationalized what was previously a unilateral U.S. practice. Other countries gained as well, as the United States adopted a mandatory material injury test before the imposition of countervailing duties. The developing countries were less enthusiastic about what they considered a fait accompli by the developed countries, and only accepted it grudgingly. They hoped it would be administered in a way which took their interests into account.

2. Export Subsidies on Manufactured and Mineral Products

Export subsidies for manufactured and mineral products are illegal under the 1979 Subsidy Code. When it can be shown that the subsidy is conditioned on the export of the product and that the product is a manufactured or a mineral product, then the subsidy is illegal and a breach of the GATT code. Nothing else needs to be shown, not even material injury to a domestic industry.

Unlike Section B of Article XVI, there was no need to demonstrate that an export subsidy on manufactured or mineral products resulted in dual pricing. Also, although there was no comprehensive definition of "export subsidy," an illustrative list of 22 export subsidy practices was included in the agreement.

When a code signatory employs an export subsidy in violation of the rules of the code, this is *prima facie* evidence of nullification and impairment of the benefits accuing to other signatories, and this signatory is under an obligation to cease the practice. If it fails to do so, other signatories should be able to win a GATT Panel Decision authorizing them to take countermeasures without any proof of injury.

3. Export Subsidies on Agricultural Products

Under the Code, export subsidies are not to be granted to non-mineral primary products when this results in the subsidizing country obtaining more than an equitable share of world export trade in such products. The principal refinement from the GATT rules was a more detailed definition of what constitutes an "equitable share" of world export trade.

Based on these concepts, there eventually emerged in the Agreement the following provisions on equitable market share:

(a) "more than an equitable share of world export trade" shall include any case in which the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets;

(b) with regard to new markets, traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated shall be taken into account in determining "equitable share of world export trade;"

(c) "a previous representative period" shall normally be the three most recent calendar years in which normal market conditions existed.

Signatories further agreed not to grant export subsidies on exports of certain primary products to a particular market in a manner which results in prices materially below those of other suppliers to the same market.

There are ambiguities in these rules that are the inevitable result of the negotiating process. Displacement is to be judged "bearing in mind developments on world markets." This is likely to reduce the ability of other nonsubsidizing countries to press a case against a subsidizing country when overall exports from the subsidizing country of the product in question are clearly down. Also, the injunction against price undercutting is directed at prices "materially" below those of other suppliers. Does this include price shaving?

4. Production or Domestic Subsidies

Production subsidies per se are not allowed or disallowed under the Code, nor is the share of world export trade a determining factor of their legality under the GATT rules. The GATT Code notes that production subsidies may "cause or threaten to cause injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory or may nullify or impair benefits accruing to another signatory." Countries merely agree to "seek to avoid causing such effects through the use of subsidies."

The practices governing these subsidies were tightened. First, some possible forms of domestic subsidies were identified and listed. Second, the principle was reiterated that where a domestic subsidy caused or threatened serious prejudice to the trade or production interest of another Code signatory there should be consultations to correct the adverse affects. Procedures for such consultations were established. If such consultations failed, a procedure was established under which countermeasures could be undertaken by the adversely affected party. This was the first time GATT recognized the right of a country to take action against domestic subsidies. Finally, the concept of serious prejudice was clarified by accepting the premise that serious injury could arise through adverse effects caused by competition in one's home market by import substitution (i.e., reduction of imports into the subsidizing country's market or through competition in third markets).

Despite these concrete steps, however, there is still not a clearly binding and enforceable standard. The GATT does not appear to offer any effective remedies against production subsidies. It is also generally recognized that this is the case, and that enforcable standards will be the subject of future negotiation. It is generally recognized that this issue was not comprehensively dealt with in the Tokyo Round of the Multilateral Trade Negotiations.

5. Special and More Favorable Treatment for Developing Countries

The Subsidy/Countervailing Duty Code contains few provisions allowing special and more favorable treatment for developing countries. First, there is no special treatment under the countervailing duty provisions of the Code. Developing country exports are subject to the same injury test to countervailing duties as are developed country exports. Second, the rules on the use of export subsidies on primary products apply equally to exports from developed and developing countries. Third, the rules on notification, consultation and dispute settlement contain no provisions of special and differential treatment. A small measure of special and differential treatment was granted for domestic subsidies by developing country signatories; redress is limited to cases of injury or of nullification and impairment.

There is only one significant area of special and differential treatment for developing countries. The basic prohibition on export subsidies on nonprimary products does not apply to them. Indeed, it is recognized that subsidies are an integral part of many LDC development programs. The LDCs agreed, however, not to use export subsidies for their industrial products in a manner that will cause "serious prejudice" to the trade or production interests of other signatories. They also agree to endeavour to enter into commitments to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with their competitive and development needs.

6. Countervailing Duties (CVDs)

The Code permits CVDs on any subsidy where injury is found. In essence, the Code accepts the U.S. practice of going after the full economic value of any subsidy in return for the injury test.

E. U.S. Domestic Law on Countervailing Duties

Introduction

Because of the complexity of the topic and the number of statutes, we will not review the complete U.S. domestic law. We will confine our analysis to those aspects which are particularly relevant to Costa Rica.

The U.S. law does not distinguish between different types of subsidies as the GATT and the Code do. Thus under U.S. laws, production and export subsidies on agricultural, mineral and manufactured products are all subject to countervailing duties. The only condition is that material injury be demonstrated. This treatment is claimed to be consistent with international law, because even the illegal subsidies are not likely to prejudice domestic producers, and as long as injury is demonstrated the U.S. can claim that its producers are being prejudiced.

In analyzing the U.S. domestic law, one must understand that the changes in the Trade Agreements Act of 1979 were designed principallyto toughen its implementation. Congress was frustrated over the following points:

(a) the requirement of an injury test for most dutiable imports as a condition for the successful conclusion of Multilateral Tariff Negotiations (MTN). Previously, only a finding of a subsidy was necessary to allow countermeasures to be taken;

(b) strong domestic pressure for an automatic and operating law with no discretion on the part of the Administration;

(c) dissatisfaction with the allegedly ineffective administration of the law, especially over allegations that the administering agency used dilatory tactics in order to avoid taking action;

(d) the belief that as tariff barriers were lowered, there was more need for protection against "unfair" and subsidized trade; and

(e) the special and more favorable treatment provided for the increasingly competitive LDCs.

The consequences of these complaints will be discussed in the pages to follow.

2. Shorter Time Limits for Executive Decisionmaking.

Only a handful of subsidy cases had been successful in the post-war period between 1947 and 1979. One reason was the administrative delay which the previous law did little to discourage. In fact, the previous law established no time limits whatsoever.

The current law sets up short time limits for both the preliminary and final subsidy findings, as well as the injury determination. The Department of Commerce normally has 85 calendar days to determine on the best information available whether there is "a reasonable basis to believe or suspect" that a subsidy is being provided. In cases where injury must also be proved, the United States International Trade Commission (USITC) has 45 calendar days to determine whether there is a reasonable indication that a U.S. industry is materially injured, threatened with material injury or the U.S. industry is materially retarded by reason of the subsidized import.

If this finding is made, the Department of Commerce will investigate the case. If Commerce finds a subsidy, it will order the suspension of customs liquidation of all new imports of the products and will direct the Customs Service to require a cash deposit on the posting of a bond or some other security in the amount of the estimated net subsidy from the country in question. Initial decisions favorable to the petitioner are encouraged by the petitioner's ability to choose the time and place for his petition, the need to demonstrate only a reasonable indication, and the short time period for the exporter or the foreign government to provide information and organize its defense.

Within 75 days of the preliminary decision, Commerce must make a final determination as to whether a subsidy is being provided, the amount of the countervail and against which companies. Where necessary, the USITC must then determine the injury question within 45 more days.

3. Minimal Discretion Allowed the Administration

Unlike other aspects of U.S. trade law, the Administration is allowed very little discretion in countervailing complaints. The Administration cannot take into account the factors that it considers in an escape clause case, such as the effect on U.S. foreign policy objectives, price levels for industrial users and final consumers of the products, the possibility of recovery of the industry. It cannot take the development needs of an exporting developing country into account.

The only discretion allowed the Administration is the possibility to negotiate solutions to the subsidy. However, these negotiations are also significantly circumscribed. Four types of agreement are possible:

(a) an agreement in which the exporting country or companies agree to eliminate the subsidy completely or to completely offset the amount of the net subsidy;

(b) the exporting country may agree to cease exports to the United States of the goods on which the subsidy is suspected.

(c) the suspension of the investigation will be more beneficial to the U.S. industry than continuation of the investigation, especially in cases of complex investigations.

(d) the suppression or undercutting of price levels of U.S. products by the imports to be prevented, and at least 85 percent of the net subsidy will be offset.

The third and fourth type of agreement, however, can only be negotiated if a country is entitled to an injury test.

The Department of Commerce will monitor any agreement to make sure that it is being honored.

4. Offsets are Almost Completely Disallowed

Congress believed that the Administration abused the previous law by offsetting the value of the subsidies with "unsubstantiated diseconomies inherent in the development process" (e.g., poorer infrastructure). As a result, the Congress wrote into the new law restrictions which only allow the Administration to take into account those offsets required by the GATT or the Code, (e.g., indirect taxes levied on inputs directly incorporated into the product). The country must demonstrate that the subsidy was based on these indirect taxes, not allow an expost-facto determination of incidence of these taxes. The Commerce Department cannot consider such offsets as inadequate infrastructure, special training costs, high direct tax burden of the productive sector, need for regional incentives to develop new growth centers, or similar factors which are typical of developing economies.

5. Transfer of Responsibility from Treasury to Commerce.

The responsibility for administering the law was transferred to the Commerce Department in 1980. This move was the result of criticism of the Treasury Department's failure to levy many countervailing duties, coupled with the belief that Treasury's global responsibilities would interfere with diligent prosecution of subsidies, A separate unit under the International Trade Administration was set up which was to largely insolated from foreign policy and international economic concerns.

6. The Injury Test is Only Granted When Absolutely Required by the International Obligations

The Administration only grants the injury test when required to do so under its international obligations. This means that the injury test is only granted to non-Code GATT members on duty-free imports, and to Code members on both their dutiable and duty-free imports. However, the U.S. reserves the right to withhold agreement privileges even for Code members.

This is particularly true for the injury test in the case of developing countries failing to enter into acceptable commitments. In such a case, neither the U.S. nor the signatory country is obligated by the Code in their bilateral relations. The United States has indicated that for developing countries failing to undertake sufficient obligations with respect to reducing or eliminating their subsidies, no injury test will be granted with two exceptions:

(a) countries which had an agreement requiring unconditional MFN treatment in force as of on June 1, 1979. The countries which were enumerated in the Congressional report to the 1979 Act are Honduras, El Salvador, Venezuela, Liberia, Nepal, North Yemen and Paraguay;

(b) countries which enter into agreements with the U.S. involving "substantially equivalent" obligations as those in the 1979 Code, specifically Taiwan.

5. Insistence that Developing All Countries Accept Obligations to Reduce or Eliminate Subsidies

The Administration has insisted that countries agree to a phase-out schedule for export subsidy practices prior to receiving the injury test either under the Code or through a bilateral agreement with substantially equivalent obligations. Developing countries point out that the Code only requires a developing country to endeavor to undertake commitments to reduce or eliminate those export subsidies which are not consistent with their development needs.

6. Easier to Demonstrate Material Injury.

Congress was extremely reluctant to accept the injury test for subsidy cases. It therefore adopted a test which in some ways was considered the minimum allowable by international law:

> harm that is not inconsequential, immaterial or unimportant. In assessing whether there is injury, the USITC must decide whether the subsidized import has contributed to the injury suffered by the industry. Unlike other aspects of U.S. trade law, there is no need to weigh the injury against other causal factors and decide whether the subsidized imports is the principal cause of the injury. Also, in determining injury, the USITC can add the effect of subsidized imports from several sources in cases where individual suppliers may have an insignificiant market share.

A second track available to the United States is to ask the exporting country to eliminate those subsidies inconsistent with the Code as nullifying benefits accruing to the United States. If a country refuses, the U.S. can seek the approval of the Code members to take unilateral action to restore the balance of concession. In such a case, the U.S. can take countervailing action or other steps to restore the balance.

III. ANALYSIS OF THE CURRENT COSTA RICAN LAW AND PROPOSED MODIFICATIONS TO EXPORT LAWS

A. General Principles

The Subsidies Code provides for a developing country to endeavor to enter into commitments to reduce or eliminate export subsidies when the use of such export subsidies is inconsistent with its competitive and development needs. Thus it would appear that as long as Costa Rican export subsidies are consistent with their competitive and development needs and do not prejudice the trade or production interests of other signatories, they are not inconsistent with the Code. For subsidies on non-mineral primary products, no illegality is involved as long as countries do not receive more than an equitable share of the world export trade in such products. Given the small and diversified Costa Rican agricultural sector, it is doubtful that Costa Rica would ever gain more than an equitable share of trade in any agricultural product.

The question of illegality usually does not arise under U.S. law. All subsidy practices, whether for export of the domestic market, are considered to be subsidies and subject to countervailing actions. Since Costa Rica is not a member of GATT or the Code, it does not receive an injury test before such action is taken. In other words, the United States is not obligated to take into consideration the illegality of a subsidy or the necessity of special LDC exceptions, it simply applies its own countermeasures.

B. The Caribbean Basin Initiative and Costa Rica's Letter of Commitment

The Caribbean Basin Economic Recovery Act (CBERA) provides that in determining beneficiary country designation, the President shall take into account the degree to which such countries use export subsidies which distort international trade. No clear procedures exists for measuring international trade distortions caused by subsidies, or the degree which the President should take this into account.

There is a question whether this provision is now moot, since Costa Rica has been designated for CBI treatment. The law does allow the President to withdraw or suspend the designation of any country as a beneficiary. However, this can only occur if the President determines that as a result of changed circumstances, such countries would be barred from designation. Because the subsidy provision is only a requirement to be taken into account, it is questionable whether a violation of the subsidy commitment would actually endander a country's designation as a beneficiary.

In its November 14, 1983 letter to the United States Government requesting designation as a CBERA beneficiary, Costa Rica maintained that its incentive system provides for the production and export of non-traditional goods which require temporary assistance in order to broaden the country's range of export goods. The purpose of any new incentives proposal would be to take advantage of the country's comparative advantage in the production of certain goods, and to guard against artificial reduction in the sale price of exports which would cause harm to the commercial interests of other countries.

The Government of Costa Rica agreed to keep under review on a continuing basis its fiscal objective of avoiding distortions in international trade. The Government agreed to discuss and consult with the United States in those cases in which the U.S. believed that any trade promotion practices of the GOCR distort trade. In the interim, the Government agreed not to increase the overall level of subsidies. The United States has not requested such consultations so this commitment is not yet in effect.

Therefore, it would not seem that Costa Rican law violates either the Subsidy Code or U.S. trade laws. Nevertheless, certain aspects of it may be subject to virtually automatic countermeasures under U.S law. Legal interpretations aside, the U.S. Congress is very sensitive to export subsidization. It is important for Costa Rica to be aware of this sensitivity because the CBI is a unilateral program and one whose benefits can be withdrawn.

C. Costa Rican Practices

We would now like to review current and proposed Costa Rican practices. Where appropriate, we will suggest alternatives which would reduce if not eliminate the possibility of U.S. countermeasures.

Before beginning, however, we would emphasize that this paper is not meant to be a legal treatise covering Costa Rican practices. The United States Commerce Department determines whether each subsidy practice should be countervailed against based on individual investigations. This paper does not purport to have any influence whatsoever on any possible future investigation, but merely attempts to comment on general trends on the basis of past U.S. trade policy experience.

(1) Income Tax Rebates.

Current Costa Rican legislation exempts income generated from export sales of non-traditional production to third country markets from Costa Rican taxation.

U.S. law and the Subsidy Code do not allow rebates of direct taxes such as income taxes. Thus it would appear that this practi is potentially subject to countermeasures.

The mere existence of such a program may not be countervailabl It must be demonstrated that the taxpayers actually had an income which benefited from this tax deduction.

This type of incentive has received much attention in the context of a United States and European Communities (EC) subsidy dispute. The United States Domestic International Sales Corporati (DISC) provided for tax deferment (not an exemption) on export income for an indefinite period of time. The EC claimed that DISC was illegal under the GATT. The GATT accepted the European Community argument that the DISC was illegal. It pointed out, however, that if the interest had been assessed on the deferred taxes, there would not have been an export subsidy. The U.S. Congress is now considering the replacement of the DISC with the Fiscal International Sales Corporation (FISC). The FISC would exempt offshore export operations from income taxes.

If there is a complaint against Costa Rican practices, Costa Rica can consider similar steps. First, the country could defer rather than exempt the tax liability, and assess interest on the defered taxes. A second alternative is to allow the establishment of an export sales facility in foreign countries. Since Costa Rica accepts the territorial tax concept, any establishment of a foreign export corporation would not be subject to Costa Rican taxes or to countervailing action. Costa Rica may have to review its currency law to allow the establishment of such facilities.

2. Export Bounties

Costa Rica has two systems of export payments. The Tax Credit Certificate (CAT) is a tax credit certificate equal to 15 percent o the FOB value of the export for non-traditional exports to third country markets. The Export Increment Certificate (CIEX) allows additional credit for increases in certain non-traditional exports.

The Subsidy Code and U.S. law only allow export payments equivalent to indirect taxes incorporated in the production process. Whereas the Subsidy Code allows the rebate of indirect taxes on all inputs used incorporated in the production process, U.S. law (and EC countervailing duty law) allows only for the rebate of such taxes on inputs which are actually incorporated into the final product which is exported. Rebates of taxes on services, energy and other inputs which are not physically incorporated in the product would be considered inadmissable rebates, and therefore subject to countervailing action.

Another requirement is that there be a clear linkage between eligibility for export payment and payment of indirect taxes. Such a linkage requires the subsidizing government to calculate and document the actual indirect tax borne by the exported product.

It is suggested that Costa Rica calculate the indirect tax by process for several export products. Depending on the calculation, one could decide whether to revise the export payment laws to take this into account.

Here again, we would emphasize that the mere existence of the law does not subject Costa Rican goods to countervailing actions; only the actual payments do. Therefore, the CIEX would not be countervailable in the last few years, as it has not operated for want of finding.

3. Rebates on Import Duties for Raw Materials and Capital Equipment

Under Costa Rican law, import duties on capital equipment and inputs necessary for export production can be rebated. These rebates apply to export production for both the Central American Common Market area and for third markets.

The rebate on imported raw material is allowable under U.S. law. The rebate on imports of capital equipment is countervailable, however, since the capital good is not physically incorporated in the finished export products. A distinction is made between production in a drawback industry and a customs free zone located within the customs area of Costa Rica. A subsidy would be involved, because the rebate is for indirect taxes that are not incorporated in the final product. If the rebate is provided only for machinery used for export production, it could be considered an export subsidy. If it is provided for all production a particular sector, it is considered to be a domestic subsidy.

In the latter, there is no duty rebate, and therefore no subsidy should be involved. There still might be some question of U.S. countervailing duty law.

Import permits (special permits) granted to producers for inputs incorporated in export goods are not a subsidy. The issuance of special permits which allows the exporter to use the imported inputs in either export of domestic production could be considered a subsidy. This is not the case in Costa Rica.

4. Reduced rates for Export services

The new Costa Rican law provides a framework for allowing lower charges for certain export services such as port charges, freight rates, etc., as part of an export contract. The law itself does not provide for implementing authority. This practice, if put in place, could be considered a subsidy. An alternative system may be to allow these rates to be freely negotiated between the suppliers and users of these services. This may not be a subsidy.

Export Financing

Export financing below commercial rates is considered an export subsidy.* Lower rates given to specific sectors can be considered a domestic subsidy.

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* For purposes of its commitment policy, the U.S. only requires countries to observe the OECD "Gentlemen's Agreement" on Subsidization. This agreement establishes a floor for various types of export credit. Therefore, the anomalous situation is created where, for purposes of U.S. commitment policy, export credits below commercial interest rates are acceptable, but for purposes of countervailing actions, they are considered actionable.

IV. IMPLICATIONS FOR COSTA RICA

A. Joining the Subsidy Code and the GATT

Costa Rica is in an unfavorable position in the subsidy area. Under the current situation, Costa Rica is in the least favored position of any country in relations to the U.S. countervailing duty law:

(1) As a result of Code non-adhesion, failure to enter into a bilateral agreement with substantially equivalent obligations, and not having in effect in 1979 an unconditional MFN agreement,* the country does not receive the injury test or other procedural protections of the Code.

(2) Because Costa Rica is not a GATT member, it does not receive an injury test or the procedural protection of the GATT in subsidy cases.**

(3) As a result of its CBI designation, Costa Rican practices will continue to be closely monitored, limiting Costa Rica's freedom of maneuver.

(4) Under current U.S. practice, any subsidy complaints will probably be investigated. Even if unsuccessful, the investigation could harm Costa Rican exports by (a) leading to uncertainty in the market; (b) requiring large legal and consulting fees to defend against the change: and (c) possibly result in the levying of countervailing duties.

Therefore, Costa Rica should expedite its consideration of joining the GATT. In its CBI designation letter, Costa Rica stated its intention to seek entry into the GATT. Such adhesion would provide the injury test for duty free imports and allow other GATT procedural safeguards. The only exceptions would be textiles, footwear and those assembly products which do not meet the CBI rules of origin. The government should investigate if it is worth joining the Subsidies Code, and undertaking the required commitment so as to allow these products to also benefit from the injury test.

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* Honduras and El Salvador receive the injury test on all imports as a result of unconditional MFN treaties.

** Nicaragua and most of the Caribbean nations are GATT members and receive the injury test on duty-free imports. In light of the virtually all-inclusive nature of duty-free treatment under the CBI, this might be a significant for the Caribbean nations.

Similarly, Costa Rica should consider joining the Subsidy Code and/or entering into a bilateral commitment with the United States.

B. Review Current Laws

Current Costa Rican practices should be analyzed in light of international and U.S. practices. Such a study should include a review of the current legislation to determine if modification in the law would reduce the possibilities of a countervailing action. Specifically, this study would include:

(1) identification of indirect tax burden on inputs directly incorporated into export products;

(2) consideration of modifying foreign exchange procedures and other laws to allow the establishment of offshore operations for export marketing, rather than income tax exemptions on export operation. Also, one could consider tax deferral on income associated with export operations.

(3) consideration of the adoption of incentives suggested by Costa Rica in its letter requesting designation for CBI.

C. Implement Practices Which Are Not Countervailable

In the Costa Rican CBI designation letter, Government of Costa Rica indicated that it would consider the following incentives:

(1) the simplication of administration procedures;

(2) the rationalization of export levies;

(3) the improvement of finance services for the exporters;

(4) the improvement in efficiency and reductions of cost of loading and transport service;

(5) the adequate training of national labor force; and

(6) governmental investigation of potential products and markets for exports.

Such incentives can be developed with little or no subsidization which would be subject to U.S. countervailing duties. There should be no problem with simplifying administrative procedures, improving the efficiency of loading and transport services, the adequate training of a national labor force and the identification of potential export products and markets export. Such actions, however, should be applicable to all sectors of the economy rather than being applicable only to export sectors or to specific sectors with export potential. To do otherwise would make the actions more liable to U.S. retaliation.

The rationalization of export levies could be to limit export levies to the amount of indirect taxes directly incorporated into the product. Finance services for exporters could be improved by facilitating bank credit rather than giving exporters special rates or privileges. In order to avoid the possibility of countervailing actions, loading and transport costs should be reduced by a general improvement in the efficiency of operations or through freely negotiated rates between ocean shippers and air freight operators and users.

In short, most of the proposals mentioned in the CBI designation letter should be applied to the economy on the whole and not to specific exports. Government services, particularly in assistance in marketing products, should be provided where possible on a reimbursible basis.

D. Macro-Economic Measures

The Costa Rican government has received many suggestions for improving the overall efficiency of its economy. We do not propose to explore these points in any great detail, nor do we suggest the necessary balance between those measures which have been introduced for equity purposes and those measures which may put more of an emphasis on efficiency. We would emphasize, however, that too great an emphasis on improving production at the expense of other goals could undercut the basis of the stable political system. The obverse is also true: too great an emphasis on social objectives can undercut stable production, and any political system will deteriorate in the absence of economic productivity.

The following are other economic measures which have been recommended to improve the export production sector:

1) cutting public expenditures;

2) improving the attitude of government functionaries vis-a-vis the exporter; and

3) adoption of a more realistic exchange rate system.

In general, none of these measures would be subject to countervailing actions.

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