

# RECENT STIMULUS PACKAGES AND WTO LAW ON SUBSIDIES

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## Abstract

Major world economies are simultaneously experiencing deep recession due to the world economic crisis, and in attempting to contain the extent of damage, governments have been introducing unprecedented stimulus packages. These stimulus programs raise many concerns from the perspective of international trade rules. This paper analyses those concerns in relation to possible conflicts with the World Trade Organization's (WTO) Agreement on Subsidies and Countervailing Measures (ASCM). The concept of 'subsidy' in WTO law is discussed, together with the analysis of two salient measures, export credit support and the automobile industry, that are currently being adopted in response to the current crisis. A further critical analysis is provided on recent developments in the review of the ASCM as part of the Doha Round.

## 1. Introduction

Amid the current economic crisis, that has thrown the major world economies into a simultaneous deep recession, governments are struggling to contain the extent of the damage. Due to the apparent failure of past economic policies that encouraged minimum State intervention and regulation of the markets, previously regarded as 'heterodox' economic policies are the order of the day and, as a result, unprecedented stimulus packages have been unleashed.<sup>1</sup> These stimulus programs raise many concerns from the perspective of international trade rules. In this paper we will analyse possible conflicts with the World Trade Organization's (WTO) Agreement on Subsidies and Countervailing Measures (ASCM). The relevance of this issue is highlighted by the fact that, in the context of the present financial and economic crisis, subsidies in developed countries have so far been the measure causing most concern for the international trade regime.<sup>2</sup>

In Section 2, we elaborate the concept of subsidy in WTO law<sup>3</sup> and establish the elements for an analysis of different measures adopted in response to the current crisis, which is presented in Section 3. Then, in Section 4, we provide a critical analysis of recent developments in the review of the ASCM as part of the Doha Round.

## 2. Subsidies from the WTO law perspective

Article 1 of the ASCM defines a subsidy as a financial contribution by a government or any public body within the territory of a Member by which a benefit is conferred.<sup>4</sup> 'Financial contribution' and 'benefit' are two different legal elements of the concept of subsidy that require a separate analysis.<sup>5</sup> While the 'financial contribution' relates to an action of the government, the 'benefit' focuses on the recipient.<sup>6</sup> The 'financial contribution' is to be determined in 'the actual amounts *provided* by a government and not just those *authorized* or *appropriated* in its budget for that year'.<sup>7</sup> The Appellate Body (AB) has interpreted that 'a 'benefit' does not exist in the abstract, but must be received and enjoyed by a beneficiary or

recipient. Logically, a ‘benefit’ can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something. The term ‘benefit’, therefore, implies that there must be a recipient’.<sup>8</sup> The benchmark to identify a ‘benefit’ is the marketplace, therefore a ‘benefit’ exists when the recipient sees their wealth increased in respect to what would have been the result if only market forces were in play. As the AB has stated:

We also believe that the word ‘benefit’, as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no ‘benefit’ to the recipient unless the ‘financial contribution’ makes the recipient ‘better off’ than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a ‘benefit’ has been ‘conferred’, because the trade-distorting potential of a ‘financial contribution’ can be identified by determining whether the recipient has received a ‘financial contribution’ on terms more favourable than those available to the recipient in the market (*Canada-Aircraft*, WT/DS70/AB/R, para. 157; later quoted in *Lead Bismuth*, WT/DS138/AB/R, at para. 67).

The ‘benefit’ need not be a ‘competitive benefit’, meaning that it is not necessary that as a result of the subsidy the recipient has their cost of production lowered.<sup>9</sup> In other words, the ‘benefit’ must be identified in a subject, not in the object (that is, the goods). The ‘recipient’ of a benefit might be the company itself or its shareholders.<sup>10</sup>

In order to be actionable, a subsidy must be found to be ‘specific’ in accordance with the provisions of Article 2 and cause adverse effects (that is, injury to the domestic industry of another Member; nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994; or serious prejudice to the interests of another Member<sup>11</sup>). Subsidies contingent upon export performance (‘export subsidies’) and subsidies contingent upon the use of domestic over imported goods (‘import substitution subsidies’) are regarded as ‘prohibited subsidies’ (Article 3 ASCM) and are automatically deemed to be ‘specific’.<sup>12</sup>

The ASCM only covers subsidies which might have an impact on the international trade of goods, with the exception of agricultural goods. Subsidies in the field of agricultural goods are governed by the provisions of the Agreement on Agriculture. Subsidies in the field of services are subject to the discipline of Article XV GATS, which is quite unspecific in nature (it does not define the concept of subsidy) and does not establish any legal remedy.

### **3. Analysis of two salient measures: export credit support and the automobile industry**

#### **3.1 Export credit support**

Export credit enables a buyer (importer) to defer payment for the goods to the seller (exporter) or to a financial institution. This goal can be achieved in different ways: the exporter can provide the credit themselves; the exporter can provide the credit by means of an agreement with a financial institution; or the importer can obtain a loan from a financial institution. The financial institution involved in this credit can be an Export Credit Agency (ECA), which is a government-sponsored agency that promotes exports by facilitating export credit, either to the exporter or to the importer. The involvement of an ECA in export credit is termed either ‘official financing support’ (that is, when the credit is directly provided by the ECA to the buyer) or ‘pure cover’ (that is, when the credit is provided by a private financial institution and the ECA simply offers insurance or guarantees that facilitate the provision of credit). An ECA may also offer interest rate support for export credits.

Export credit is a relevant cost component in any operation of international trade. Therefore, government intervention that affects this cost can distort trade – as the WTO Panel in *Canada-Aircraft* observed.<sup>13</sup> Export credit support can satisfy the criteria of a subsidy, as defined by the ASCM, when:

- It is a *financial contribution* by the government. This can take several forms: it can be provided by either a public body (which includes state-owned agencies or corporations) or a private body which is entrusted or directed to carry out the financial contribution. There are doubts as to whether export credit provided by international institutions would meet this criterion, although it seems most likely that the answer is ‘no’.<sup>14</sup>
- It confers a *benefit*. The recipient of the credit (and thus the financial contribution) can be the importer but there is nevertheless a passing-on of the benefit to the exporter, ‘as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products’.<sup>15</sup> As we have explained above, there is a benefit when the conditions offered to the exporter are more favourable than they would have been in the market without government intervention (either in the form of official financing support or pure cover), even when no cost to the government results from the financing operation.<sup>16</sup> This is an important point because some government sponsored ECAs are mandated to be self-sustaining, that is, in the long term they need to cover their costs with the income they obtain from offering their services (that is, in the form of interests, insurance premiums or guarantee fees). Therefore, the fact that the ECA is self-sustaining is not relevant when the recipient is found to be receiving terms more favourable to them than those offered by the market. This is consistent with the ASCM provisions but it conflicts with the economic arguments that justify the establishment of ECAs.

ECAs are a useful instrument to address different market failures in export financing. In some circumstances, governments may have better risk information than private financial institutions and therefore they may be in a better position to assess the costs of risk. In other cases, the amounts involved in a transaction might be too high for a private institution, even though the operation could be commercially sound. ECAs can also foster trade when there is a financial crisis and private institutions cut trade financing out of systemic fear (‘herd behaviour’), as is the case in the current financial and economic crisis. However, if we establish that market conditions are the benchmark for deciding if there is a ‘benefit’ then the operations of an ECA that try to address these failures will be deemed to constitute a ‘benefit’ because they provide financing or cover for an operation that would otherwise not have taken place in the market under those terms or not at all (that is, because private institutions might have worse risk information or the amounts involved could be too high for them or there is a systemic fear). If the market is the only benchmark, we will be defenceless against market failures since the realisation that the economic fundamentals justifying the establishment of an ECA are in play would indicate that there is a deviation from market conditions – even when that deviation is justified precisely because the market is failing.<sup>17</sup> In fact, the AB has recognised that private prices might not be an adequate benchmark, but that only happened in cases where government intervention distorted prices.<sup>18</sup>

Once the ‘benefit’ element is established, export credit support will most likely fall in the category of ‘prohibited subsidies’ because it is *de jure* contingent upon export performance. That is so because the credit is for exports and thus it is granted for the sale of goods for export.<sup>19</sup> Nevertheless, note 5 to the ASCM provides that ‘Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement’. Annex I of the ASCM contains an ‘illustrative list of export subsidies’. Therefore, the items contained in this list are, in principle, prohibited subsidies. Items (j) and (k) in Annex I of the ASCM are relevant for our discussion on export credit support. They provide as follows:

- (j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the

cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

(k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement (Annex I, ASCM).

The only explicit exclusion from the category of ‘prohibited subsidies’ that we can find in these two items is contained in the second paragraph of item (k). This paragraph establishes an exception by (an indirect) reference to the ‘Arrangement on Guidelines for Officially Supported Export Credits’ (OECD Arrangement).<sup>20</sup> This arrangement is not an international treaty, nor even an OECD act, but a so-called ‘gentlemen’s agreement’ that is not legally binding and which can be modified by the Participants without having to follow the OECD decision-making procedures. Interestingly, when a country provides official support against the rules that it establishes, the solution provided in this Arrangement is to allow other participants to provide ‘matching’ credit support.

Since the paragraph makes reference to the original OECD Arrangement ‘or a successor undertaking’, the Panel in *Brazil-Aircraft* held that ‘the relevant successor undertaking is the *most recent* successor undertaking which has been adopted... prior to the time that the second paragraph is considered’.<sup>21</sup> This raises an interesting issue, since not all WTO Members are parties to the OECD Arrangement. This means that a subset of the WTO membership can in fact modify the content of item (k) in Annex I of the ASCM, a fact that Brazil contended rendered the result of the Panel ‘manifestly absurd or unreasonable’. It argued instead that the relevant version of the Arrangement should be the 1992 version (the version in force at the time the ASCM was agreed). However, the Panel did not accept that its interpretation led to ‘manifestly absurd or unreasonable’ results since such results could be explained, for example, if the Parties considered ‘that the Participants [of the OECD Arrangement] at the time, had greater expertise in the area of officially supported export credits. Similarly, they could have considered that it was inappropriate to “freeze” the scope of the safe haven in the light of the fact that the *OECD Arrangement* was [and still is] in a process of evolution’.<sup>22</sup>

The ‘delegation’ to the OECD Arrangement in item (k) of Annex I is quite limited in scope: it refers only to ‘the interest rates provisions of the relevant undertaking’. Thus, a country that provides export credit support applying interest rates in line with those provided for in the OECD Arrangement will not be deemed to offer prohibited subsidies under the ASCM.<sup>23</sup> As the Panel held in *Canada-Aircraft*, ‘the safe haven in the second paragraph of item (k) at present is potentially available *only* to export credit practices in the form of direct credits/financing, refinancing, and interest rate support at fixed interest rates with repayment terms of two years or more’.<sup>24</sup> ‘Pure cover’ operations fall outside the actual scope of the ‘safe haven’ provided by the OECD Arrangement because they are not subject to the minimum interest rate provisions (the Commercial Interest Reference Rate or CIRR) but only to disciplines on minimum premiums and repayment requirements.<sup>25</sup> For the pure cover to benefit from the safe haven, the OECD Arrangement should set a minimum interest rate for the export credits covered. Further, although only

measures that apply the interest rate provisions of the OECD Arrangement qualify for this safe haven provision, the credit terms must also comply with the rest of the OECD requirements (such as repayment requirements and minimum premiums) and not just the interest rate provisions.<sup>26</sup>

Of particular relevance is the possibility that a credit, which is in conformity with the OECD Arrangement due to the application of the ‘matching’ remedy, would qualify as an exclusion from a prohibited subsidy under the ASCM. The Panel in *Canada-Aircraft* answered this question in the negative, arguing that ‘matching’ is a derogation of the Arrangement rules and besides, it would put WTO Members which are not Participants to the OECD Arrangement at a disadvantage.<sup>27</sup>

It is a controversial issue whether the scope of footnote 5 ASCM would allow measures of export finance support that do not fully meet the requirements of items (j) and (k) of the Illustrative List in Annex I (implicit exclusions) to be excluded from the definition of ‘prohibited export subsidies’. For example, a country could provide export credit guarantee at premium rates which are *adequate* to cover the long-term operating costs and losses of the programs. Since item (j) prohibits export subsidies credit guarantees at premium rates which are *inadequate* to cover long-term operating costs and losses then *a contrario* it follows that the measure will not qualify as a prohibited export subsidy when the premium rates are adequate. Note that this interpretation can result in the general provision of Article 3.1.a) ASCM being overridden or corrected since (as we have already explained) what is relevant for the ‘benefit’ component in the concept of subsidy (as construed by the AB), is not that the program has no cost to the government but the fact that the recipient is offered conditions that are not available to them in the market. An ECA program can offer better terms than the market and still be able to cover its long-term operating costs and losses. Thus, an *a contrario* reading of items (j) and (k) would entail a gyration towards the ‘cost to the government’ standard.<sup>28</sup> Although the AB so far has not explicitly ruled whether an *a contrario* interpretation of the items of the Illustrative List in Annex I is permissible, the Panels have rejected it in two cases and the arguments supporting this finding seem solid.<sup>29</sup> These are:

- This interpretation does not render items (j) and (k) ineffective, since it is possible to demonstrate that a measure falls within the scope of those items without being required to demonstrate that Articles 1 and 3 are satisfied.
- This interpretation does not result in a disadvantage to developing nations, rather it favours them because an *a contrario* interpretation would systematically allow developed countries to offer export credit terms more favourable than those offered by developing countries.
- This interpretation allows a common set of rules in respect of export credit practices.

Besides the exclusion deriving from footnote 5 to ASCM, it should be noted that some developing nations (those referred to in Article 27.2 ASCM) benefit from the exclusion of the provisions in Article 3.1.a) ASCM<sup>30</sup> (prohibited export subsidies). Therefore, those countries can provide export credit support without risking a challenge before the WTO on the grounds that it constitutes a prohibited export subsidy. In fact, the WTO promotes export finance support by international organisations in favour of developing nations’ exports.<sup>31</sup> Nevertheless, subsidies granted by developing countries can still be challenged as ‘actionable subsidies’<sup>32</sup> and other countries can impose countervailing duties (CVD) against goods from developing countries that benefit from such credit support.

### 3.2 The automobile industry

The automobile industry has been heavily hit worldwide by the economic downturn. Automobile sales in the US and European markets were falling by 18 and 19 per cent respectively by the end of 2008 to the beginning of 2009.<sup>33</sup> Due in good part to government incentives, sales have since recovered and even rebounded in some markets from 2008 figures but there are still worries that this recovery might be heavily dependent on such incentives and therefore, there are doubts as to its sustainability.<sup>34</sup> The situation has been especially dire for the ‘Big Three’ US automakers, in particular GM (currently in

bankruptcy proceedings, despite massive infusions of public funds) and Chrysler. These are companies 'too big to fail', since a 50 per cent reduction in their US operations could lead to a loss of 2.5 million jobs in direct, indirect and spinoff employment in 2009.<sup>35</sup> To head-off this situation, governments have adopted a mix of measures that require an analysis from the ASCM provisions perspective.

**Nationalisation.** One of the possible actions that a government can take in order to maintain the business of troubled car makers is the partial or full nationalisation of the company. Full nationalisation would be a measure outside the scope of the ASCM since (as discussed above) the concept of 'benefit', as construed by the AB, requires that there be a 'recipient'. In this case, the recipient would be the State itself that owns the company.

From the perspective of the ASCM it is interesting to note, however, that when the State privatises a company the resources injected to improve it during the time in which it was under public control will not be deemed a subsidy in contravention of WTO law provided that the privatisation is made at arm's length and for fair market value.<sup>36</sup> That is so because the term 'benefit' implies that there must be a recipient<sup>37</sup> who receives a 'financial contribution' on terms more favourable than those available to them in the market.<sup>38</sup> When privatisation has been made at 'fair market value' there is no benefit bestowed on the privatised company and, therefore, no subsidy because the sale occurred under market conditions.<sup>39</sup>

On the other hand, we feel that a partial nationalisation (that is, if the State were to acquire a stake in the company) would only avoid being considered a subsidy if it were made under market conditions. That is so because if the State were to inject more capital than the market value of the shares received in compensation, the difference could clearly be regarded as a subsidy (that is, a financial contribution that confers a benefit to the company) since the recipient would be receiving a 'financial contribution' on terms more favourable than those available to them in the market. Since the very object of a partial nationalisation would be to provide resources in amounts or on terms which the market fails to provide, partial nationalisation would, in all likelihood, constitute a subsidy. The result would be the same if the 'benefit' were conferred by a private body under the direction of the government.<sup>40</sup>

**Credit support.** One of the measures most widely used by governments to assist car makers has been the offer of credit. The car industry has experienced a simultaneous collapse in sales and a tightening of credit conditions, while many of their costs cannot be reduced in such a short time span. This has resulted in a number of companies needing financial support to continue their operations under such adverse conditions or else face a shutdown with dire consequences.

As we have explained in the section devoted to export credit support, the provision of credit under terms which are more favourable than those available to the recipient in the market is deemed a subsidy. However, contrary to export credit support, this is not a 'prohibited subsidy' because it is not contingent upon either export performance or the use of domestic over imported goods. Nevertheless, it can still be regarded as an actionable subsidy, provided that the requisite of specificity is fulfilled. This requisite will be easy to verify when the authority granting the credit 'explicitly limits access to a subsidy to certain enterprises' or when it is possible to show the 'use of a subsidy programme by a limited number of certain enterprises'.<sup>4</sup>

Even when the financial support is not provided in the form of an injection of funds, it should be noted that a mere change in the conditions of a financial agreement (such as an extension of debt maturity; an interest reduction or a swap of debt for equity), even without supplemental resources being granted to the debtor, will constitute a subsidy if the change in conditions constitutes an improvement over the terms and conditions available to the debtor in the market.<sup>42</sup>

In some instances, public loans to car companies have been subject to a variety of requirements and conditions that could make it more difficult to ascertain to what extent credit is offered on better terms than those available in the market. For example, the loan can be protected with super seniority above

all other debt; it can be made conditional upon the company accepting a cap in executive compensation or it can be made conditional upon the development of fuel efficient and low carbon emitting cars. All these factors could complicate the determination of the amount of the 'benefit' conferred through the loan but, nevertheless, would not affect the existence of a subsidy, provided that the credit would not have been available to the recipient in the market. In particular, it should be borne in mind that the provisions in Article 8 ASCM were phased out in 1999 and have ceased to apply since 1 January 2000. The significance of this Article was that it deemed as 'non-actionable' those subsidies which consist in 'assistance to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations which result in greater constraints and financial burden on firms'.<sup>43</sup>

In the most protectionist fashion, the French President Nicolas Sarkozy announced credit lines to the automobile industry conditional on the manufacturers maintaining the production in France and purchasing a certain volume of parts from French suppliers. Those terms caused well founded outrage in eastern European countries, which feared that French manufacturers might decide to close factories there and keep the French factories working instead in order to comply with the conditions imposed on the credits. In the end, the French authorities decided not to implement those measures that would contravene not just WTO law but also European Community law in relation to State Aid (that is, Article 87 EC Treaty).<sup>44</sup>

**Cash for clunkers.** Incentives to the consumer are an alternative way to improve the lot of the automobile industry. Many developed countries have now enacted programs that award direct subsidies and/or tax incentives for the buyers of cars. Most of the time, these incentives are conditional on a number of requisites, for example, the buyer might be required to trade-in their previous car that must have a minimum age; the new car must comply with strict fuel-efficiency standards or with strict carbon emissions limits; there might be a maximum value threshold for the new car to qualify for the program, etc.

It is important to stress that the incentive is conferred on the consumer, not on the manufacturer. These programs allow the consumer to choose which manufacturer better satisfies their needs (apart from some possible requirements based on public interest regarding emissions or fuel efficiency) and therefore they are neutral regarding the whole industry, both domestic and international. From the point of view of the WTO subsidies law, it is also relevant that no difference be made between domestic and imported cars and this seems to be the case with the programs now in place. Provided that these requisites are met, 'cash for clunkers' programs constitute a powerful aid that does not conflict with WTO law. In fact, the relative neutrality of the measure has made it a contested remedy for companies in the most difficult situations.<sup>45</sup>

**Is it likely that a case be brought to the WTO?** We have argued that some measures adopted to confront the difficulties of the automobile industry could be regarded as actionable subsidies under the ASCM. Nevertheless, the Dispute Settlement Body (DSB) cannot decide in a case unless a complaint is brought to it by a Member State.

As highlighted by Brunel and Hufbauer, even though it is difficult to negate the existence of a subsidy in light of WTO rules, it is unlikely that a case will be brought before the DSB.<sup>46</sup> First, there is the difficulty of providing evidence regarding the adverse effects derived from the contested measure. Although serious prejudice under Article 6.3.a) ASCM covers situations where 'the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidising Member', it is important to note that the evidence of prejudice would most likely entail providing data for several years showing that car imports have been affected as a result of the provisions adopted. A case could be made alleging 'a threat of serious prejudice', since footnote 13 to Article 5.c) ASCM provides that 'The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious

*prejudice*' (emphasis added). So far we do not have further guidance on the interpretation of the concept of 'threat of serious prejudice' because, in the only precedents in previous cases before the DSB where a claim of a 'threat' was made, the Panel found that an actual or effective prejudice had been made out and, therefore, there was no need to establish an additional 'threat of serious prejudice'.<sup>47</sup>

Further, the likelihood that a case be brought to the DSB is reduced because many car-manufacturing countries have adopted measures that could be regarded as actionable subsidies. Although the fact that a country has provided an actionable subsidy does not preclude it legally from bringing a case against another country's subsidies, it is very unlikely that any country would risk doing so because it would be safe to assume that such action would trigger retaliation in the form of a counter-complaint brought by the defendant country.

The possibility of imposing CVD based in internal laws that mirror the ASCM provisions is much more likely from a technical point of view. At least in the US, the evidence required to pass the test of 'threat of serious prejudice' seems quite easy to obtain.<sup>48</sup> However, a CVD case has to be promoted by a representative share of the domestic industry and that is unlikely to happen in the case of the automobile industry because it is a highly concentrated business sector worldwide, which means that there are a small number of firms that operate in different countries. For obvious reasons, a company that is benefiting from actionable subsidies in one country will not seek the imposition of CVD in another country against imported cars that benefit from that same subsidy.

If it is unlikely that a case be brought to the WTO DSB and that CVD be imposed internally, the biggest risk is that the automobile industry could, in fact, fall outside the scope of WTO subsidies law, as was the case in the past with the shipbuilding industry, steel industry, aircraft industry or in agriculture. This development would reduce effective competition amongst manufacturers and manufacturing countries and thereby reduce the economic efficiency in the sector. This could result in the creation of isolated regional car markets instead of an integrated worldwide market.

## 4. The ASCM in the Doha Round

The ASCM has been subject to intense debate during the negotiations of the Doha Round. In this context, the US has led an ambitious movement to broaden the scope of the measures covered by the ASCM and thus restrict the ability of Members to grant subsidies. This train of events also explains that Article 8 ASCM, the provision on non-actionable subsidies that provided legitimate causes that might justify a subsidy, has been left to expire. Already in June 2007, US Trade Representative (USTR) Susan Schwab proposed new provisions that would result in the prohibition of five additional subsidies under WTO rules. She explained that:

It is time to take the next step in the development of stronger WTO rules that will rein in the use of industrial subsidies. In an increasingly global economy, foreign government subsidies provide an unfair competitive advantage. *The subsidies we want to prohibit maintain inefficient production capacity in industries* (emphasis added) ranging from steel to semiconductors. Stronger rules for these types of subsidies would address significant trade distorting practices of many of our trading partners that often lead to unfair trade.<sup>49</sup>

The categories of subsidies that the US pressed to include in the 'prohibited subsidies' basket were:

- (a) the direct transfer of funds to cover operating losses sustained by an enterprise or industry;
- (b) forgiveness of debt, *i.e.*, forgiveness of government-held loans or other instruments of indebtedness, and grants to cover repayment of government-held loans or other instruments of indebtedness;
- (c) loans and other instruments of indebtedness provided directly to enterprises that are uncreditworthy;

(d) provision of equity capital where the investment decision is inconsistent with the usual investment practice (including for the provision of risk capital) of private investors in the territory of that Member; and

(e) other financing (*i.e.*, ‘royalty-based’ or ‘sales-contingent’ financing or other similar financing) to an enterprise or project that otherwise would be unlikely to receive such financing from commercial sources.<sup>50</sup>

In the months following these statements, a financial and economic storm originating in the same country Ms Schwab represented has brought the world’s financial system to the brink of total collapse. While it is true that subsidies that ‘maintain inefficient production capacity’ should be under the discipline of WTO law, things tend to look different when those industries are located close to home, let’s say Detroit.<sup>51</sup> When pain hits home it is easier to understand that some government intervention is necessary to smooth the transition period towards a new and efficient business model. However, it is very important that we manage to establish the international rules that govern that transition in a way which is fair and non-discriminatory. In previous crises (for example, the Asian crisis), the countries that suffered most were not given the privilege of a reconsideration of the rules, instead they were lectured on the virtues of unrestricted open markets.<sup>52</sup>

Our discussion has shown that the subsidies regime currently in force can be improved. For example, regarding export credit support we have seen that ‘market conditions’, as construed by the Panels and the AB, are the only benchmark against which support credit can be measured in order to decide whether or not it confers a ‘benefit’. This approach is confirmed in the new language of the last draft of the ASCM circulated by the Chair, which adds a new footnote 2, with the following text:

A benefit is conferred when the terms of the financial contribution are more favourable than those otherwise commercially available to the recipient in the market. Where relevant, for the determination of the existence of a benefit Article 14.1 shall provide guidance for determining whether such more favourable terms exist.<sup>53</sup>

In the case of export credit support this interpretation (that could become a rule if the draft is confirmed) is too narrow, since ECAs can fill a gap in circumstances where there is a market failure. The recent financial turmoil has made this point very clear because private lenders have almost vanished from international trade, at least for the time being. Therefore, it seems reasonable that a provision that allows some scope for public intervention in export credit support in circumstances of market failure should be introduced in the ASCM. The alternative to an explicit provision is an *ad hoc* political compromise whenever a situation arises that requires an especial treatment. This latter option represents a defeat for an international legal system.

The situation is somewhat different regarding some of the measures adopted to support the automobile industry. While some of them conform to WTO law (for example, cash for clunkers) others clearly do not (for example, partial privatisation; credit support). The fact that it is unlikely that a case be brought to the WTO is no consolation. As Ms Schwab would probably agree, the harm is done when inefficient industries are artificially sustained. In this case, as we have discussed, it seems clear that these subsidies fall within the scope of actionable subsidies in the ASCM. So here we have a new case of a defeat of the international legal system.

The trouble with the subsidies to the automobile industry is that in this case the problem is probably one of excess capacity<sup>54</sup> (as was the case with the shipbuilding industry for some time). Here, the reasonable remedy would be to let the less efficient producers fall and then have production capacity adjust to demand. When President Obama argues that the ‘goal is not to further burden an already struggling industry. It is to help America’s automakers prepare for the future’,<sup>55</sup> we should bear in mind that,

confronted with overcapacity, not all the industry will be able to survive and that the subsidies that are being granted now aim to alter the results that the market would have otherwise delivered.

Nevertheless, it would probably make sense to reinstate non-actionable subsidies, that is, to explicitly establish some purposes that legitimise government intervention in the economy, based in the economic theory on market failure. This has been a road long tested in the European Union's (EU) State Aid regime which is more restrictive than the WTO regime while, at the same time, it provides a generous list of detailed exceptions.<sup>56</sup> This should not be taken as a suggestion to imitate the European model at the WTO. The European model is based in an institutional framework that is not available at international level, where the European Commission has ample powers to decide whether or not an exception to the prohibition of State aid applies (see Article 88 EC Treaty). Nevertheless, there are some lessons to be learned from this experience. One is that there is room in a market economy for well-designed State aid. As the European Commission puts it:

State aid may be declared compatible with the Treaty provided it fulfils clearly defined **objectives of common interest** and does not distort intra-community competition and trade to an extent contrary to the common interest. *State aid measures can sometimes be effective tools for achieving objectives of common interest. They can correct market failures, thereby improving the functioning of markets and enhancing European competitiveness. They can also help promote e.g. social and regional cohesion, sustainable development and cultural diversity, irrespective of the correction of market failures* (emphases added).<sup>57</sup>

While the first of the aims of compatible State aid (that is, the correction of market failures) may to some degree be achieved at the WTO level, the second (that is, the promotion of other common goals irrespective of market failures) is probably out of reach unless there is an institutional framework that can exert some discretionary powers to implement the rules. Therefore, the efforts should concentrate on trying to draft detailed and satisfactory rules that provide coverage to economically sound and efficient subsidies that aim to correct market failures.<sup>58</sup>

The latest draft of the ASCM circulated by the Chair still does not address this issue. The modifications introduced are relatively few. For example, none of the US proposed new categories of 'prohibited subsidies' is included although there is one new category for the fisheries sector. There are new provisions that deal with the problem posed by regulated prices. In Article 2.1.(c), in order to determine whether a subsidy is specific, the fact that some firms within the country in question might be excluded from access to the goods or services at the regulated prices establishes specificity. Moreover, Article 14.1.(d) establishes specific rules for the calculation of the amount of the subsidy in respect to goods and services provided at regulated prices. In general, the modifications are probably more visible in Article 14.

The regulatory challenge to address the interaction between subsidies and market failures is not the only one that the ASCM faces today. The economic crisis has shown the importance of a vigorous regulation (and implementation<sup>59</sup>) of subsidies law, while at the same time it has evidenced the limitations as well as the achievements of the WTO regime. The rescue of troubled financial institutions has thrown light on the fact that subsidies in the field of services still lack an international framework of rules. Efficient banks are being penalised while the inefficient ones receive government support that distorts competition in this highly integrated business sector. The critical recent events could offer a good opportunity to bring subsidies in the service sector under the effective discipline of the WTO. In doing so, it would be worth trying to establish a unique set of rules, both for subsidies that refer to goods and for subsidies that refer to services. Otherwise there could be significant problems due to the overlapping of rules.<sup>60</sup>

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## WTO CASE-LAW:

- Indonesia – Certain measures affecting the automobile industry (Indonesia-Autos), WT/DS54, WT/DS55, WT/DS59, WT/DS64.
- Canada – Measures affecting the export of civilian aircraft (Canada-Aircraft), WT/DS70.
- United States – Tax treatment of foreign sales corporations (US-FSC), WT/DS108.
- United States – Imposition of countervailing duties on certain hot-rolled lead and bismuth carbon steel products originating in the United Kingdom (US-Lead Bismuth), WT/DS138.
- United States – Countervailing measures concerning certain products from the European Communities (US-Certain Products), WT/DS212.
- United States – Final countervailing duty determination with respect to certain softwood lumber from Canada (US-Softwood lumber), WT/DS257.
- United States – Subsidies on upland cotton (US-Upland Cotton), WT/DS267.
- Korea – Measures affecting trade in commercial vessels (Korea-Commercial Vessels), WT/DS273.
- Japan – Countervailing duties on dynamic random access memories from Korea (Japan-DRAM), WT/DS336.

## Endnotes

- 1 Changes have occurred at such a fast pace that, as discussed below, previous statements of policy are now coming back to haunt those who made them. Also, it has been necessary to adapt normal procedures in order to deliver quick decisions (see EC Commission: ‘State Aid Scoreboard- Spring 2009 update. Special edition on State Aid interventions in the current financial and economic crisis’, *COM (2009) 164*, Brussels, 08.04.2009, p. 27).
- 2 Gamberoni & Newfarmer 2009, p. 3.
- 3 WTO case law will be quoted by its short title throughout the text. The list of cases, with their full case titles and citations, is provided at the end of the paper.
- 4 Article 1 ASCM states: ‘For the purpose of this Agreement, a subsidy shall be deemed to exist if:  
(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as ‘government’), i.e. where:  
(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);  
(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);  
(iii) a government provides goods or services other than general infrastructure, or purchases goods;  
(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or  
(a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and  
(b) a benefit is thereby conferred’.
- 5 AB Report *Brazil-Aircraft*, WT/DS46/AB/R, para. 157.
- 6 WTO AB Report *Canada-Aircraft*, WT/DS70/AB/R, para. 156: ‘Thus, subparagraphs (a) and (b) of Article 1.1 define a “subsidy” by reference, first, to the action of the granting authority and, second, to what was conferred on the recipient’.
- 7 AB Report *Brazil-Aircraft*, WT/DS46/AB/R, para. 148.
- 8 WTO AB Report *Canada-Aircraft*, WT/DS70/AB/R, adopted 2 August 1999, para. 154. Later quoted in AB Report *Lead Bismuth*, WT/DS138/AB/R, para. 55.
- 9 Diamond 2008. In *Canada-Aircraft*, the AB clearly distinguishes the concept of ‘benefit’ from the concept of ‘prejudice’ (AB Report, WT/DS70/AB/R, para. 159).
- 10 AB Report, *US-Certain products*, WT/DS212/AB/R, para. 113.
- 11 Article 5 ASCM. ‘Serious prejudice’ is defined in Article 6 ASCM.

- 12 The ASCM should be construed in light of Article XVI GATT (US-FSC, Report of the Panel, at 7.82, WT/DS108/R, 8 October 1999). Nevertheless, *General interpretative note to Annex 1A* states that ‘In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization (referred to in the agreements in Annex 1A as the “WTO Agreement”), the provision of the other agreement shall prevail to the extent of the conflict’.
- 13 ‘Among the various forms of export subsidies, subsidised export credits arguably have the most immediate and thus greatest potential to distort trade flows’, Panel Report *Canada-Aircraft* (Article 21.5), WT/DS70/RW, para. 5.137.
- 14 As the Expert Group Meeting on Trade Financing stated: ‘The ASCM is in general drafted to address situations where a WTO Member is subsidizing the production or sale of its own goods, and it is not entirely clear whether or not the Agreement applies where the subsidizing entity is not within the territory of the Member whose goods are allegedly being subsidized. Leaving aside this legal uncertainty, many WTO Members appeared to be of the view that development aid provided by multilateral development institutions lay outside the scope of ASCM disciplines, or in any event that it would not be proper to take action under the Agreement in this context. To date, no Member has challenged multilateral development assistance as a subsidy in WTO dispute settlement proceedings’ (WT/GC/W/527, 16 March 2006, para. 21).
- 15 As the Panel in the *Brazil-Aircraft* stated: ‘We note that PROEX III payments are made in support of export credits extended to the *purchaser*, and not to the *producer*, of Brazilian regional aircraft. In our view, however, to the extent Canada can establish that PROEX III payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market, this will, at a minimum, represent a *prima facie* case that the payments confer a benefit on the *producers* of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products’ (Second recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW2, footnote 42). A prominent case of pass-through of a benefit is *US-Softwood lumber*, see Gagne and Roch 2008, pp. 557-560.
- 16 AB Report *Canada-Aircraft* (WT/DS70/AB/R, para. 160).
- 17 This point is made by Coppens 2009, p. 84. The WTO seems to be somewhat aware of this problem. In the Note of the Secretariat on the Expert Group Meeting on Trade Financing this issue is briefly addressed, as follows: ‘it was felt that there was need for more conceptual work to define an economic benchmark which allowed risk to be properly priced in extreme situations, for example of a currency crisis. It was noted that this was difficult to do a priori, given the day-to-day uncertainty that prevailed at such times, and that it was difficult also to stipulate “market clearing” conditions that would allow commercially viable behaviour to be defined. It was noted also that even if such a benchmark could be found and agreed on, no existing institution had the mandate to determine when “exceptional circumstances” exist’ (WT/GC/W/527, 16 March 2006, para. 23). It is reasonable that in 2006, coming out from the Asian currency crisis, the ‘extreme situation’ envisaged had to do with ‘currency crisis’. The financial crisis that started in 2007 has been a case of systemic failure to ascertain risk, not just a currency crisis.
- 18 *US-Softwood Lumber*, WT/DS257/AB/R, para. 103. See an analysis of this case in Gagne & Roch 2008, pp. 547-572.
- 19 Export credit support for the sale of services is beyond the scope of this paper because it would not be under the discipline of the ASCM but of the GATS, as previously observed.
- 20 The last available consolidated version is from 16 February 2009 (TAP/PG(2009)6) at [www.oecd.org](http://www.oecd.org). See Levit 2004.
- 21 *Brazil-Aircraft*, WT/DS46/RW2 (second recourse by Canada to Article 21.5 of the DSU), para. 5.81 and 5.83.
- 22 *Brazil-Aircraft*, WT/DS46/RW2 (second recourse by Canada to Article 21.5 of the DSU), para. 5.84-5.91, text quoted from para. 5.88. This topic is a matter of ongoing discussion at the Doha Round: ‘Views differ widely as to whether the second paragraph of item (k) should be amended such that any changes to the OECD Export Credit Arrangement would not automatically take effect for purposes of the SCM Agreement. At one end of the spectrum, some delegations consider that only amendments not objected to by any Member within a certain period should have legal effect under the second paragraph of item (k), while at the other end of the spectrum some delegations consider that Members should not have any basis on which effectively to veto decisions taken by Participants to the Arrangement’ (WTO Document *New draft consolidated chair texts of the AD and SCM Agreements*, TN/RL/W/236, of 19 December 2008, p. 74).
- 23 Relying in AB Report *US- FSC*, WT/DS108/AB/R, para. 93, and other WTO case law, Coppens (2009, pp. 107-108) argues that a subsidy included in the ‘safe haven’ of the second paragraph of item (k) Annex I could still be regarded as a subsidy under the ASCM and could be subject to CVD by an importing country, although it is less certain if it could also be regarded as an actionable subsidy.
- 24 *Canada-Aircraft* WT/DS70/RW (recourse by Brazil to Article 21.5 of the DSU), para. 5.106. The paragraph goes on to state: ‘In other words, any such practices involving floating interest rates, as well as official support for export credits with shorter maturity or in the forms of guarantees and insurance, because none are *subject to* the *Arrangement’s* “interest rates provisions”, most especially the CIRR but also the sector-specific minimum interest rates in the *Sector Understandings*, would not be eligible for the safe haven, as it simply would not be possible to judge their “conformity” with the relevant interest rate provisions of the *Arrangement*, all of which pertain exclusively to fixed rates’.
- 25 Coppens 2009, p. 99.

- 26 *Canada-Aircraft* WT/DS70/RW (recourse by Brazil to Article 21.5 of the DSU), para. 5.114: ‘Thus, we conclude that full conformity with the “interest rates provisions” – in respect of “export credit practices” subject to the CIRR – must be judged on the basis not only of full conformity with the CIRR but in addition full adherence to the other rules of the *Arrangement* that operate to support or reinforce the minimum interest rate rule by limiting the generosity of the terms of official financing support’.
- 27 *Canada-Aircraft* WT/DS70/RW (recourse by Brazil to Article 21.5 of the DSU), para. 5.121 and 5.134. See also *Brazil-Aircraft*, WT/DS46/RW, para. 5.114-5.115. The signatories to the OECD Arrangement have changed the wording of the ‘matching’ clause in order to configure it not as a derogation but as a measure ‘in conformity’ with the Arrangement. However, it is doubtful that this modification will change the determination of future panels in this regard. See Coppens 2009, pp. 103-104.
- 28 In the WTO Document *New draft consolidated chair texts of the AD and SCM Agreements*, TN/RL/W/236, of 19 December 2008, the new footnote 6 (that substitutes footnote 5 in force) makes it explicit that an *a contrario* interpretation of the Illustrative List in Annex I is not permitted.
- On the other hand, the *draft* reflects that there are discussions regarding the new language of items (j) and (k) of the Annex I: ‘Delegations disagree regarding whether the texts of item (j) and the first paragraph of item (k) should be amended to replace the cost-to-government benchmark with one based on benefit-to-recipient. Those favouring such changes consider that the current provisions work to the disadvantage of developing Members and are inconsistent with the Agreement’s general definition of “subsidy”. Other delegations, however, consider that such changes would increase costs for developing country borrowers, and would reduce predictability for export credit agencies’ (TN/RL/W/236 2008, p. 73).
- 29 *Brazil-Aircraft*, WT/DS46/RW, para. 635-641; *Korea-Commercial Vessels*, WT/DS273/R, para. 7.195-7.207. See Coppens 2009, pp. 91-93.
- 30 Article 27.1 ASCM provides that ‘Members recognize that subsidies may play an important role in economic development programmes of developing country Members’.
- 31 WT/GC/W/527, 16 March 2006, para. 1. As referred to by Auboin, ‘the Director-General of the WTO defined the role of the WTO in this area: encouraging liberalization of this type of financial services under the financial services agreement, being a regulator of export credit and guarantee subsidies under the ASCM, and serving as a forum to discuss WTO-compatible ways of providing support to developing countries’ (Auboin 2007, p. 2).
- 32 See Article 27.9, that limits the ‘adverse effects’ that the complainant can invoke. Developing countries also benefit from an increased *de minimis* rule in Article 27.12 ASCM.
- 33 In the US, overall auto sales dropped 18 per cent between 2007 and 2008, while in Europe sales dropped by 19 per cent in December 2008, year on year, with sales in relevant European countries dropping by as much as 50 per cent (Spain). See Brunel & Hufbauer 2009, pp. 1, 5. For Europe, see European Commission, ‘Responding to the crisis in the European automotive industry’, *COM(200) 104 Final*, Brussels, 25.02.2009, pp. 3-4, stating that in ‘the last quarter of 2008 new car registrations in Europe declined by an average of 20%’, while ‘In January 2009, the European passenger car market was 27% lower than a year before’.
- 34 ‘Sales by Volkswagen in Germany, where the government is offering buyers 2,500 Euros when they trade in a model that’s at least nine years old for scrapping, climbed 18 percent to 534,000 vehicles in the six months through June. The country’s market surged 26 percent in the first half, according to the Federal Motor Vehicle Office. European car-industry sales rose 2.4 percent in June, the first increase in 14 months, as customers took advantage of incentives across the region. German carmakers are unlikely to sustain sales growth into 2010 as trade-in subsidies will expire this year, the VDA industry association said July 2. Registrations in Germany may plunge to 2.6 million from as many as 3.7 million in 2009, said Rolf Dielenschneider, head of VW’s Seat division’ ([www.bloomberg.com/apps/news?pid=newsarchive&sid=azpN5x4JPjul](http://www.bloomberg.com/apps/news?pid=newsarchive&sid=azpN5x4JPjul)).
- See also [www.bloomberg.com/apps/news?pid=newsarchive&sid=arbQkPT4QBfk](http://www.bloomberg.com/apps/news?pid=newsarchive&sid=arbQkPT4QBfk), ‘a mix of credits, tax breaks and subsidies to get consumers to trade in old cars for newer, more fuel-efficient models, in France, Germany and Japan, among others, are stemming a plunge in demand’.
- 35 Brunel & Hufbauer 2009, p. 1, citing data from the *Center for Automobile Research*.
- 36 See the cases *US-Lead Bismuth*, WT/DS138, and *US-Certain Products*, WT/DS212. In *US-Certain Products*, the Panel found that: ‘Privatizations at arm’s-length and for fair market value *must* lead to the conclusion that the privatized producer paid for what he got and thus did not get any benefit or advantage from the prior financial contribution bestowed upon the state-owned producer. While Members may maintain a rebuttable presumption that the benefit from prior financial contributions (or subsidization) continues to accrue to the privatized producer, privatization at arm’s-length and for fair market value is sufficient to rebut such a presumption’ (WT/DS212/R, para. 7.82). Nevertheless, the AB concluded that a privatisation at arm’s-length and for fair market value merely establishes a rebuttable presumption that a benefit ceases to exist after such a privatisation (WT/DS212/AB/R, para. 127). The AB rejected the US contention that the privatised company (and not its shareholders) should be regarded as the recipient of the ‘benefit’ and thus the subsidy would not cease to exist after the privatisation.
- 37 WTO AB Report *Canada-Aircraft*, WT/DS70/AB/R, adopted 2 August 1999, para 154. Later quoted in AB Report *Lead Bismuth*, WT/DS138/AB/R, para. 55.

- 38 WTO AB Report *Canada-Aircraft*, WT/DS70/AB/R, para. 157. Later quoted in AB Report *Lead Bismuth*, WT/DS138/AB/R, para. 67. The ‘benefit’ does not necessarily entail a cost to the government (AB Report *Canada-Aircraft*, WT/DS70/AB/R, para. 155-156: ‘the reference to “benefit to the recipient” in Article 14 also implies that the word “benefit”, as used in Article 1.1, is concerned with the “benefit to the recipient” and not with the “cost to government”, as Canada contends’).
- 39 AB Report *Lead Bismuth*, WT/DS138/AB/R, para. 68. See an analysis of this WTO case in Diamond (2008, pp. 649-678) arguing that the AB resorts to a strict textual interpretation of the ASCM that does not take into full consideration its context, or its object and purpose, which are interpretation criteria under Article 31 of the Vienna Convention; and that, when considering the purpose of the ASCM, the economic implications of the facts under discussion have to be taken into account.
- 40 Article 1.1.a)iv) ASCM; WTO AB Report *Canada-Aircraft*, WT/DS70/AB/R, para. 160.
- 41 Article 2 ASCM.
- 42 See *Japan-DRAM*, WT/DS336/AB/R, para. 250-256.
- 43 The broad categories of non-actionable subsidies in Article 8 ASCM are: assistance for research activities; assistance to disadvantaged regions within the territory of a Member; and assistance to promote adaptation of existing facilities to new environmental requirements. Some developing countries, led by Venezuela and Cuba, promoted a re-instatement of non-actionable subsidies, especially for developing countries. Developed countries mostly resisted this attempt (ICTSD-IISD 2003, ‘Doha Round Briefing Series’, vol. 2, no. 7 of 13 (August), p. 3).
- 44 ‘State aids: the Commission obtains guarantees from the French government on the absence of protectionist measures in the French plan for aid to the automotive sector’, MEMO/09/90, Brussels, 28 February 2009. The closing remark on the Memo is nevertheless very telling: ‘The Commission will of course monitor closely the implementation of this plan’.
- 45 Brunel & Hufbauer 2009, p. 3, ‘The Big Three worry that the Bill would not help them because auto buyers would replace their American cars with foreign made ones’, citing Brody Mullens and Elisabeth Williamson 2009, ‘Cash for clunkers plan is considered’, *Wall Street Journal*, 30 January.
- 46 Brunel & Hufbauer 2009, pp. 7-8.
- 47 *US-Upland Cotton*, WT/DS267/R, para. 7.1479-7.1504; *Indonesia-Autos*, WT/DS54/R, para. 14.257.
- 48 Brunel & Hufbauer 2009, p. 9. As Diamond points out, building on the AB Report in *Japan-DRAM*, while in a case brought to the WTO the claimant must show that the subsidy has caused adverse effects, in a CVD investigation there is no need to trace the injury to the subsidy (provided the existence of a subsidy has been shown) but just to the subsidised (Diamond 2008, pp. 672-674).
- 49 United States Trade Representative (USTR): *US proposes strengthened subsidy rules to World Trade Organization* (4 June 2008). Previously available at [www.ustr.gov](http://www.ustr.gov) (viewed 13 February 2009). This policy is reflected and articulated in *Subsidies Enforcement Annual Report to the Congress*, Joint Report of the Office of the USTR and the US Department of Commerce, February 2008, [www.ustr.gov](http://www.ustr.gov).
- 50 *Subsidies Enforcement Annual Report to the Congress* 2008, pp. 5-6.
- 51 In fact, the measures adopted to rescue the ‘Big Three’ would be deemed prohibited subsidies under items (a), (c) and (d), and even possibly (e), of the US proposal as reproduced above.
- 52 Stiglitz 2002.
- 53 WTO Document *New draft consolidated chair texts of the AD and SCM Agreements*, TN/RL/W/236, 19 December 2008.
- 54 As the European Commission has put it: ‘Recent falls in demand and production have made the situation worse and average overcapacity in Europe is estimated to be at least 20%. Globally, vehicle production capacity is currently at ca. 94 million per year at a time when demand for 2009 is estimated at ca. 55 million’...Nevertheless, the document also signals that, ‘However, the **long term global outlook** for the automotive industry is promising’ (European Commission *COM(2009) 104 Final*, 25.02.2009, p. 4). Gamberoni and Newfarmer argue that ‘To the extent that the industry is laden with excess capacity, these subsidies impede exit and delay adjustment’ (Gamberoni & Newfarmer 2009, p. 2).
- 55 Thomas et al. 2009. The same philosophy is behind the European Commission’s stance on this matter, stressing the need to increase investments in R&D to speed up the development and production of ‘green’ cars (European Commission *COM(2009) 104 Final*, 25.02.2009, p. 6).
- 56 Some examples are aid for climate change and other environmental protection; for research, development and innovation; regional aid; for the rescue and restructuring of firms in difficulty; for small and medium-sized enterprises; employment aid; training aid; risk capital measures; aid elements in the sale of land and buildings by public authorities; services of general economic interest. See *Vademécum: Community law on State Aid*, Brussels, 30 September 2008.
- 57 See *State Aid Action Plan. Less and better targeted State Aid: a roadmap for State Aid reform 2005-2009*, European Commission *COM (2005) 107 Final*, Brussels, 07.06.2005, para. 10. The document previously highlighted that ‘**Competition policy** rests upon the idea that a market-based economy provides the best guarantee for raising living conditions in the EU to the benefit of citizens, one of the primary objectives of the EU Treaty’ (para. 6) and ‘State aid control comes from the need to **maintain a level playing field** for all undertakings active in the Single European Market, no matter in which Member State they are established’ (para. 7).

- 58 In some cases, as with export subsidies, the key could be not in the rule prohibiting them, but in the remedies applicable in case of breach. See for example Green and Trebilcock 2007. The authors argue that, in order to allow efficient uses of export subsidies, there should be a strict rule prohibiting them – as it is already the case – but the remedy should be calculated on the basis of the harm caused, not on the basis of the subsidy itself, in what they call ‘liability rule’; they also criticise the prospective nature of remedies, that allow the adoption of short-term subsidies without fear of formal penalties.
- 59 In the EU State aid regime, in some cases prohibited subsidies must be reimbursed (‘Where negative decisions are taken in cases of unlawful aid, the Commission shall decide that the Member State concerned shall take all necessary measures to recover the aid from the beneficiary’, Article 14 Council Regulation (EC) 659/1999, 22 March 1999, laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 83, 27.03.1999, p. 1). See Linares 2001, pp. 45-54.
- 60 Luja 2005, p. 113.

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