The Interface between EU State Aid Control and the WTO Disciplines on Subsidies

*Claus-Dieter Ehlermann and Martin Goyette**

I. Introduction

The European Union is unique among the members of the WTO in applying a stringent internal subsidies regime. In general, this regime is more constraining on the EU's Member States than the WTO disciplines on subsidies. This creates both challenges and dilemmas for the EU, its Member States, and potential EU recipients of subsidies and raises the question of the extent to which the EU may, by virtue of its State aid regime, be unduly constraining itself and its members and thereby placing itself at a disadvantage vis-à-vis its counterparts, e.g. the other WTO Members. The question is not theoretical given that the EU, together with its Member States, is one of the world's largest donors of subsidies together with the US and, on a smaller scale, the other members of the OECD.[1]

It is important to understand the relevance of WTO rules to the State aid regime and to its reform. The EU has bound itself to significant constraints under the WTO regime. One might think that given its relatively strict internal subsidies regime (the State aid regime), the EU has little to fear from multilateral disciplines. However, the EU has been one of the primary targets of countries challenging foreign subsidies before the WTO and of countervailing duty measures. Also, the European Commission is currently in the process of reforming its State aid rules. The Commission's objective is to render the State aid regime more efficient and more equitable to arrive at 'less and better targeted State aid' that will foster innovation, economic growth, and job creation.[2] It seems appropriate, in this context, to examine what external constraints or opportunities the EU needs to take into consideration as part of the State aid reform exercise. This paper does so by exploring the limits imposed on EU State aid rules by the WTO disciplines on subsidies.[3]

This article contains three parts. The first two parts are descriptive: First, we sketch a summary of the WTO's rules on subsidies contained in the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), and compare the definitions of subsidy under WTO and under EC State aid law. The second section briefly examines how the WTO rules have been applied since 1995. These two descriptive parts are completed by an analytical part in which we examine a number of scenarios of specific types of subsidies that are or could be granted by the EU and the issues that they raise under WTO law.[4]

II. Overview of the WTO's disciplines on subsidies

1. Evolution of the disciplines

a. The GATT

The GATT contained rules on subsidies prior to the entry into force of the WTO. These rules were found in Article XVI GATT, which has been amended over the years. First, Article XVI imposed on WTO Members an obligation to notify subsidies (including any form of income or price support) that directly or indirectly operated to increase exports or reduce imports of a

* Claus-Dieter Ehlermann is Senior Counsel at WilmerHale, Brussels, and former chairman and member of the WTO Appellate Body. Martin Goyette is Senior Associate at WilmerHale, Brussels. This article builds on a presentation by Claus-Dieter Ehlermann at the 4th Experts' Forum on New Developments in European State Aid Law 2006 of the European State Aid Law Institute, 18 May 2006. The authors gratefully acknowledge the research assistance of Chiara Galiffa and of Judith Schmidt and the useful insight provided on the EU State aid regime by Stefano Fratta.

1 It is worth noting that the EC's State aid rules apply to subsidies granted by the Member States of the EU, not to subsidies granted by the EU institutions. As it is, most of the subsidies granted in the EU originate from the Member States.

2 See the speech by Commissioner Neelie Kroes, 'Reforming Europe's State Aid Regime: An Action Plan for Change', Wilmer Cutler Pickering Hale and Dorr / University of Leiden Joint conference on European State Aid Reform, Brussels, 14 June 2005. For the text of the speech, and for more information on the European Commission's State Aid Action Plan, see European Commission – DG Competition website at http://ec.europa.eu/comm/competition/state_aid/overview/sar.html, last visited 19 June 2006.

3 The other facet of the problem is how the EU responds to the granting of subsidies by other WTO Members; for an overview of the means the EU has at its disposal, and uses, to respond to such subsidies, see Bronckers/Goyette, 'The EU's Response to Foreign Subsidies: An Overview', in Matsushita/Ahn/Chen, (eds.), 'The WTO Trade Remedy System: East-Asian Perspectives', London, Cameron May, 2006, pages 145-157.

4 We do not examine here the proposals on subsidy discipline tabled during the Doha Development Round. For a discussion of these proposals, see Magnus, 'WTO Subsidy Discipline: Is this the "Retrenchment Round"?', in Journal of World Trade, 38(6), (2004), pages 985-1047. We note in any case that the negotiations on subsidy disciplines in industrial goods have not been a prime concern in the Doha Round. See Bronckers/Goyette, supra, note 3, pages 148-150.

product in their territory. Another party could request consultations – with a view to limiting the subsidies – where it considered that the subsidy in question caused or threatened to cause serious prejudice to its interests. Article VI also addressed export subsidies: First, a Member should 'seek to avoid the use of' export subsidies on primary products;[5] if a Member granted such subsidies that operated to increase its exports of that primary product, then it had to ensure that the subsidy in question did not result in the Member having more than an equitable share of world export trade in that product. Export subsidies to non-primary products were to cease altogether as of 1 January 1958 where such subsidies resulted in the export price of the product being lower than its domestic price.

Article VI GATT is also relevant. That Article concerns antidumping duties and countervailing measures. Para. 3 of Article VI sets out the basic principle that countervailing duties (CVDs) may not exceed the amount of subsidisation ('bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation').

Articles XVI and VI still apply, but the basic disciplines they established were the subject of subsequent negotiations, which have resulted in the Uruguay Round SCM Agreement. The WTO disciplines on subsidies are therefore, today, primarily contained in the SCM Agreement.[6] The SCM Agreement builds on rules that had already been agreed in one of the Tokyo Round Plurilateral Agreements, the Subsidies Code. Whereas only some of the GATT Parties decided to sign up to the Tokyo Round Subsidies Code, the SCM Agreement applies to all WTO Members. This is consistent with the 'Single Undertaking' principle adopted in the Uruguay Round. There exist, however, besides the SCM Agreement, specific rules applicable to agricultural subsidies, which are found in the Agreement on Agriculture. We do not discuss these rules here as we are limiting our study to the general rules affecting industrial goods, and therefore falling within the scope of the SCM Agreement. Other WTO Agreements are potentially relevant, such as the TRIMS Agreement (Agreement on Trade Related Investment Measures) and the GATS (General Agreement on Trade in Services) but are also not discussed here.[7]

b. The SCM Agreement

The SCM Agreement contains two broad sets of rules, respectively referred to as 'Track I' and 'Track II'. Track I refers to the imposition by a WTO Member of countervailing duties on imports from a Member granting a subsidy, where that subsidy harms the former's domestic industry; Track I therefore builds on Article VI GATT. Track II refers to the multilateral disciplines, i.e. the rules that a WTO Member must respect or else find itself in violation of the Agreement and risk being the subject of a complaint before the WTO 'judicial' instances (Panel and, on appeal, Appellate Body). In other words, the rules that originated in Article XVI GATT.

Thus, contrary to the EC system, there is no ex ante control of subsidies in the WTO: a Member must apply self-discipline, and other Members can either impose countervailing duties to counter their effects on their domestic market under Track I or challenge the subsidies granted under Track II.

2. Definition of 'subsidy'

The SCM Agreement contains the first definition of 'subsidy' in GATT/WTO history. While the definition is rather all inclusive, as will be clear from the discussion below, it still leaves many questions unanswered. A subsidy is defined as a 'financial contribution', or price/income support by a government or a public body, which confers a 'benefit' on a recipient.[8] We discuss each of these requirements in turn below.

a. Financial contribution and cost to government

Article 1.1(a)(1) SCM states that the following are financial contributions:

– Direct transfer of funds and potential direct transfers of funds or liabilities (loan guarantees) (subpara. (i)).

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5 Defined as 'any product of farm, forest or fishery, or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial volume in international trade'.

6 On the relationship between the disciplines of GATT 1994 and that of the SCM Agreement, the General Interpretative Note to Annex 1A of the WTO Agreement provides that 'In the event of conflict between a provision of the [GATT] and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization [such as the SCM Agreement], the provision of the other agreement shall prevail to the extent of the conflict.' See also the Report of the Appellate Body, United States – Tax Treatment for Foreign Sales Corporations, WT/DS108/AB/R, 24 February 2000, ('US – FSC'), paragraph 117:

> … the provisions of the SCM Agreement do not provide explicit assistance as to the relationship between the export subsidy provisions of the SCM Agreement and Article XVI:4 of the GATT 1994 [yet] [i]t is clear from even a cursory examination of Article XVI:4 of the GATT 1994 that it differs very substantially from the subsidy provisions of the SCM Agreement… as we have observed previously, the SCM Agreement contains a broad package of new export subsidy disciplines that 'go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947'. … Thus, whether or not a measure is an export subsidy under Article XVI:4 of the GATT 1947 provides no guidance in determining whether that measure is a prohibited export subsidy under Article 3.1(a) of the SCM Agreement. … (footnotes omitted)

7 Services are not subject to the SCM Agreement and the GATS Agreement's provisions are unlikely to provide a potential complainant with the tools to effectively challenge any such subsidies. See Article XV GATS and Bronckers/Goyette, supra note 3, page 151. We should also note the presence of the Plurilateral Agreement on Trade in Civil Aircraft. Also, we do not discuss here the 'special and differential treatment' provisions, i.e. certain derogations (some of which have now lapsed) from the SCM Agreement's disciplines from which developing countries Members benefit under Part VIII of the SCM Agreement.

8 For a comprehensive description of the SCM's disciplines, see Clarke/Horlick, 'The Agreement on Subsidies and Countervailing Measures', in Bronckers/Horlick, 'WTO Jurisprudence and Policy: Practitioners' Perspectives', London, Cameron May, (2004), pages 311-391.

– Government revenue that is otherwise due is foregone or not collected (e.g. tax credits and other fiscal incentives) (subpara. (ii)).[9]
– Provision of goods or services other than general infrastructure or government purchase of goods (subpara. (iii)).[10]
– Government payments to a funding mechanism or government entrustment or direction to a private body to carry out one the type of functions illustrated in subparas. (i) to (iii) and which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments (subpara. (iv)).

The use of the term 'i.e.' in the chapeau of Article 1.1(a)(1) indicates that the list is exhaustive: only these four types (or broad categories) of government measures constitute financial contributions under Article 1.1(a)(1).[11] But one notes the rather broad wording – and therefore presumably rather large scope – of the different 'types' of measures that may confer a financial contribution.

The concept of financial contribution ensures that not all government measures that confer benefits can be deemed to be subsidies.[12] The presence of a financial contribution and that of a benefit are thus two separate, but equally necessary elements of a subsidy under the SCM Agreement. The Appellate Body in Brazil – Aircraft sanctioned the Panel for commingling the concepts:

> [I]n its interpretation of Article 1.1(a)(i), the Panel imported the notion of a 'benefit' into the definition of a 'financial contribution'. This was a mistake. We see the issues – and the respective definitions – of a 'financial contribution' and a 'benefit' as two separate legal elements in Article 1.1 of the SCM Agreement, which together determine whether a subsidy exists...[13]

The last item of this list (subpara. (iv)) warrants further attention. Subpara. (iv) essentially seeks to prevent a Member from doing indirectly what it cannot do directly. The issue of government entrustment or direction was addressed by the Panel in the US –

9 The foregoing of revenue otherwise due is to be determined by comparison to the 'baseline' otherwise established by the taxation system of the Member in question. See Report of the Appellate Body in US – FSC, paragraph 90, and Report of the Appellate Body, United States – Tax Treatment of Foreign Sales Corporations, Recourse to Article 21.5 of the DSU by the EC, WT/DS108/AB/RW, 14 January 2002, ('US – FSC (21.5)'), paragraphs 89-90:

> ... the treaty phrase 'otherwise due' implies a comparison with a 'defined, normative benchmark'. The purpose of this comparison is to distinguish between situations where revenue foregone is 'otherwise due' and situations where such revenue is not 'otherwise due'. As Members, in principle, have the sovereign authority to determine their own rules of taxation, the comparison under Article 1.1(a)(1)(ii) of the SCM Agreement must necessarily be between the rules of taxation contained in the contested measure and other rules of taxation of the Member in question. Such a comparison enables panels and the Appellate Body to reach an objective conclusion, on the basis of the rules of taxation established by a Member, by its own choice, as to whether the contested measure involves the foregoing of revenue that would be due in some other situation or, in the words of the SCM Agreement, 'otherwise due'....
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> In identifying the appropriate benchmark for comparison, panels must obviously ensure that they identify and examine fiscal situations which it is legitimate to compare. In other words, there must be a rational basis for comparing the fiscal treatment of the income subject to the contested measure and the fiscal treatment of certain other income. In general terms, in this comparison, like will be compared with like. For instance, if the measure at issue involves income earned in sales transactions, it might not be appropriate to compare the treatment of this income with employment income.

Also, note that as per note 1 to Article 1.1 (a) (1)(ii), the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued is not considered a subsidy. This exception does not, however, apply to the remission of import duties. See Report of the Appellate Body, Canada – Certain Measures Affecting the Automotive Industry, WT/DS139/AB/R, WT/DS142/AB/R, 31 May 2000, ('Canada – Autos'), at paragraph 92.

10 'Goods' has been interpreted as referring to a 'very broad spectrum of things the government can provide' – tangible or movable personal property, other than money and in general encompasses all in-kind contributions. Report of the Panel, United States – Preliminary Determinations with Respect to Certain Softwood Lumber from Canada, WT/DS236/R, 27 September 2002, ('US – Lumber III'), paragraphs 7.23- 7.24. In this case, the provision of standing timber to harvesting companies was held to constitute the provision of goods. See also the Reports of the Panel and Appellate Body in United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada, WT/DS257/R and WT/DS257/AB/R, 17 February 2004, ('US – Lumber IV'), at, respectively, paragraphs 7.13-7.30 and paragraphs 57-76.

11 See Report of the Panel, United States – Measures Treating Export Restraints as Subsidies, WT/DS194/R, 29 June 2001, ('US – Export Restraints'), paragraph 8.73:

> ...the negotiating history confirms that the introduction of the two-part definition of subsidy, consisting of 'financial contribution' and 'benefit', was intended specifically to prevent the countervailing of benefits from any sort of (formal, enforceable) government measures, by restricting to a finite list the kinds of government measures that would, if they conferred benefits, constitute subsidies. ...

12 Ibid., paragraph 8.65; see also paragraph 8.69:

> The submissions by participants to the negotiations suggest that the proponents' purpose behind including [the financial contribution] element was to limit the kinds of government actions that could fall within the scope of the subsidy and countervailing measure rules. In other words, the definition ultimately agreed in the negotiations definitively rejected the approach espoused by the United States of defining subsidies as benefits resulting from any government action, by introducing the requirement that the government action in question constitute a 'financial contribution' as set forth in an exhaustive list.

See also the Report of the Appellate Body, United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors from Korea, WT/DS296/AB/R, 27 June 2005, ('US – DRAMS'), paragraph 107:

Article 1.1(a)(1) SCM makes clear that a 'financial contribution' by a government or public body is an essential component of a 'subsidy' under the SCM Agreement. No product may be found to be subsidised under Article 1.1(a)(1) SCM, nor may it be countervailed, in the absence of a financial contribution.

See also Report of the Appellate Body, US – DRAMS, at paragraphs 114 and 115:

> This is consistent with the Appellate Body's statement in US – Softwood Lumber IV that 'not all government measures capable of conferring benefits would necessarily fall within Article 1.1(a)'; otherwise paragraphs (i) through (iv) of Article 1.1(a) would not be necessary 'because all government measures conferring benefits, per se, would be subsidies'.
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> Furthermore, such an interpretation is consistent with the object and purpose of the SCM Agreement, which reflects a delicate balance between the Members that sought to impose more disciplines on the use of subsidies and those that sought to impose more disciplines on the application of countervailing measures. Indeed, the Appellate Body has said that the object and purpose of the SCM Agreement is 'to strengthen and improve GATT disciplines relating to the use of both subsidies and countervailing measures, while, recognizing at the same time, the right of Members to impose such measures under certain conditions.'

13 Report of the Appellate Body, Brazil – Export Financing Programme for Aircraft, WT/DS46/AB/R, 2 August 1999, ('Brazil – Aircraft'), paragraph 157, quoted with approval in, inter alia, US – Export Restraints, at paragraph 8.20. See also, infra, note 31 and Report of the Panel in Canada – Export Credits and Loan Guarantees for Regional Aircraft, WT/DS222/R, 28 January 2002, ('Canada - Aircraft II'), paragraph 7.396:

> ...The term 'benefit' relates to the effects of a 'financial contribution'. Thus, in order to demonstrate the existence of a 'benefit', a complaining party must do more than establish the existence of a 'financial contribution'.

Export Restraints case. The Panel indicated that Article 1.1(a)(iv) SCM contains five requirements:

– a government entrustment or direction;
– to a private body;
– to carry out one or more of the types of functions illustrated in subparas. (i)-(iii);
– and those types of functions 'would normally be vested in the government';
– 'the practice in no real sense differs from practices normally followed by governments.'[14]

The US – Export Restraints Panel considered that government entrustment or direction 'refers to situations in which the government executes a particular policy by operating through a private body'[15] and that the action of the government must contain a notion of delegation (in the case of entrustment) or command (in the case of direction), and that both of these acts necessarily entail the following three elements: (i) an explicit and affirmative action, be it delegation or command; (ii) addressed to a particular party; and (iii) the object of which action is a particular task or duty.[16]

Thus, for the Panel, there had to be an 'explicit and affirmative act of delegation or command' for government entrustment or direction to exist. The Panel also distinguished government entrustment or direction from the situation in which governments intervene in the market and which intervention produces results, which may not necessarily have been intended. Thus, in the Panel's view, the existence of a financial contribution by a government must be assessed with respect to the nature of the government action – rather than the reaction or results it produces on the market, as had been advocated by the US in that case.[17] Thus, subpara. (iv) of Article 1.1(a) closes a loophole by avoiding circumvention and preventing a government from acting through an intermediary (a private body) to confer the types of financial contributions found under subparas. (i) to (iii).[18]

Subsequent Panels, while agreeing generally with the US – Export Restraints Panel's approach and with the necessity of an 'affirmative act' of delegation or command, questioned whether this act needed to be 'explicit'. Rather, they considered that subpara. (iv) 'encompassed entrustment or direction irrespective of the precise form it takes'.[19] The Appellate Body itself finally addressed the issue of government entrustment or direction in US – DRAMS. The Appellate Body agreed with the general idea that subpara. (iv) 'covers situations where a private body is being used as a proxy by the government to carry out one of the types of functions listed in paras. (i) through (iii)'[20] and that 'seen in this light, the terms "entrusts" and "directs" in para. (iv) identify the instances where seemingly private conduct may be attributed to a government for purposes of determining whether there has been a financial contribution within the meaning of the SCM Agreement.'[21] The Appellate Body, however, disagreed with the interpretation of 'entrusts' and 'directs' reached by the Panels. It found that the meaning of these terms could not be limited to that of 'delegation' and 'command'. Rather they should be construed more broadly to refer, respectively, to situations in which a government gives responsibility to a private body and exercises authority over a private body to carry out one of the types of functions in subparas. (i)-(iii). Otherwise, the Appellate Body agreed with the US – Export Restraints Panel that the difference between subparas. (i)-(iii) and subpara. (iv) has to do with the identity of the actor, and not with the nature of the action at issue and that mere encouragement on the part of government authorities cannot satisfy the test, nor can entrustment or direction be inadvertent or a mere by-product of government regulation.[22]

The recognition in the SCM Agreement, that a financial contribution is granted when a government 'entrusts' or 'directs' a private body to provide a financial contribution under Article 1.1(a)(1) (i)–(iii) suggests that the definition of a subsidy under the Agreement is broader than that of 'State aid' in EC law. EC law requires that, for a measure to constitute State aid, it must correspond to a government expenditure (i.e. a cost to the granting government). This is referred to as the requirement of a 'charge on the public account'.[23] The seminal case establishing this requirement is the Sloman Neptun case.[24] In that case, the European Court of Justice examined a measure enabling certain shipping undertakings flying the German flag to subject non-EU nationals seafarers to working and pay conditions less favorable than those applicable to German nationals. The Court refused to consider such a measure as State aid and affirmed that only advantages that are granted directly or indirectly through State resources are to be regarded as State aid within the meaning of Article 87 (then Article 92).[25]

14 See US – Export Restraints, at paragraph 8.24.
15 Ibid., paragraph 8.28.
16 Ibid., paragraph 8.29.
17 Ibid., paragraphs 8.34-8.37.
18 Ibid., paragraph 8.53.
19 Report of the Panel, European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea, WT/DS299/R, ('EC – DRAMs'). Similar reasoning (and language) is found in Report of the Panel, United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors from Korea, WT/DS296/R, 21 February 2005, ('US – DRAMS'), paragraph 7.33, and in Report of the Panel, Korea – Measures Affecting Trade in Commercial Vessels, WT/DS273/R, 7 March 2005, ('Korea-Vessels'), paragraph 7.370.
20 Ibid., paragraph 108.
21 Ibid.
22 Ibid., at paragraph 114.
23 See, for an exhaustive analysis of the issue, Slotboom, 'Do Different Treaty Purposes Matter for Treaty Interpretation?: A Comparison of WTO and EC Law', London, Cameron May, (2005), pages 97-126. The author takes the position that the requirement of a 'charge on the public account' requirement should be eliminated.
24 Joined Cases C-72/91 and C-73/91 – Firma Sloman Neptun Schiffahrts AG v. Seebetriebsrat Bodo Ziesemer der Sloman Neptun, [1993] ECR I-887, at paragraphs 18 ff.
25 Ibid.

In a more recent case, the ECJ held that legislation forcing private regional electricity suppliers to purchase electricity produced from renewable energy producers in their area of supply at fixed (and therefore above-market) minimum prices did not constitute State aid.[26] The Court found that the measure in question, while conferring an economic advantage on renewable energy producers, '[did] not involve any direct or indirect transfer of State resources to undertakings which produce that type of electricity'[27] and remarked that:

> ...the case-law of the Court of Justice shows that only advantages granted directly or indirectly through State resources are to be considered aid within the meaning of Article 92(1) [now 87(1)]. The distinction made in that provision between 'aid granted by a Member State' and aid granted 'through State resources' does not signify that all advantages granted by a State, whether financed through State resources or not, constitute aid but is intended merely to bring within that definition both advantages which are granted directly by the State and those granted by a public or private body designated or established by the State ... .[28]

In sum, State aid will only exist, under the current Court jurisprudence, where the measure entails a direct or indirect transfer of state resources to certain undertakings.[29] This requirement is however not as strict as it first appears. The Court has been ready to consider as State aid measures granted through private resources where such resources are – directly or indirectly – under the control or at the disposal of the State.[30] In such cases, measures taken by private actors can be imputed to the State.

By contrast, no 'cost to government' requirement exists under WTO law, with the result that various government-mandated measures that do not impose a 'cost' on the granting government are nonetheless regarded as subsidies,[31] meaning that a number of subsidies that would not constitute State aid under EC rules will nevertheless constitute subsidies under WTO law. As discussed above, this result is evident from the text of Article 1.1(a)(1)(iv) given that government instructions to a private body (for instance a private bank) to grant a financial contribution will satisfy the definition of subsidy.[32] The different approaches retained in the EC and in the WTO apparently result from the fact that the EC had to somehow accommodate the views of the US in the negotiations on the definition of 'subsidy'. The EC's proposal that subsidies be limited to cases where a charge on the public account is incurred was not retained.[33]

Thus, in principle, the requirement in EC law that a measure correspond to a charge on the public account signifies that EC State aid law is more lenient than the WTO's disciplines on subsidies (a somewhat counter-intuitive result). We have already noted, however, that this requirement of a charge on the public account is

26 Case C-379/98 – PreussenElektra AG v. Schleswag AG, [2001] ECR I-2099.

27 Ibid., paragraph 59.

28 Ibid., paragraph 58. The Court rejected a Commission argument that the State aid concept ought to be interpreted in such a way as to include support measures which are decided upon by the State but financed by private undertakings. See ibid., paragraph 65. See also the Opinion of Mr Advocate General Jacobs delivered on 26 October 2000.

For an overview of the Court's jurisprudence on the issue, see AG Jacobs' Opinion in PreussenElektra, paragraphs 114-116:

> The phrase 'granted by a Member State or through State resources' in Article 92(1) might be read in two different ways.
>
> On the one hand, it might be argued that the second alternative aid granted 'through State resources' covers measures financed through public funds, whilst the first alternative 'aid granted by a Member State' covers all remaining measures which are not financed through State resources. Under that extensive interpretation of Article 92(1) any measure which confers economic advantages on specific undertakings, and which is the result of conduct attributable to the State, constitutes State Aid independently of whether it involves any financial burden for the State.
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> On the other hand, Article 92(1) may be read as stating that aid must necessarily be financed through State resources and that the distinction between aid granted by a State and aid granted through State resources serves to bring within the definition of aid not only aid granted directly by the State, but also aid granted by public or private bodies designated or established by the State. Under that second narrower interpretation the measure at issue must necessarily cost the State money and financing through public resources is a constitutive element of the definition of State aid.
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> It is now well-established case-law that the second reading prevails and that only advantages which are granted directly or indirectly through State resources are to be regarded as State Aid within the meaning of Article 92(1).

29 Interestingly, the EU applied the 'cost to government' standard not only to its State aid rules, but also in the application of countervailing measures against foreign subsidised products. See Bronckers/Quick, 'What is a Countervailable Subsidy Under EEC Trade Law?', Journal of World Trade, 23(6), (1989), pages 5-31. Reading the definition of 'subsidy' in the current CVD Regulation (Council Regulation (EC) No 2026/97 of 6 October 1997, Article 2, OJ 1997, L 288), it appears that the EC has now adopted the SCM Agreement definition of a subsidy for the purpose of applying its countervailing duty legislation.

30 See, inter alia, Case C83/98 P – France v. Ladbroke Racing and Commission, [2000] ECR I-3271, paragraph 50; Case C-482/99 – France v. Commission (Stardust case), [2002] ECR I-4397, paragraphs 50-56.

31 See Report of the Appellate Body, Canada – Measures Affecting the Export of Civilian Aircrafts, WT/DS70/AB/R, 2 August 1999, paragraph 160 ('Canada – Aircraft') where the Appellate Body made this very point in response to Canada's contention that the existence of a benefit had to be examined by reference to a 'net cost to the government' criteria:

> Canada insists that the concept of 'cost to government' is relevant in the interpretation of 'benefit'. We note that this interpretation of 'benefit' would exclude from the scope of that term those situations where a 'benefit' is conferred by a private body under the direction of government. These situations cannot be *excluded* from the definition of 'benefit' in Article 1.1(b), given that they are specifically *included* in the definition of 'financial contribution' in Article 1.1(a)(iv). We are, therefore, not persuaded by this argument of Canada.

See, also, Report of the Panel, Canada – Measures Affecting the Export of Civilian Aircrafts, WT/DS70/R, 14 April 1999, ('Canada-Aircraft'), at paragraphs 9.96-9.120. As one can see, the issue of 'cost to government' was addressed somewhat indirectly (Canada had argued that the notion of benefit in the case at hand included a net cost to the government requirement, but the Appellate Body rightly replaced the issue of 'net cost to the government' in the context of 'financial contribution' and found fault with the Panel for confusing the concepts of financial contribution and of benefit. See Appellate Body Report, Canada – Aircraft, at paragraph 155.

32 We note that State-owned or controlled undertakings are assimilated to the State under both EC and WTO law.

33 In an apparent effort to limit the types of measures that could be countervailed by the US (then the prime user of the CVD instrument), the EC had proposed that subsidies only be found to exist where a financial charge is incurred by a government or administrative authority on behalf of a beneficiary (Uruguay Round Group of Negotiations on Goods (GATT), Negotiating Group on Subsidies and Countervailing Measures, Communication from the EEC, MTN.GNG/NG10/W/7, 11 June 1987, quoted in Report of the Panel, US – Export Restraints, at note 155.

in fact mitigated to a certain degree by the manner in which certain actions of private actors can be imputed to the State under EC law.

b. Benefit

WTO and EC law contain a similar requirement: a measure will only constitute a subsidy or State aid if it confers an advantage on the recipient – this follows from the wording of Article 1.1(b) SCM ('and ... a benefit is thereby conferred') and the words 'which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods' in Article 87(1)EC. As we see below, in both systems, whether an advantage is conferred is defined in relation to the marketplace.

In Canada – Aircraft, the Appellate Body noted that, because there can be no benefit unless the financial contribution makes the recipient 'better off' than it otherwise would have been, the notion of benefit implies a comparison. The market provides the relevant benchmark:

> 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.[34]

The definition of subsidy was also discussed by the Panel in EC – DRAMs. In that case, the question arose of whether the EU was entitled to impose countervailing duties on Korean DRAMS; this also raised the preliminary question of whether a subsidy existed (export subsidies were concerned, but as the Panel and Appellate Body had to address the preliminary issue of whether a subsidy existed, they did not need to look at the specific provisions concerning export subsidies). The Panel noted that the existence of a benefit is a constitutive element of the definition of a subsidy: 'only in cases where the financial contribution provides the recipient with an advantage over and above what it could have obtained on the market will the government's financial contribution be considered to have conferred a benefit and will a subsidy thus be deemed to exist.'[35] The Panel noted that 'if the public or publicly directed financial contribution is provided under the same conditions as a private market player would have provided, then there would be no reason to impose any discipline, simply because the financial contribution was provided by the government.'[36]

It is also to be noted that benefit does not always need to be established. As will be explained below, the SCM Agreement contains an Illustrative List of export subsidies. Measures meeting the criteria of an item of the list per se constitute prohibited export subsidies; benefit therefore needs not be established separately.[37]

Article 14 SCM, which concerns the 'Calculation of the Amount of a Subsidy in Terms of the Benefit to the Recipient' was found to provide relevant context for the interpretation of the concept of benefit.[38] Article 14 SCM provides that:

> For the purpose of Part V [rules on countervailing duties], any method used by the investigating authority to calculate the benefit to the recipient conferred pursuant to paragraph 1 of Article 1 shall be provided for in the national legislation or implementing regulations of the Member concerned and its application to each particular case shall be transparent and adequately explained. Furthermore, any such method shall be consistent with the following guidelines:
>
> (a) government provision of equity capital shall not be considered as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice (including for the provision of risk capital) of private investors in the territory of that Member;
>
> (b) a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market. In this case the benefit shall be the difference between these two amounts;
>
> (c) a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the

34 Appellate Body Report, Canada – Aircraft, at paragraph 157.

35 Report of the Panel, EC – DRAMs, at paragraph 7.175.

36 Ibid. In that case, the Panel found that a benefit existed because, 'if the government charges less than a market fee for its guarantee in light of the specific circumstances of the case, there would be a benefit to the recipient' (Report of the Panel, EC – DRAMs, paragraph 7.189). It found in that case that a subsidy existed because a private market operator would not have provided an export guarantee similar to the one that was provided by the public body (in fact, that public body itself was reluctant to issue a guarantee without a promise from the government that it would provide additional funding in case the granting of the guarantee would result in a shortage of payment capacity on the public body's part). It also found that the commercial banks that had provided loans to the recipient would simply not have agreed to grant a comparable commercial loan absent the government guarantee. In other words, the Panel did not need to compare the cost of the loan received (and backed by a government guarantee) and a commercial benchmark, since there were none of the latter.

37 Conversely, this means that the Illustrative List should not be used as context to define the notion of subsidy under Article 1. See the Panel Report in Canada-Aircraft, at paragraph 9.117:

> '... we are unable to accept Canada's argument that item (k) of the Illustrative List of Annex I of the SCM Agreement constitutes contextual guidance for determining the existence of "benefit" in the specific context of government credit under Article 1. In our view, item (k) of the Illustrative List applies in determining whether or not a prohibited export subsidy exists. We do not consider, and the parties have not argued, that item (k) determines whether or not a "subsidy" exists within the meaning of Article 1 of the SCM Agreement...'

38 Panel Report, Canada-Aircraft, at paragraph 9.113, and Appellate Body Report, Canada-Aircraft, at paragraphs 155-158.

firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees;

(d) the provision of goods or services or purchase of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration. The adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale).

We note, however, that there may not always be a 'market' to serve as a benchmark. In Lumber IV, the US had argued that the price of lumber in Canada did not represent a valid commercial benchmark because of the overwhelming presence (supply) of (allegedly) subsidised lumber originating in public land, which meant that the price of the lumber from private forests was depressed. The US authorities had used a so-called cross-border benchmark, i.e. they used as a benchmark the price of lumber of comparable species in neighboring US States. As we have seen, Article 14(d) SCM requires that the adequacy of remuneration for the goods provided be determined by reference to 'prevailing market conditions...in the country of provision or purchase'. The issue was therefore whether the US authorities' use of a cross-border benchmark was at all acceptable. The Appellate Body found that although domestic market conditions provided the starting point of the analysis, certain conditions prevailing on the market might justify the use of other benchmarks. In other words, the Appellate Body accepted – at least in principle – that the overwhelming presence of the State on the market for a given good may invalidate the market as the relevant benchmark for the determination of whether a benefit exists.[39]

EC State aid law includes a concept similar to that of 'benefit'. In order for State aid to exist, it is necessary that there is an aid favoring certain undertakings or the production of certain goods, in other words that it confer an advantage on the recipient.[40] While sometimes formulated differently, the operation is similar to the determination of a benefit under WTO law. The test is whether the benefit would not have been received in the normal course of business, or under 'normal market conditions'.[41] Thus, also under EC State aid law, the relevant benchmark is the market.

For instance, in the case of investments made by governments, the government's conduct will be assessed in comparison to a 'private investor' principle.[42] This means that the situation in question under the prevailing market conditions will be assessed in comparison with how private investors would behave in a similar situation. The granting government, if it behaves like a private investor, will not be considered to have granted an advantage. A second principle, that of the 'private creditor', means that a government will confer an advantage where it neglects to collect money that it is due.[43]

In conclusion, the EC and WTO disciplines on the issue are similar.

c. Specificity

Specificity is not, per se, a requirement for a subsidy to exist under WTO law. But a subsidy is only subject to the provisions of Parts II (prohibited subsidies), III (actionable subsidies) and V (CVDs) of the SCM Agreement if it is specific (to an enterprise, industry or group of enterprises or industries – collectively referred to as 'certain enterprises') within the jurisdiction of the granting authority. Prohibited subsidies are deemed specific, meaning that even if they are available to all enterprises, the disciplines of Parts II and V will apply.[44]

Article 2.1 SCM provides principles to determine whether subsidies are specific:

– De jure specificity: De jure specificity exists where access to a subsidy is explicitly limited to certain enterprises (or groups or enterprises, or industries, etc.) by the granting authority, or the legislation pursuant to which it operates.[45]
– Presence of objective criteria: specificity does not exist where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions – defined as criteria or conditions which are neutral, which do not favor certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise – governing the eligibility for, and the amount of, a subsidy, and provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. In addition, the 'criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification'.[46]

39 Appellate Body Report, US – Lumber IV, paragraphs 80-122.

40 See, inter alia, Case C-353/95 – Tiercé Ladbroke v. Commission, [1997] ECR I-7007.

41 See Case C-39/94 – Syndicat français de l'Express international (SFEI) and others v. La Poste and others, [1996] ECR I-03547, paragraphs 60-62.

42 See e.g. Case C-301/87 – France v. Commission, [1990] ECR I-307.

43 See e.g. Case C-342/96 – Spain v. Commission [1999] ECR I-02459, paragraph 46.

44 Article 2.3 SCM. Interestingly, the Panel, in Korea – Vessels, at paragraph 7.514, held that a subsidy that is specific by virtue of Article 2.3 SCM (by virtue of export contingency) is automatically specific for the purpose of both Part II (prohibited export subsidy) and Part III (actionable subsidy) claims.

45 Article 2.1(a) SCM.

46 Article 2.1(b) SCM.

- De facto specificity: a subsidy may be considered to be specific even in the absence of explicit limitation to certain enterprises or the presence and adherence to objective criteria or conditions. If there are reasons to believe that a subsidy may in fact be specific, other factors will be considered:
  - use of a subsidy programme by a limited number of certain enterprises;
  - predominant use by certain enterprises;
  - the granting of disproportionately large amounts of subsidy to certain enterprises; and
  - the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy (the frequency with which applications for a subsidy are refused or approved and the reasons for such decisions shall be considered).[47]

The Panel in Lumber IV held that a determination of de facto specificity does not need to be based on an examination of all four of these factors listed under Article 2.1 (c) SCM, but can be based on an examination of only some (for instance 2).[48]

Also, Article 2.1(c) requires that due account be taken of 'the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation'. While this provision is not very explicit, one can imagine that, for instance, it may help push into the non-specific category a programme that has only benefited one or two industries in a country where the economy is dependant on a few sectors or where the program has not been in use long enough for data on its use to be reflective of an intent to grant subsidies only to certain enterprises, industries, or groups thereof. It may be hard for a developed country to make use of the first element of that provision.[49]

Article 2.2 SCM contains special rules for regional aid. According to Article 2.2 first sentence, a subsidy, which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority, shall be specific. This wording suggests that a subsidy granted to all enterprises in a certain region is non-specific.[50]

Article 2.2 second sentence addresses the special case of subsidies granted through fiscal measures. According to this sentence, 'the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement'. Different tax rates of different provinces, autonomous regions, Länder, etc. are therefore 'non-specific'.

There is relatively little WTO jurisprudence – and no Appellate Body guidance – on the issue of specificity, and most of the issues addressed have been relatively basic ones. For instance, Panels have examined the concept of limitation to certain enterprises or industries. The US – Cotton Panel found that an 'industry', or group of 'industries' could generally be defined by reference to the type of products they produce. In the Panel's view, 'a subsidy would cease to be specific because it is sufficiently broadly available throughout an economy as not to benefit a particular limited group of producers of certain products'.[51] Thus, it considered that subsidies limited de jure to a restricted number of agricultural products (even if granted to farmers who may produce other types of commodities) and 'not widely or generally available in respect of all agricultural production, let alone the entire universe of United States production of goods' were specific. While the Panel avoided deciding whether subsidies limited to all agricultural products would be specific, it left no doubt that limitation to a portion of the US agricultural sector was sufficient to reach a finding of specificity.

The Panel in Lumber IV adopted a similar approach. Interestingly, in that case, Canada had argued that provincial 'stumpage' programmes (programmes giving the right to harvest standing timber on public land against – allegedly below-market – compensation) were not de facto specific as had been determined by the US Department of Commerce. Canada argued that standing timber was by its nature only of interest to a limited number of industries and that for specificity, in law or in fact, to exist, the authorities must have deliberately limited access to the subsidy to a group of enterprises producing similar products. The Panel rejected Canada's arguments: it found no support in Article 2 for an interpretation that specificity could only exist, where the inherent characteristics of a good provided by the government limit the possible use of the subsidy to a certain industry, where access to the subsidy is limited to a sub-set of this industry (i.e. to certain enterprises within the poten-

47 Article 2.1(c) SCM.

48 Report of the Panel in US – Lumber IV, at paragraph 7.123.

49 For instance, in US – Lumber IV, the Panel rejected arguments by Canada in this respect, noting that it is a publicly known fact that the Canadian economy and the Canadian provincial economies in particular are diversified economies. See paragraph 7.124.

50 We note that an earlier draft of Article 2.2 first sentence SCM (the 'Dunkel Draft') would have made regional subsidies specific, even if these subsidies were available to all enterprises:

'2.2 A subsidy which is available *to all* enterprises located within a designated geographical region shall be specific irrespective of the nature of the granting authority.'

Contrast with the present language of Article 2.2, first sentence, SCM:

'2.2 A subsidy which is limited to *certain* enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific.'

See Dunkel Draft (Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, GATT document MTN.TNC/W/FA, 20 December 1991, page I. 3, Article 2.2). Horlick and Clarke report that the change was apparently a result of a deal between the US and Canada. See Clarke/Horlick, supra note 8, page 333, note 82.

51 Report of the Panel, United States – Subsidies on Upland Cotton, WT/DS267/R, 8 September 2004, ('US – Cotton'), at paragraph 7.1142.

tial users of the subsidy engaged in the manufacture of similar products).[52] For the Panel, Article 2 addresses the limitation to or predominant use of a subsidy by a limited number of enterprises, not of the use by a limited number of certain eligible enterprises. In fact, the Panel found that in the case of a good that is provided by the government (as opposed to money) and that has utility only for certain enterprises, it was all the more likely that a subsidy conferred via the provision of that good would be specific.[53] Finally, the Panel held that specificity is examined at the enterprise or industry, not product level: what matters is not the end products that are manufactured by the industry or industries using the programme but rather the fact that the subsidy is limited to these industries or groups of industries.[54]

The Panel in EC – DRAMs also addressed the notion of specificity. The Panel in that case reviewed the findings of the EU authorities in imposing CVDs against Korean DRAMS. The EU authorities had concluded that the subsidies in questions were de facto specific because the programme under which they had been granted was only used by six of more than 200 eligible companies, and had been disproportionately used (41 % of the total funds under the programme in question) by the DRAMS manufacturers.[55] Korea argued that it was not sufficient in this respect that a programme only be used by a limited number of companies if, for example, the eligibility criteria are broad enough and the restricted use of the programme depends on the willingness of eligible enterprises to make use of it rather than on the government. The Panel disagreed and found no flaw in the authorities' finding of de facto specificity.[56] Unsurprisingly, the Panel also validated a finding of de facto specificity with respect to the tailor-made restructuring operations: the EU authorities had concluded that these 'were not simply the application of a generally available support programme', but rather, had been provided under a procedural framework for restructuring that did not in itself involve any financial contributions.[57]

Thus, a number of questions have not yet been resolved with respect to how the concept of specificity should be applied in WTO law. For instance, it is not yet totally clear whether the concept of predominant use is to be assessed with respect to eligible enterprises. Our reading of the cases discussed above is that, a priori, the predominant use by only a part of the eligible enterprises or industry is sufficient for a finding of specificity, but that, in a broader sense, access to the subsidy need not be limited to a sub-set of eligible enterprises to be specific where eligibility is limited by natural factors. In any case, as can be seen from these few examples, specificity determinations are very much fact-specific.

The concept of selectivity in EC State aid law does not differ fundamentally from the notion of specificity under WTO law. Article 87(1) EC requires an assessment of whether, under a particular scheme, a State measure is such as to 'favour certain undertakings or the production of certain goods' in comparison with other undertakings.

The notion of selectivity, as interpreted by the ECJ, is rather broad and embraces all measures that are not of general application. The ECJ has held that neither the large number of eligible undertakings nor the diversity and size of the sector to which those undertakings belong, provide sufficient ground to conclude that a measure is a general measure of economic policy.[58] Also, a measure that favors virtually all enterprises, but excludes large enterprises, is selective.[59] Thus, unlike under WTO law, aid that is limited to SMEs is selective.[60] The fact that some firms or sectors benefit more than others does not necessarily make a measure selective,[61] but aid granted under measures of general application may become selective where the administering authority is granted a wide discretion in apply-

52 US – Lumber IV, Panel Report at paragraph 7.116.

53 Ibid.

54 Id, paragraph 7.121.

55 Report of the Panel in EC – DRAMs, at paragraph 7.223. The EC authorities had considered that the program was not de jure specific yet found that the subsidies granted under it to were de facto specific. They had reached that conclusion based on an examination of three of the four criteria mentioned above (the use of the programme by a limited number of companies, predominant use by certain companies and the granting of disproportionately large amounts of subsidy to certain companies).

56 But the Panel also noted that the EC had taken into consideration the manner in which the authorities had exercised their discretion in admitting companies to the programme in question. The fact that (according to the EC authorities) 'there was a lot of criticism within Korea from companies in similarly difficult situations complaining about the lack of transparency and the eligibility criteria' after the programme was announced seems to have played a role in this respect.

57 Report of the Panel in EC – DRAMs, paragraph 7.231.

58 See e.g. Case C-143/99 – Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v. Finanzlandesdirektion für Kärnten, [2001] ECR I-8365, paragraphs 35-41 (rebate of certain energy taxes limited to undertakings whose activities consists primarily in the manufacture of goods, found to be selective); Case C-75/97 – Kingdom of Belgium v. Commission of the European Communities, [1999] ECR I-3671, paragraphs 28-31 (limitation of increased reductions of social security contributions to certain sectors rendered the measures selective); Case 173/73 – Italian Republic v. Commission of the European Communities, [1974] ECR, page 709 (partial reduction of social charges to employers in the textiles sector found to be selective).

59 See Case C-351/98 – Spain v. Commission, [2002] ECR I-8031, paragraph 43. In that case, the ECJ itself noted a discrepancy between the notion of State aid in EC law and under the SCM Agreement (ibid., paragraph 44).

60 But such aid can nevertheless be authorised under Article 87(3)EC. See, infra, the section on 'State aid'. We say that such measures would not be specific under WTO law because Article 2.1(b) specifies that subsidies granted pursuant to legislation containing objective criteria and conditions, for instance with respect to the size of the enterprise or the number of employees, are not specific.

61 See Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ 1998 C 384/3, point 14.2. See also, on de facto selectivity – where a measure is facially general but, in fact, favours certain enterprises -, Case 203/82 – Commission v. Italy, [1983] ECR I-2525.

ing it and in determining the modalities of the aid granted.[62]

In addition, in the area of fiscal measures, special rules apply. In spite of the formally selective nature of a tax, the measure may be justified by the 'nature or general scheme of the system', in which case the measure will not be considered selective and will hence not constitute State aid.[63]

However, one important difference between WTO and EC law is that of regional selectivity. As we have seen above, subsidies applying only to part of a Member's territory are non-specific in the sense of the SCM Agreement, if these subsidies are available to all enterprises in the region. Under EC law, these subsidies could well be specific.

Of particular interest are measures adopted by regional authorities in the field of taxation. In the recent Azores case,[64] the Court rejected arguments put forward by the Commission that a reduction in the national tax rate, decided by regional authorities, and which applied only in the territory subject to their jurisdiction was necessarily selective.[65] Rather, the Court held that:

> It is possible that an intra-State body enjoys a legal and factual status which makes it sufficiently autonomous in relation to the central government of a Member State, with the result that, by the measures it adopts, it is that body and not the central government which plays a fundamental role in the definition of the political and economic environment in which undertakings operate. In such a case it is the area in which the intra-State body responsible for the measure exercises its powers, and not the country as a whole, that constitutes the relevant context for the assessment of whether a measure adopted by such a body favours certain undertakings in comparison with others in a comparable legal and factual situation, having regard to the objective pursued by the measure or the legal system concerned.[66]

The Court held that in such a case, it is appropriate to examine whether the measure was adopted by the body in question 'in the exercise of powers sufficiently autonomous vis-à-vis the central power'.[67] The Court indicated that where all local authorities at the same level have the autonomous power to set the tax rate applicable in the territory for which they are competent, such a measure would not be selective 'because it is impossible to determine a normal tax rate capable of constituting the reference framework'.[68] Another situation is where a regional or local authority adopts, in the exercise of sufficiently autonomous powers in relation to the central power, a tax rate lower than the national rate and which is applicable only to undertakings present in the territory within its competence. The Court enunciated a number of factors relevant to determine whether a decision adopted in this context can be regarded as having been adopted in the exercise of sufficiently autonomous powers: First, the decision must have been taken by a regional or local authority 'which has, from a constitutional point of view, a political and administrative status separate from that of the central government'. Second, 'it must have been adopted without the central government being able to directly intervene as regards its content'. Finally, the 'financial consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government'.

In the present case, the measures were found to be selective because reductions in tax rates decided by the regional authorities were offset by budgetary transfers from the central government.

It is not totally clear how the same situation would be addressed by WTO Panels and the Appellate Body. Again, under Article 2.2 second sentence, a horizontal tax rate decided by a regional government which has the constitutional power to establish a tax rate for its territory would not be specific, even if that tax rate is lower than the national rate. While one can suspect that the WTO 'judicial' instances would regard with suspicion a situation where (as in Azores) the national authorities offset reductions of the national tax rate decided by regional authorities, the words 'or change' in Article 2.2 second sentence would seem to mandate a finding of non-specificity.

In short, it seems that, although generally similar in their basic tenets, the concept of selectivity under EC law and the concept of specificity under WTO law differ in some respect. It seems that the EC law concept has a broader reach in certain cases (e.g. regional specificity or aid limited to SMEs). Yet, any definitive conclusion in this respect would seem to be premature given the lack of guidance received from WTO Panels and the Appellate Body on the exact scope of the specificity concept.

62 See Case C-241/94 – French Republic v. Commission of the European Communities, [1996] ECR I-4551, paragraphs 23-24. In that case, the Court held that even though proceeding under a general scheme, the conferral of wide discretion to national authorities in the administration powers enjoyed by the body implementing the scheme (enabling the body to adjust its financial assistance having regard to a number of considerations such as, in particular, the choice of beneficiaries, the amount of the financial assistance and the conditions under which it is provided) could make contributions under the general scheme selective. See also Case C-256/97 – Déménagements-Manutention Transport SA (DMT), [1999] I-03913, paragraph 27.

63 See Commission Notice on the application of the State Aid rules to measures relating to direct business taxation, cit., point 12; Spain v. Commission, supra note 59, paragraph 42.

64 Case C 88/03 – Portugal v. Commission, Judgment of 6 September 2006, not yet reported.

65 Ibid., paragraph 57.

66 Ibid., paragraph 58.

67 Ibid., paragraph 62.

68 Ibid., paragraph 64.

d. Other criteria of the definition of State aid in EC law

We might add that in the EU, a measure of support only constitutes State aid if, in addition to the above, it also affects trade between Member States, and distorts the competition in the common market. Prima facie, these requirements are additional to those of the WTO, such that they may result in some EU measures not being recognised as State aid, but nonetheless constituting subsidies under the SCM Agreement. This would, however, seem to be more of a theoretical than a practical concern: First, the Commission and European Courts have interpreted the requirement broadly, for instance, not necessarily requiring that the beneficiary of the aid participate directly in intra-Community trade.[69] Second, one cannot really imagine that financial support which is either de minimis, does not affect trade between the Member States or does not distort competition in the Common Market would ever be challenged before the WTO.[70]

e. State aid that is compatible with the common market

Another important difference between the two systems is that the presumption in Article 87(1) that State aid is incompatible with the common market is not absolute. Articles 87(2) and 87(3) EC mandates (in the case of Article 87(2), or allows (in the case of Article 87(3), the Commission to declare that certain State aid measures are, in fact, compatible with the common market.

Thus, whereas under Article 87(2) the Commission must authorise the aid once it has determined that it falls under one of the listed categories, Article 87(3) only provides that the different categories of aid listed may be authorised. The Commission will therefore assess whether authorising the aid is in the Community's interest, weighing the benefits provided by the measures to their potential detrimental effects on internal competition. The Commission has developed a body of Guidelines, Communications and Block Exemptions to guide the exercise of the discretion under Article 87(3), as well as to provide some predictability to the Member States and affected undertakings or sectors. These 'soft law' measures are either horizontal or sectoral in nature.

The fact that State aid may be so authorised creates a real risk of conflict with WTO law. This is because, since the disappearance of the concept of non-actionable subsidies, the SCM Agreement recognises no exception to its disciplines on the basis of the objectives of a measure. Conversely, the Commission does not assess the international trade effects of a measure before authorising it. As a result, measures, which the Commission finds are compatible with the common market, may run afoul of the SCM Agreement's provisions.

The risk of conflict with the WTO disciplines is real. Of particular concern are the following:

– Aid authorised on the basis of Article 87(3)(a), such as ad hoc regional aid to large investment projects: given that they concern large investment projects, such aid, where provided to undertakings exporting to the world market, are likely to cause adverse trade effects.[71]
– Aid authorised on the basis of Article 87(3)(b), i.e. aid to promote the execution of an important project of European interest, such as aid for Airbus.
– Aid authorised under Article 87(3)(c), such as 'rescue and restructuring aid': such aid would seem to offer the greatest danger of a reaction by the EU's international counterparts as aid to firms in financial difficulties will often take the form of operating aid – which a priori has the potential of causing adverse trade effects.[72]

3. Types of subsidies under WTO law

a. Multilateral rules

Introduction

The SCM Agreement recognises two different categories of subsidies: prohibited subsidies and actionable subsidies. They are, in common parlance, referred to as, respectively, red light and yellow light subsidies. Such subsidies can be either countervailed (Track I) or subject to dispute settlement (Track II). From the outset, and until 1999, a third type existed: non-actionable (or green light) subsidies.[73] This was in fact a means of shielding certain subsidies regarded as non-distortive from challenge under Track II or action under Track I – certain R&D, regional assistance and environmental subsidies.[74] Non-specific subsidies were also included in the category of non-actionable subsidies.

There are two types of prohibited subsidies: export subsidies and import-substitution subsidies. The for-

69 See e.g., Case C-66/02 – Italian Republic v. Commission of the European Communities, [2005] ECR I-10901, at paragraph 117.

70 The issue is not worth further consideration, but one might imagine that a Member State measure that only affects the domestic industry of a neighboring, non-EC Member, country, could fit the bill.

71 Subject to the Communication on Multisectoral Framework on regional aid for large investment projects, OJ 2002 C 70/8.

72 See the Commission Communication on the Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty, OJ 2004 C 244/2.

73 See Part IV of the SCM Agreement. Article 31 SCM provided that Part IV would only apply for a period of five years unless extended by the WTO Members. Since no extension was agreed, the provisions of Part IV lapsed on 1 January 2000.

74 Worth noting are the (surprising) provisions of Article 9.4 SCM, which allowed a Member WTO to impose 'countermeasures' when it was established before the Subsidies Committee that non-actionable subsidies granted by another WTO Member caused adverse trade effects to its industry. This shows that non-actionable subsidies were in fact not totally non-actionable.

mer refers to subsidies de jure or de facto contingent – whether solely or as one of several conditions – upon export performance. The latter are subsidies where the payment is conditional – also whether solely or as one of several conditions – upon the use of domestic, as opposed to imported, goods. Thus, in both cases, the characterisation as prohibited subsidies depends on the conditions attached to the granting of the subsidy.

By contrast, actionable subsidies are defined not by their nature, but by their effects: a subsidy is actionable when it causes adverse effects on another Member's interests.[75]

We examine below both categories of subsidies in more detail.

Prohibited subsidies

The main question that has arisen so far in the context of WTO dispute settlement is whether the subsidies in question are indeed 'export subsidies'. We therefore concentrate on this category of subsidies.

De jure and de facto export subsidies

We note, with respect to de facto export contingency, that footnote 4 to the SCM Agreement provides that:

> This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

The Appellate Body has interpreted the meaning of export contingency in Canada – Aircraft.[76] In the Appellate Body's view, the legal standard expressed by the word 'contingent' is the same for both de jure and de facto contingency – the difference lies in the type of evidence that will support a conclusion of export contingency: de jure export contingency will be demonstrated on the basis of the legislative texts creating the subsidy whereas de facto export contingency will be inferred from the total configuration of the facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case.[77] The Appellate Body also noted that, as per the terms of footnote 4, three elements need to be established for export contingency: (1) the 'granting of a subsidy', (2) that it 'is ... tied to' (3) 'actual or anticipated exportation or export earnings'. In the Appellate Body's view, the first element is whether the granting authority imposed a condition based on export performance in providing the subsidy – the analysis focuses on the granting authority, not the recipient's knowledge.[78] 'Tied to', the Appellate Body found, confirms the linkage of 'contingency' with 'conditionality' in Article 3.1(a), so that the facts must, in the Appellate Body's words, 'demonstrate' that the granting of a subsidy is tied to or contingent upon actual or anticipated exports. Merely demonstrating that the granting authority anticipated that exports would result is not sufficient. The third element ('anticipated') refers, in the Appellate Body's view, to an expectation. Importantly, the Appellate Body reasoned that the sole fact that a subsidy may be granted in the knowledge, or with the anticipation, that exports will result is not sufficient. It relied on the footnote, which precludes a finding of de facto contingency on the sole basis that a subsidy is 'granted to enterprises which export'. Thus, merely knowing that a recipient's sales are export-oriented is not sufficient to demonstrate that the granting of a subsidy is tied to actual or anticipated exports. Such export orientation may, however, be taken into account as a relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding.

In Canada – Aircraft, the Panel's finding of export contingency was based on an examination of 16 factual elements (including the granting authority's record of funding in the export field and the importance of projected export sales by applicants for funding to the export orientation of the firms concerned) and was considered adequate by the Appellate Body.[79]

The Illustrative List of Export Subsidies

In some cases, the SCM Agreement helps complaining WTO Members to establish that a measure is a prohibited export subsidy. It provides, in its Annex A, for an Illustrative List of Export Subsidies. The List has 12 entries, most of which are either self-explanatory or not especially problematic:

- The provision by governments of direct subsidies to a firm or an industry contingent upon export performance (item a).
- Currency retention schemes or any similar practices, which involve a bonus on exports (item b).
- Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments (item c).
- The provision, directly or indirectly, of imported or domestic products or services for use in the production of exported goods on terms or conditions

75 Article 5 SCM.

76 See Appellate Body Report in Canada – Aircraft, paragraphs 162-180.

77 Ibid., paragraph 167.

78 Ibid., paragraph 170.

79 On de facto export contingency, see also the Panel Report in Australia – Subsidies provided to Producers and Exporters of Automotive Leather, WT/DS126/R, 25 May 1999, ('Australia – Leather'), paragraphs 9.50-9.76. The Panel in that case took several factual elements into consideration in reaching its conclusion that the challenged measures were de facto specific, notably the fact that the recipient was, because of its export orientation, in fact obliged to meet export targets established by the grant contract.

more favorable than for provision of like products or services for use in the production of goods for domestic consumption, where such terms or conditions are more favorable than those commercially available on world markets to their exporters (item d).
– The full or partial exemption, remission, or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises (item e).
– The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged (item f).
– The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption (item g).
– The exemption, remission or deferral of prior-stage cumulative indirect taxes on goods or services used in the production of exported products in excess of the exemption of like prior-stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption (item h).
– The remission or drawback of import charges in excess of those levied on imported inputs that are consumed in the production of the exported product (item i).
– The provision 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' (item j).[80]
– The grant of export credits at rates below those that governments actually have to pay for the funds so employed or the payment by governments 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 (item k).
– Any other charge on the public account constituting an export subsidy in the sense of Article XVI of GATT 1994 (item l).

A few comments on the nature of the List:
First it is not exclusive. The very title of the List ('Illustrative List') and the terms of Article 3.1(a): ('...subsidies contingent upon export performance, including those illustrated in Annex I') indicate this. The list contains examples of prohibited export subsidies, but it does not exclude the existence of other such subsidies under the terms of Article 3.1.[81]

Second, under the terms of note 5 to Article 3.1, measures referred to in the List as not constituting export subsidies are not prohibited under either Article 3.1 or any other provision of the SCM.[82] This, however, only applies to those situations where the List contains a clear indication that the measures in question are not prohibited export subsidies. The mere fact that a measure does not meet conditions listed under one of the items for it to constitute a prohibited export subsidy is not sufficient.[83]

Third, measures that fall under the scope of the Illustrative List are deemed to be prohibited export subsidies, i.e. the List allows a Member to directly go to the List to show that a measure is a prohibited subsidy, without having to first demonstrate that the measure falls within the scope of Article 3.1(a) SCM.[84] Thus, the List provides a shortcut for an aggrieved Member to establish that another member grants a prohibited export subsidy.[85] It cannot, however, be relied on as context in the interpretation of the general definition of subsidy contained in Article 1.[86]

Export credits and the OECD Arrangement on Officially Supported Export Credits
Most of the items on the List are of no particular interest. However, item (k) has led to some controversy, and warrants further discussion.

The full text of item (k) is as follows:

'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

80 We note that Item (j) is phrased in terms of cost to the government.

81 Report of the Panel, Brazil – Export Financing Programme for Aircraft, Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW, 9 May 2000, ('Brazil – Aircraft (21.5)'), at paragraph 6.30.

82 Article 3.1(a) SCM.

83 On this point, see, infra, note 93.

84 Report of the Panel, Brazil – Aircraft (21.5), at paragraph 6.31.

85 Ibid., paragraph 6.42:
...In our view, the primary role of the Illustrative List is not to provide guidance as to when measures are not prohibited export subsidies – although footnote 5 allows it to be used for this purpose in certain cases – but rather to provide clarity that certain measures are prohibited export subsidies. Thus, it would be possible to demonstrate that a measure falls within the scope of an item of the Illustrative List and was thus prohibited without being required to demonstrate that Article 3, and thus Article 1, was satisfied. To borrow a concept from the field of competition law, the Illustrative List could be seen as analogous to a list of per se violations.

86 The Panel in Canada – Aircraft, at paragraph 9.117, was faced with an argument by Canada that item (k) of the Illustrative List constituted contextual guidance for determining the existence of 'benefit' in the specific context of government credit under Article 1. As we have already noted, supra, note 37, the Panel rejected Canada's arguments and stated that, in its view, 'item (k) of the Illustrative List applies in determining whether or not a prohibited export subsidy exists. We do not consider, and the parties have not argued, that item (k) determines whether or not a "subsidy" exists within the meaning of Article 1 of the SCM Agreement.' See also the Appellate Body Report in US – FSC, at paragraph 93.

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.'

As can be seen, item (k) is composed of two paragraphs. The first establishes the general rule: export credits at rates below the government's cost of funds and payments of costs incurred by exporters or financial institutions in obtaining credits, provided they confer a material advantage, constitute prohibited export subsidies. The second paragraph provides for what has been termed a 'safe harbour' or 'safe haven': export credit practices which would otherwise be prohibited under the first paragraph will nevertheless not be prohibited if they are in conformity with the interest rate provisions of an 'international undertaking on official export credits to which at least twelve original Members to [the SCM] Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members)'. In practice, the OECD Arrangement on Guidelines for Officially Supported Export Credits is the only such international undertaking.[87]

The OECD Arrangement does not impose 'hard rules' on the countries seeking to conform to its provisions – rather, it is in the nature of a Gentlemen's Agreement. It provides a framework 'for the orderly use of officially supported export credits' and essentially seeks to avoid a race to the bottom among OECD countries trying to offer the best possible export credit terms. In order to do so, the Arrangement sets forth certain guidelines with respect to the terms and conditions of export credits benefiting from official support (on the basis of so-called Commercial Interest Reference Rates or CIRRs).

The incorporation by reference into the second paragraph of item (k) of rules developed in another forum is remarkable. Even more surprising is the fact that this agreement in question is one developed by the OECD, a 'club' of developed nations. Moreover, the reference to the OECD Arrangement is an evolving one: by the very terms of para. 2 of item (k), the reference is to the version of the Arrangement currently in force. This means that the Arrangement can be modified by the OECD Members without the approval of the rest of the WTO membership.[88]

In other words, a sub-group of the WTO – composed of its most developed Members – can unilaterally alter the terms of the SCM Agreement. Unsurprisingly, this interpretation has irked some of the WTO's non-OECD Members, such as Brazil. Brazil fought against the interpretation of the reference to the OECD Arrangement as a moving target on these very grounds.[89] Also, in a recent proposal in the context of the Doha negotiations, Brazil made a proposal that would cure this perceived injustice.[90]

Going back to the text of item (k), the Panel and Appellate Body in Brazil – Aircraft devoted a lot of attention to the interpretation of the first paragraph of item (k). They did so because Brazil argued – in the original proceedings and the first and second 21.5 proceedings[91] – that the first paragraph, and particularly its last clause ('...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') could be read a contrario: payments not conferring a material advantage, Brazil argued, not only are not prohibited export subsidies, but are in fact 'permitted' by the SCM Agreement. Further, Brazil claimed that 'material advantage' had to be read in relation to what other Members provide their ex-

87 Report of the Panel, Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU, WT/DS70/RW, 9 May 2000 ('Canada – Aircraft (21.5)'), at paragraph 5.78.

88 In the words of the Panel in Canada-Aircraft (21.5), at paragraph 5.132:
> ... the second paragraph of item (k) is quite unique in the sense that it creates an exemption from a prohibition in a WTO Agreement, the scope of which exemption is left in the hands of a certain subgroup of WTO Members – the Participants, all of which as of today are OECD Members – to define, and to change as and when they see fit.

See also Panel Report in Canada – Aircraft (21.5), at paragraph 5.68, cited by the Panel in Brazil – Export Finance Programme for Aircraft, Second Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW/2, 26 July 2001, ('Brazil – Aircraft (21.5 II)'), at paragraph 5.86.

89 See Brazil – Aircraft (21.5 II), at paragraph 5.68 (Brazil wanted to prevent the panel from holding that the current version of the Arrangement was that referred to by the second paragraph of item (k)).

90 See WTO, Negotiating Group on Rules, Treatment of Government Support for Export Credits and Guarantees under the Agreement on Subsidies and Countervailing Measures, TN/RL/GEN/66, 11 October 2005, paragraphs 4 ff. where Brazil argues that this 'evolutionary interpretation' (incorporation of the current version of the OECD Arrangement, by reference, in paragraph 2 of item (k)) 'raises profound systemic concerns regarding procedural fairness and sovereignty, as not all WTO Members are Participants to the Arrangement'. Brazil makes the point that '[u]nder no circumstances, however, should a small group of WTO Members be allowed to change those rules through decisions taken in another forum'. India takes a similar stance. See WTO Negotiating Group on Rules, Intervention by India on the Proposal by the EEC Captioned WTO Negotiations Concerning the WTO Agreement on Subsidies and Countervailing Measures, TN/RL/W/30, TN/RL/W/40, 10 December 2002.

91 '21.5 proceedings' are proceedings launched by a Member that considers that another has not correctly implemented the conclusions of an original Panel or the Appellate Body (and is therefore still in violation of its WTO obligations). There can be more than one such proceeding, hence the reference, in the Brazil – Aircraft case, to the first and second '21.5 Panels'.

porters.[92] Thus, Brazil's argument was essentially that whether a payment 'is used to secure a material advantage in the field of export credit terms' should be determined by comparing the export credit terms of the transaction supported by the payment with those of potential competing transactions; in other words, that the benchmark be the support that other Members (here, Canada) grant their exporters.

Brazil's argument was rejected by two of the three Panels.[93] The Panels based their rejection of Brazil's arguments on the fact that Brazil's reading of item (k) was at odds with the general manner in which the SCM Agreement determines benefit.[94] 'Material advantage' was interpreted to mean that the net interest rate (actual interest rate applicable minus government payment) must be compared to the CIRRs or alternatively, an alternative benchmark, the appropriateness of which must be demonstrated by the Party seeking to make use of it. [95]

Thus, the Panels and the Appellate Body refused a reading that makes compliance dependant on another Member's practices.

This leads us to the second paragraph of item (k) where the issue of matching came up even more directly. Is 'matching', which is permitted under the OECD Arrangement, also part of the 'safe harbour' under the second paragraph such that a Member matching another Member's support would also be covered by the safe harbour? Again, the discussion took place in the context of the Aircraft cases.

The main pronouncement on the issue came in the Canada – Aircraft (21.5) case. The Panel in that case examined in detail the various components of the safe harbour. First, it examined what constitutes an 'export credit practice' for the purpose of the second paragraph of item (k). It found that the term is broader than 'export credits' and 'credits' in the first paragraph of item (k).[96] Thus, for the panel, the 'export credit practices' that could potentially qualify for the safe harbour of item (k) were a broad category of measures. The Panel then turned to the Arrangement's 'interest rate provisions' with which an 'export credit practice' ought to conform in order to benefit from the safe harbour and found that they were the OECD Arrangement's provisions which specifically, directly or explicitly address interest rate support in the form of direct credits/financing, refinancing, and rate support at fixed interest rates with repayment terms of two years or more.[97] Last, the Panel examined what constitutes 'conformity' with the Arrangement's interest rate provisions. It found that this refers to conformity with the rules mentioned above as well as the other ancillary rules that support or reinforce them. It then examined whether, as argued by Canada, the Arrangement's matching derogation (which allows an OECD Party to match the terms of another Member's

92 See Report of the Panel in Brazil – Aircraft, at paragraphs 7.15 ff., and Appellate Body Report at paragraphs 165 ff.; Brazil Aircraft (21.5), Panel Report at paragraphs 6.24 ff., and Appellate Body Report at paragraphs 48 ff.; Report of the Panel, Brazil – Aircraft (21.5 II), paragraphs 5.209 ff.

93 The original Panel did not reach this issue as it considered that Brazil had not established that PROEX (Brazil's export credit scheme) payments were not used to secure a material advantage in the field of export credit terms. It nevertheless expressed doubts as to the admissibility of Brazil's arguments. See Report of the Panel, Brazil – Aircraft, paragraph 7.18, and Report of the Appellate Body, Brazil – Export Financing Programme for Aircraft, WT/DS46/AB/R, 2 August 1999, ('Brazil – Aircraft'), at paragraph 187.

The Panel in Brazil-Aircraft (21.5) reached the issue and rejected Brazil's arguments. In doing so, it relied especially on note 5 to the SCM, which states that 'Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provisions of this Agreement'. The Panel emphasised that footnote 5 refers to situations in the Illustrative list where a measure is referred to as not constituting an export subsidy (i.e. it contains some affirmative indication that a measure is not a prohibited export subsidy) – for instance the 2nd paragraph of item (k) offering a 'safe harbour' to measures in conformity with the OECD's Arrangement on Export Credits. The Panel Brazil-Aircraft (21.5) reasoning was endorsed by the Panel in Korea – Vessels, at paragraphs 7.309 ff. The Report of the Appellate Body in Brazil – Aircraft (21.5), however, suggests that the Appellate Body was of a different opinion even though it did not formally rule on the issue:

> If Brazil had demonstrated that the payments made under the revised PROEX were not 'used to secure a material advantage in the field of export credit terms', and that such payments were 'payments' by Brazil 'of all or part of the costs incurred by exporters or financial institutions in obtaining credits' *then we would have been prepared to find that the payments made under the revised PROEX were justified under item (k) of the Illustrative List.* However, Brazil has not demonstrated that those conditions of item (k) are met in this case. In making this observation, we wish to emphasize that we are not interpreting footnote 5 of the SCM Agreement, and we do not opine on the scope of footnote 5, or on the meaning of any other items of the Illustrative List. (paragraph 80, emphasis added)

Finally, the Panel in Brazil – Aircraft (21.5 II), paragraphs 5.269-5.275, rejected Brazil's argument and referred to its findings in the Brazil – Aircraft (21.5).

94 See Panel in Brazil – Aircraft, paragraphs 7.24-26:

> In no cases [under the SCM Agreement] is it suggested that whether or not a benefit exists would depend upon a comparison with advantages available to competing products from another Member...Nor can we find any suggestion in either Article 3.1(a) of the SCM Agreement or the Illustrative List of Export Subsidies that whether a measure is a prohibited export subsidy should depend upon whether the measure merely offsets advantages bestowed on competing products from another Member... In short, in asking us to look at the relative position of competitors in determining the disciplines applicable to item (k) payments, Brazil is asking us to construe that 'material advantage' clause in a manner which does not conform to the general approach of the SCM Agreement... In essence, Brazil's approach to 'material advantage' boils down to an argument that an admitted export subsidy should not be deemed to be prohibited if it can be demonstrated merely to offset some advantage or advantages available to the competing product of another Member. We consider that such an interpretation would produce results that would be contrary to the object and purpose of the SCM Agreement.... The Brazilian approach to item (k), however, would effectively allow a Member to raise the provision of export subsidies – or indeed of any subsidy – by the complaining Member as a defense justifying its own provision of export subsidies. This would entail a race to the bottom...

The Appellate Body faulted the Panel for equating 'material advantage' with benefit under Article 1.1(b), (see paragraph 179) but otherwise (at least implicitly) endorsed the Panel's more general point that an (objective) market benchmark should be used (see e.g. paragraph 181).

95 See Appellate Body Report, Brazil – Aircraft, at paragraph 181; Panel Report in Brazil – Aircraft (21.5), at paragraph 6.83 ff.; Appellate Body Report in Brazil – Aircraft (21.5), at paragraphs 61-77; Panel Report in Brazil-Aircraft (21.5 II), at paragraphs 5.236 ff. In Brazil – Aircraft (21.5 II) the Panel found that a CIRR is not, on its own, an appropriate market benchmark, but that the other export credit terms provided for in the Arrangement must be respected. That is because, a Member could otherwise, for instance 'support export credits with net interest rates at CIRR level, repayment terms of 100 years, no cash payment requirement and with the principal sum to be repaid at the very end of the credit term'. Such a scenario would, in the second 21.5 Panel's terms, 'deprive the material advantage clause of the first paragraph of item (k) of any useful effect.' See Panel Report in Brazil – Aircraft (21.5 II), at paragraphs 5.243 and 5.249.

96 Panel Report in Canada – Aircraft (21.5), at paragraph 5.80.

97 See also Panel Report in Brazil – Aircraft (21.5 II), at paragraphs 5.96 ff., which summarise the findings of the Panel in Canada – Aircraft (21.5).

offer that does not comply with the Arrangement) was covered by the 'safe haven'.[98] It held that it does not. Canada's reading of the scope of the safe haven was, in the Panel's view, simply at odds with 'the overarching principles and purposes of the WTO Agreement and the SCM Agreement':[99]

> … it is important to keep in mind the role of the safe haven in the second paragraph of item (k) in the overall context of the prohibition on export subsidies. … we believe that an interpretation of item (k) that would create a very broad exemption from prohibition in respect of export credits would not be consistent with the purpose of that prohibition in the context of the SCM Agreement. … Under this approach as well, matching of derogations no matter how low the interest rate or how generous the other terms also would qualify for that protection, even where the initiator of the derogation was not a WTO Member. In such circumstances, there would be no real disciplines of any kind on export credits. …[100]

It is notable that Canada brought an appeal against the Panel report, but that it did not appeal this specific finding.

The reasoning of the Canada – Aircraft (21.5) Panel was subsequently adopted by the Brazil – Aircraft (21.5 II) Panel and the Panel Report in Canada – Aircraft II.[101]

Actionable subsidies

The second type of subsidies is actionable subsidies. This is in fact the fall back category of subsidies. Actionable subsidies are defined not by their nature, but by their effects: a subsidy is actionable when it causes adverse effects to another Member's interests.[102] Broadly speaking, determining whether a subsidy is actionable is an exercise which is similar to the one conducted by national authorities in the context of a CVD investigation when assessing whether foreign subsidies cause injury to the domestic industry (though, as we see below, the definition of adverse effects is broader than injury under CVD law). Whether a subsidy meets the conditions set out under Part III of the SCM Agreement (dealing with actionable subsidies) is, however, determined by a dispute settlement panel.

Adverse effects exist:

i) where another Member's industry is injured as a result of the subsidies;
ii) where benefits accruing directly or indirectly to another Member under the GATT (and in particular the benefits of tariff concessions) are nullified or impaired; or
iii) where the subsidy causes serious prejudice to the interests of another Member.

Injury

Injury is defined in similar terms as the injury that must be established before CVDs can be imposed, as prescribed under Article 15 SCM ('Determination of Injury' in the CVD context).[103] Thus, it refers to 'material injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry'.

The determination of injury is a complex exercise. It involves an examination of the volume of subsidised imports, their effect on prices of the domestic like product and the impact of the imports on domestic producers. The latter involves an evaluation of, at least, 'all relevant economic factors and indices having a bearing on the state of the industry, including actual and potential decline in output, sales, market share, profits, productivity, return on investments, or utilisation of capacity; factors affecting domestic prices; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments and, in the case of agriculture, whether there has been an increased burden on government support programmes.'

Nullification or impairment of benefits

Nullification or impairment is used here in the same sense as under Article XXIII of GATT 1994 and relevant practice under that Article. Article XXIII in turn recognises two types of nullification or impairment: 'violation' nullification or impairment (i.e. the quasi-irrebuttable presumption of nullification or impair-

98 Panel Report in Canada – Aircraft (21.5), at paragraphs 5.137 ff.

99 Ibid., at paragraph 5.139.

100 Ibid., at paragraph 5.137.

101 See the Panel Report in Brazil – Aircraft (21.5 II), at paragraphs 5.64 ff.; Panel Report in Canada – Aircraft II, at paragraphs 7.158 ff. In Brazil – Aircraft (21.5 II) Panel Report , the US and the EC, as third parties, had made the argument that the Panel erred in concluding that financing involving matching of derogations was not eligible for the safe haven in the second paragraph of item (k). The Brazil-Aircraft (21.5 II) Panel rejected these arguments. It noted (paragraphs 5.114-5.116) that:

> It seems to us that both third parties tend to argue – incorrectly – from the standpoint of the OECD Arrangement rather than from the standpoint of the safe haven clause and the SCM Agreement. The United States considers that it would be unfortunate if Participants to the OECD Arrangement were dissuaded from using its matching provisions for fear that doing so might be contrary to the provisions of the SCM Agreement. The United States appears to suggest that, deprived of the possibility of matching, Participants would somehow be left defenceless in the face of non-conforming practices under the OECD Arrangement. This is not the case, however. It notably overlooks the fact that, to the extent those non-conforming practices are covered by the SCM Agreement, they would be enforceable through the WTO dispute settlement mechanism. … the fact that the OECD Arrangement allows matching of derogations does not logically imply that it should also be allowed under the SCM Agreement. Indeed, the OECD Arrangement and the SCM Agreement are very different. The European Communities itself acknowledges that the OECD Arrangement is a non-binding gentlemen's agreement. In those circumstances, matching may serve an important deterrent and enforcement function. That rationale for matching does not apply to the SCM Agreement. The SCM Agreement is a binding instrument, and it is enforceable through the WTO dispute settlement mechanism. The European Communities' argument is therefore unavailing.

102 Article 5 SCM.

103 Article 5(a) SCM, note 11.

ment flowing from a Member not respecting its obligations under the Agreement) and 'non-violation' nullification or impairment (i.e. impairing or nullifying the benefits another Member received from the provisions of the Agreement without violating a provision of the Agreement – in practice, where a Member increases or creates new subsidies to counter negotiated tariff reductions).[104]

Serious prejudice
Serious prejudice is, itself, defined as:
– displacement or impedance of the imports of another Member's imports into the market of the subsidising Member or in a third country market; or
– significant price undercutting, price suppression, price depression of another Member's products by the subsidised products in the same market or lost sales in the same market; or
– an increase in the world market share of the subsidising Member in a particular subsidised primary product compared to the average share it had in the previous three years and this increase follows a consistent trend over a period when subsidies have been granted.[105]

b. Countervailing duties and other types of unilateral measures

Countervailing duties
Part V of the SCM Agreement establishes rules governing the imposition by a WTO Member of countervailing duties (CVDs) on another Member's products. A Member who considers that another has imposed CVDs on 'its' exports in contravention to these substantive and procedural requirements may, like under track II, bring a challenge before the WTO's 'judicial' instances.

Like anti-dumping duties, countervailing duties are an 'unfair trade' remedy, meaning that they are adopted to rectify what is seen as an unfair market practice. Both are applied in a vastly similar manner. The main distinction is that CVDs counteract a government's actions (indirectly by imposing additional duties on products sold by a private entity, in order to counter the benefit of subsidies received by that enterprise) while AD measures counteract the private entity's action (selling at less than it sells on its home market or at an abnormally low price in order to capture market share). We note that both actionable and prohibited subsidies can be countervailed.

The SCM Agreement establishes procedural requirements which a Member must respect before duties can be imposed. An investigation must be conducted following the submission of a complaint by the domestic industry producing the like product or by a decision of the authorities to self-initiate an investigation. Substantively speaking, countervailing duties may only be imposed after the following have been established:
– the existence of a (prohibited or actionable) subsidy;
– injury to the domestic industry;
– causation between the two.

The reader is referred to the sections on prohibited and actionable subsidies where these concepts have been explained. Any such subsidy (provided, in the case of actionable subsidies, that it is specific)[106] can be countervailed. This means that today, all types of subsidies can be countervailed, even those that had previously fallen in the non-actionable category, for instance regional aid, environmental subsidies and R&D subsidies (provided they are specific). The EC has countervailed not only export subsidies, but also other types of subsidies, such as regional assistance[107] (not qualifying, at the time, as non-actionable) or domestic support subsidies.[108] In fact, the EC has also countervailed services.[109] The US has also taken a broad approach and countervails subsidies of various types, for instance, R&D subsidies. It has been suggested however that the US has been reluctant to countervail 'investment incentives'. The reason for this perceived self-restraint may have more to do with the fact that the US itself may be granting large amounts of such subsidies rather than a more legal reason.[110]

'Matching' subsidies
Are there, besides the countervailing duty instrument, other types of unilateral actions that, though not for-

104 For some examples, see Anderson/Husisian, 'The Subsidies Agreement', in Stewart (ed.), The World Trade Organization: The Multilateral Framework for the 21st Century and U.S. Implementing Legislation, Washington D.C., American Bar Association, Section of International Law and Practice, (1996), page 314 and corresponding notes.

105 Article 6.1 of the SCM listed situations under which a presumption of serious prejudice existed: where the total ad valorem subsidisation of a product exceeded 5 %; subsidies to cover operating losses sustained by an industry other than one-time, non-recurrent aid granted under certain conditions, and direct debt forgiveness. Like Part IV on non-actionable subsidies, Article 6.1 lapsed on 1 January 2000. Note also Magnus, 'World Trade WTO Subsidy Discipline: Is This the 'Retrenchment Round'?', supra note 4, page 986:
> 'New presumptions were provisionally included in ASCM Article 6.1, aimed at making the "serious prejudice" remedy more readily usable during a five-year trial period. But these provisions did not cure other, more serious defects in the serious prejudice scheme, and even where applicable, did not really absolve complainants of demonstrating actual trade effects. They had to be prepared to prove trade effects at the initial panel stage in the not – unlikely event that the presumption of serious prejudice might be rebutted by a defendant, and of course, they had to be ready to back up their damage claims at the suspension of concessions stage as well.'

106 See Article 1.2 SCM.

107 See Commission Regulation (EC) No 1810/1999 of 17 August 1999 imposing a provisional countervailing duty on imports of polyethylene terephthalate (PET) film originating in India, OJ 1999 L 219/14; Council Regulation (EC) No 1891/97 of 26 September 1997 imposing a definitive countervailing duty on imports of farmed Atlantic salmon originating in Norway, OJ 1997 L 267/19.

108 Council Regulation (EC) No 1891/97 of 26 September 1997 imposing a definitive countervailing duty on imports of farmed Atlantic salmon originating in Norway, supra note 107.

109 See Bronckers/Goyette, supra note 3, page 155.

110 Surprisingly, there is a general lack of analysis of the US authorities' CVD practice. One can only invite researchers to address the topic.

mally recognised by the SCM Agreement, can be used by a Member in response to foreign subsidies?

The most obvious instrument that comes to mind is that of 'matching' subsidies.

Matching subsidies are not specifically addressed in the SCM Agreement. As we have seen above, matching is a technique, which is exceptionally allowed under the OECD Agreement on Guidelines for Officially Supported Export Credits, referred to in item (k) of the Illustrative List. But we have also seen that several panels have found that the matching derogation of the OECD Arrangement is not covered by the 'safe haven' provisions of the second paragraph of item (k). Matching aid is thus not given any special treatment under the SCM Agreement: in order to be WTO compatible, a matching subsidy needs to be SCM Agreement-consistent on its own right. A matching subsidy may therefore be prohibited or actionable under Track II or countervailable under Track I if the relevant conditions are fulfilled.

It is interesting to note that under certain conditions, matching of non-actionable subsidies was possible until 2000. Article 9.4 SCM provided that the imposition of countermeasures could be authorised to offset the adverse trade effects of a foreign non-actionable subsidy.

'Retaliatory' subsidies

Another type of unilateral action (or perhaps a subset of the previous one) is that of so-called 'retaliatory' subsidies. This expression refers to subsidies that are granted in order to pressure another Member into withdrawing its own subsidies. Though the effect of the subsidy is the same as the above, the intention behind them is different. The EU has imposed such subsidies in its temporary defense mechanism against Korean subsidies to the shipbuilding sector.[111] Under this mechanism, Member States could grant operating aid (of up to 6 % of the value of the contract) to European shipbuilding undertakings that were in competition with a Korean shipyard on specific contracts. The mechanism was part of the dual strategy – filing a WTO complaint[112] and granting retaliatory subsidies – adopted by the EU to address the injury caused to EU shipbuilders by the Korean subsidies. But Korea challenged the mechanism before a WTO Panel. The Panel held that the mechanism was inconsistent with the EU's obligations under the SCM Agreement.[113] The Panel concluded that the EU was not permitted to resort to this type of unilateral pressure, but should have limited itself to its WTO procedure against Korea. The panel emphasised, however, that it was not condemning 'palliative' action – where the EU would give subsidies merely to offset the injury suffered by its shipbuilders.[114]

As the reader sees, both actions involve the matching of foreign subsidies, albeit for different motives. The EC – Vessels case tells us that the EC would have to be careful in granting subsidies to pressure another Member into dropping its own subsidies. But it seems perfectly acceptable to 'match' foreign subsidies, as long as the aid granted in the context of the matching exercise is itself consistent with the SCM Agreement's disciplines.

III. How have the WTO rules imposing disciplines on subsidies been applied since 1995?

We first note that the WTO subsidy disciplines have first and foremost been enforced unilaterally, i.e. through the imposition of CVDs. Many reasons can explain this result. First, imposing CVDs is faster than going through the WTO dispute settlement process and easier in that Members can rely on authorities that are well versed in the application of CVD laws. Also, CVDs will suffice in most cases to meet the domestic industry's concerns. Second, one may think that the CVD instrument offers better chances of success: considerations of national interest may play a role here, even though any excesses would eventually be corrected by WTO dispute settlement panels. Taking the unilateral route is also easier as a Member can impose measures and then await a possible challenge on the part of the Member whose exports have been countervailed. Time (and the burden of proof, which normally falls upon the Party alleging a violation) will then play in the favor of the Member imposing the CVDs.

There are nevertheless cases in which the imposition of CVDs will not suffice. First and foremost, this will be the case where the national industry is not so much concerned about the effect of subsidies on its home market (in which case CVDs can be sought and imposed), but where the effect of the subsidies is felt either on third country markets or even on the markets of the WTO Member granting the subsidy. In such cases, recourse to WTO dispute settlement will become a necessity. This reasoning is reflected in the experience of WTO dispute settlement to date. Most cases that have made it to WTO dispute settlement were motivated by a desire to restore the competitive

111 Council Regulation (EC) No 1177/2002 of 27 June 2002 concerning a temporary defensive mechanism to shipbuilding, OJ 2002 L 172/1; Council Regulation (EC) No 502/2004 of 11 March 2004 amending Regulation (EC) No 1177/2002 concerning a temporary defensive mechanism to shipbuilding, OJ 2004 L 81/6.

112 Report of the Panel in Korea – Vessels.

113 Report of the Panel, European Communities – Measures Affecting Trade in Commercial Vessels, WT/DS301/R, 22 April 2005. For its conclusions the panel relied on Article 23 of the WTO Dispute Settlement Understanding (DSU). According to Article 23, Members shall not make a determination that a violation has occurred, except through recourse to dispute settlement in accordance with the rules and procedures of the DSU.

114 Ibid., at paragraphs 7.197 and 7.219.

playground on a global scale, as opposed to merely preventing subsidies from flooding the home market.

As mentioned before, countervailing duties have in fact been the primary means by which the SCM Agreement's subsidy disciplines have been enforced. While from the outset the CVD instrument was used almost exclusively by the United States, its use has now become more generalised.

Up until the 1980s, the EU was reluctant to make recourse to the CVD instrument.[115] Since then, it has become progressively more CVD-friendly. For instance, the EU has in the 1995-2004 decade, initiated 43 investigations, compared to 3 in the preceding decade and 7 in 1980-1984.[116] The US initiated 69 investigations in 1995-2004 and 149 in the preceding decade.[117] Of those initiations, the EC imposed 3 definitive measures in 1980-1984, none in 1985-1995, and 28 in 1995-2004.[118] The US, in the same periods, imposed 47 definitive measures in 1980-1984, 83 in 1985-1994 and 38 in 1995-2004.[119]

It is also interesting to compare the use of countervailing duty measures to that of the anti-dumping instrument. In both the EU and the US, anti-dumping duties are used much more frequently than countervailing duties.[120]

The predominant use of CVDs may also have to do with the remedies that are available under, respectively, CVDs and the multilateral rules. The multilateral rules only offer a prospective remedy (ex nunc), i.e. they do not affect subsidies that have been granted in the past.[121] The remedy for prohibited subsidies is the withdrawal of the subsidy;[122] for actionable subsidies, it is the withdrawal of the subsidy or the removal of its adverse effects[123] (presumably this means that the subsidy programme must be, at the very least, amended and is therefore not substantially different from the 'withdrawal of the subsidy'). Thus – at least under the prevailing opinion – there is no repayment of subsidies violating the SCM Agreement provisions. Countervailing measures, on the contrary, will grant some remedy against past subsidies: subsidies may be countervailed as long as the benefit they conferred persists. Hence, non-recurring subsidies may be countervailed for many years after they have been granted, provided they are not amortised.

Most of the WTO subsidy dispute settlement cases to date have concerned export subsidies. Only a handful has addressed complaints against actionable subsidies: Indonesia Autos,[124] US – Cotton[125] and Korea – Vessel.[126] The US and EC Large Aircraft cases (which are pending) also include claims of actionable subsidies (as well as claims of export subsidies).[127]

The EU itself has initiated 7 requests for consultations in which it invoked the SCM Agreement's multilateral disciplines. 5 of these proceeded to panel or Appellate Body stage: Indonesia – Autos, US – FSC, Canada – Autos, Korea – Vessels, US – Large Aircraft, China – Auto Parts.[128] With the exception of US – FSC, the EC has never, since 1995, taken multilateral action against foreign agricultural subsidies.

Contrasted with this, the EU has been one of the primary targets of countries challenging foreign subsidies before the WTO. Under the GATT, EU Member States measures were challenged a total of 9 times before a Panel, most of them concerning subsidies to agricultural products.[129] EU subsidies were recently challenged twice under the multilateral rules, in the EC – Sugar[130] and EC – Commercial Vessels cases (not to mention the pendings EC – Large Aircraft case). The EC has similarly been one of the major targets of countervailing duties. For instance, of the 45 CVD measures imposed by the US since the inception of

115 It has been suggested that, historically, the EU made less use of the CVD instrument than the United States because the EU was more reluctant in using it against domestic subsidies (vs. export subsidies) while the US used it indiscriminately against domestic and export subsidies. Didier, World Trade Instruments in EU law, London, Cameron May, (1999), page 211.

116 Mayer Brown Rowe & Maw LLP, Evaluation of EC Trade Defence Instruments, Report prepared for the European Commission, 2005, Annex 7, page 20, available at: http://trade.ec.europa.eu/doclib/docs/2006/february/tradoc_127382.pdf, last visited 19 October 2006. See also WTO website, 'Statistics on subsidies and countervailing measures', http://www.wto.org/english/tratop_e/scm_e/scm_e.htm, last visited on 19 October 2006. These statistics (which slightly differ from those reported in the Mayer Brown Report) are based on the Members' semi-annual reports to the WTO; each initiation or measure reported covers one product imported from one country.

117 Ibid.

118 Ibid., page 22.

119 Ibid.

120 Ibid., page 25. The EU initiated 299 antidumping measures from 1995 to the end of 2004, resulting in 188 definitive measures.

121 We note however that one Panel has found otherwise: Australia – Leather (21.5). But this remains an isolated case.

122 Article 4.7 SCM.

123 Article 7.8 SCM.

124 Report of the Panel, Indonesia – Certain Measures Affecting the Automobile Industry, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2 July 1998 ('Indonesia – Autos').

125 Report of the Panel, US – Cotton.

126 Report of the Panel, Korea – Vessels.

127 First and Second Requests for the Establishment of a Panel, United States – Measures Affecting Trade in Large Civil Aircraft, WT/DS317/2 and WT/DS317/5 (pending); Request for Establishment of a Panel, European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft, WT/DS316/2 European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint), WT/DS347/3 and WT/DS316/6 (pending).

128 Request for the Establishment of a Panel by the European Communities, China – Measures Affecting Imports of Automobile Parts, WT/DS 33918 (pending). ReTwo other requests for consultations (Brazil – Certain Measures Affecting Trade and Investment in the Automotive Sector, WT/DS81/1, 7 May 1997 and Japan – Tariff Quotas and Subsidies Affecting Leather, WT/DS147/1, 14 October 1998) did not result in panel decisions.

129 Report of the Panel, German Exchange Rate Scheme for Deutsche Airbus, SCM/142, 4 March 1992; Report of the Panel, EEC – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins, L/6627, 25 January 1990; Report of the Panel, EEC-Production Aids Granted on Canned Peaches, Canned Pears, Canned Fruit Cocktail and Dried Grapes, L/5778, 20 February 1985; Report of the Panel, EEC – Subsidies on Export of Pasta Products, SCM/43, May 19, 1983; Report of the Panel, EEC – Subsidies on Exports of Wheat Flour, SCM/42, 21 March 1983; Report of the Panel, Income Tax Practices Maintained by the Netherlands, L/4425, 7-8 December 1981; Report of the Panel, Income Tax Practices Maintained by Belgium, L/4424, 7-8 December 1981; Report of the Panel, Income Tax Practices Maintained by France, L/4423, 7-8 December 1981; Report of the Panel, French Assistance to Exports of Wheat and Wheat Flour, L/924, 21 November 1958.

130 Report of the Panel, European Communities – Export Subsidies on Sugar, WT/DS283/R, 15 October 2004.

the WTO in 1995, 18 concerned subsidies granted by EU Member States (none concerned EU-proper subsidies).[131] Surprisingly, the EC seems to never have initiated a CVD investigation against a US subsidy.[132]

While the number of cases in which EC subsidies have been countervailed by foreign governments is evidently important, in only 3 instances did the EU challenge countervailing measures imposed on its exports: United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany,[133] United States – Countervailing Measures Concerning Certain Products from the European Communities,[134] United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom.[135] These cases primarily addressed the question of the extinction of a benefit.

IV. Practical implications of the WTO rules

The purpose of this last section is to offer the authors' own views as to the consequences of the conclusions reached above concerning the WTO's rules on subsidies and the course of action which the EU might want to adopt in applying and possibly reforming its own State aid regime.

As we have seen, the definition of subsidies under the two sets of rules is largely similar. We have noted, however, that some subsidies – those granted under government direction or entrustment (as defined under WTO law) but not representing a cost to the government – may be allowed under EC law as not constituting State aid, while they are subject to the WTO disciplines. There is therefore a risk that recipients of such subsidies would find them countervailed or challenged before a WTO Panel.

As we have also seen, the EC rules allow the Commission to authorise State aids, which may fall foul of the SCM Agreement's provisions on prohibited or actionable subsidies. Particularly exposed to this risk is State aid granted ad hoc and authorised under Article 87(3) (a), (b) or (c) EC Treaty, i.e. State aid for major investments in assisted regions, for important projects of European interest, and rescue and restructuring aid.

However, in general, the EC State aid discipline is – if only for the procedural reasons mentioned above – stricter than the corresponding WTO subsidy discipline. The reason is simple: The EU has to pursue a severe State aid policy in order to avoid distortions of competition within the internal market. It is not surprising that over the last 20 years, accompanying the progressive implementation and completion of the internal market program, this policy has become ever more demanding.

But subsidies are not granted only by EU Member States. Third countries, i.e. other Members of the WTO, also grant subsidies. As noted before, no other WTO Members has an internal regime of subsidy control. It is therefore appropriate to ask the question whether the EU should loosen its strict State aid rules, if the State aid of one (or more) of its Member States is seeking to match subsidies granted by another WTO Member.

1. The case of matching aid granted by another Member State

First, it is useful to briefly address the issue of matching aid granted by another Member State from an EU law perspective. The principle that a Member State should not act on its own to counter the effects of unlawful aid from another Member State has been recognised by both the Court and the Commission. In Steinike, the ECJ held that:

> 'Any breach by a Member State of an obligation under the Treaty in connexion (sic) with the prohibition laid down in Article 92 [now 87] cannot be justified by the fact that other Member States are also failing to fulfill this obligation. The effects of more than one distortion of competition on trade between Member States do not cancel one another out but accumulate and the damaging consequences on the common market are increased.'[136]

The Commission relied on Steinike in a recent decision; in the same decision, it also suggested that matching could be allowed to counter foreign subsidies.[137]

131 As reported to the WTO. See WTO website, 'Statistics on subsidies and countervailing measures', available at: http://www.wto.org/english/tratop_e/scm_e/scm_e.htm, last visited 19 October 2006.

132 Ibid.

133 Report of the Panel, United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany, WT/DS213/R, 3 July 2002 ('US – German Steel').

134 Report of the Panel, United States – Countervailing Measures Concerning Certain Products from the European Communities, WT/DS212/R, 31 July 2002 ('US – CVD EC Products').

135 Report of the Panel, United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom, WT/DS138/R, 23 December 1999 ('US – Lead Bars').

136 Case 78/76 – Steinike & Weinlig v. Federal Republic of Germany, [1977] ECR, page 595, paragraph 24.

137 See Commission Decision 2005/122/EC of 30 June 2004 on the State aid which the Netherlands is planning to implement in favour of four shipyards to support six shipbuilding contracts, OJ 2005 L 39, paragraph 17. The Commission referred to the Steinike case (paragraph 17 of the Decision) and added:

> The Commission observes that the notified aid aims at matching alleged illegal aid from another EC Member State. This is therefore contrary to the general principles of the EC Treaty. The notified aid is incompatible with the EC Treaty and should therefore not be authorised.

In that case, the Commission refused to authorise aid proposed by the Netherlands, the purpose of which was to match aid allegedly granted by Spain. The Netherlands had invoked a Commission decision to authorise a prior Netherlands export credit aid programme that seemingly contained a clause on matching aid; in its decision on the shipbuilding aid, the Commission noted that matching aid could only be allowed for aid initially granted by a third country and that in any case, the Netherlands aid scheme initially approved by the Commission had expired.

2. The case of matching aid granted by a third country

Thus, there is some evidence that the EC is more prepared to allow Member States to match aid granted by third countries. Yet, the only express provision allowing matching is found in the Commission's Community Framework for State aid for research and development.[138] The Framework's section on aid intensity specifies that aid may be allowed to reach the maximum permitted intensities:

> if similar projects or programmes of competitors located outside the European Union have received (in the last three years), or are going to receive, aid of an equivalent intensity for the two types of research.[139]

It is noteworthy that the Commission has proposed maintaining this 'matching clause' even though the SCM Agreement no longer recognises non-actionable subsidies.[140]

But this is not the only instance where the EU has indicated its openness to matching aid. The Commission, in a 1995 decision concerning aid scheme for the Spanish motor vehicle industry, noted that:

> On the implications of the WTO Agreement on Subsidies and Countervailing Measures for State aid control in the European Union and the possible distortive effects of applying the Community framework to motor vehicle manufacturers in the Community in cases where they face unfair competition from third countries, the Commission stresses that the new WTO Agreement is a major step forward. As far as regional aid is concerned, the new code makes it possible for aid granted by third countries to international competitors to be monitored for the first time, since regional aid must now be based on a coherent and economically justifiable aid plan to be submitted to the WTO and to which the Commission can object if necessary. As regards research and development aid, difficulties may arise as the WTO rules allow higher aid intensities than those applicable within the Community. Nevertheless, if it were demonstrated that the international competitors of Community motor manufacturers were benefiting from more generous treatment, the Commission would consider applying the 'matching clause` written into the new Agreement.[141]

While the Commission provides no further explanation of the basis for its reasoning, we believe it was making reference to Article 9.4 SCM which, as we have signaled above, permitted the imposition of countermeasures against non-actionable subsidies under certain conditions.

Finally, we have noted that matching aid was authorised in the temporary defense mechanism against Korean subsidies to shipbuilding.[142]

We now proceed to our main question: could the EU loosen its State aid control rules so as to allow EU Member States the matching of foreign aid, without exposing itself to the risk of multilateral or unilateral action under the SCM Agreement? If so, what considerations come into play?

We will examine this question for export credit guarantees, R&D aid, investment incentives and operating aid.

In reading the following paragraphs, the reader might remember that the SCM Agreement applies only to trade in goods and not to the provision of services.[143]

a. Can non-EU export credit guarantees be matched by an EU Member State?

Our first scenario is whether the Member States can match foreign export credit assistance, without falling foul of the SCM Agreement. Doing so, we have seen, poses no problem under the SCM Agreement, provided the provisions of the OECD Guidelines for Officially Supported Export Credits (other than the exceptional matching provisions of the Guidelines) are respected. The 'motive' behind the matching exercise only becomes relevant in EC – Vessels situations (e.g. where the EU would be applying pressure on another member of the WTO to force it to put an end to its own subsidies). In all other situations, export credit assistance will be assessed on its own merits

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138 Community Framework for State Aid for research and development, (96/C 45/06), OJ 1996 C 45; on the fact that this would be the only instance in EC State aid law, see Staff Paper – Preliminary draft – Memorandum on the Community Framework on State Aid for research and development and innovation (R&D&I), 4 May 2006, available at: http://ec.europa.eu/comm/competition/state_aid/others/action_plan/rdi_en.pdf, last visited 20 October 2006:
'The only State Aid rules that foresee a possibility of matching the aid intensity granted to a third country competitor by a Member State, after examination by the Commission, is the 1996 R&D framework.'

139 Ibid., point 5.13.

140 See the Draft Community Framework for State Aid for Research and Development and Innovation, 14 September 2006, available at: http://ec.europa.eu/comm/competition/state_aid/overview/sar.html, last visited 19 September 2006, page 23. See also Staff Paper – Preliminary draft – Memorandum on the Community Framework on State Aid for research and development and innovation (R&D&I), supra, note 138., page 25:
7.1.5. Matching clause
The matching clause was already included in the 1996 R&D-framework. It refers to the situation that an aid applicant can prove or demonstrate that a competitor has received a higher aid intensity than permissible under R&D State Aid rules for a comparable project in a third country. In that situation, the clause allows under certain conditions to 'match' this intensity, thereby exceeding the normal ceilings for intensities. This clause does not refer to the situation where an applicant claims that he could receive a State Aid with a higher aid intensity in a third county. The matching clause in the 1996 Framework has never been used.
The Commission has decided to maintain this clause in substance, while deleting all procedural elements which are now covered by Council Regulation 659/1999.

141 Commission Decision 96/313/EC of 20 December 1995 amending Spanish aid schemes for the motor vehicle industry, OJ 1996 L 119.

142 See, supra in II.3.b. in the section on 'retaliatory' subsidies.

143 See, supra note 7.

regardless of the subsidies that are provided by another Member. The matching of SCM-consistent aid can therefore a priori be WTO-consistent, whereas the matching of SCM-inconsistent aid could a priori be countered by other WTO Members under Track I or Track II procedures. As long as the assistance so granted conforms to the OECD discipline (other than the exceptional matching clause),[144] it will fall under the safe harbour of item (k) of the Illustrative List of Export Subsidies, and cannot be challenged.

b. The matching of R&D Aid

We have shown above that R&D is the only sector in which the existing (and proposed new) Commission State aid rules explicitly envision the granting of matching aid. Would such matching risk the EU violating the SCM Agreement's disciplines?

As we have seen, R&D subsidies are no longer non-actionable as they were (at least in part) until 2000. Thus, in theory, the matching of R&D subsidies could be dangerous. In practice, however, the risk may be remote, for several reasons. First, R&D aid will very rarely constitute export subsidies: the Illustrative List contains no reference to R&D assistance, which already means that a WTO Member challenging EU R&D under Article 3 SCM would have to independently establish export contingency. Except in exceptional circumstance, one can hardly imagine that export contingency could be established.

Second, such subsidies may of course be actionable. There would be an increased likelihood that R&D subsidies are injurious if amounts are sizeable and if R&D gets closer to the 'product development' stage. Small amounts of R&D assistance that are remote from the product development state are unlikely to produce the adverse trade effects necessary for either a successful challenge in WTO dispute settlement procedures or for the imposition of countervailing duties.

c. The matching of investment incentives

Another type of subsidies the EU might be particularly concerned about is that of assistance to large investment projects (FDI).

Favoring outward investment

A first question is whether the EU can authorise State aid for outward investment – i.e. financial support to assist EU enterprises in establishing or developing production facilities in third countries. One of course wonders why the EU would want to help its enterprises to delocalise? Assistance to large investment projects is usually granted so that companies either establish themselves in the EU or maintain their operations in the EU. But one can imagine that the EU, exceptionally, may want to encourage its undertakings to establish themselves in a third country in order to better compete on the market of that country, when other foreign manufacturers are already established there.

Authorising outward investment aid raises no particular problem under WTO rules. Such aid would neither constitute a prohibited export subsidy nor an import substitution subsidy. Such aid may be actionable, but the injury would be caused by a third country, not the EU (the products would originate not in the EU, but in the country where the EU producer establishes its operation).

In any case, any injury would likely be limited if the subsidy is of a limited size (as one would assume to be the case where the Member States grant financial assistance to EU companies to establish themselves in a third country).

Attracting FDI to the EU

Conversely, granting financial assistance to attract FDI to the EU is more problematic than granting 'outward-looking' FDI support. While conceptually both situations are similar, in practice, such assistance would be more likely to be challenged by other WTO Members.

It is unlikely that such assistance would be regarded as de jure export subsidies, but it may in some cases become de facto export-contingent where provided to heavily export-oriented industries.

Also, such assistance could be challenged as actionable, if adverse effects can be demonstrated. The main – practical – consideration here may be that the subsidy amounts granted are likely to be larger than in the previous case of favoring outward investment, with the result that adverse effects are more likely to follow. Finally, FDI assistance may lead to the imposition by another WTO Member of countervailing duties. However, as we have seen, anecdotal evidence suggests that at least the US is reluctant to do so with respect to investment aid.

d. The matching of operating aid

The matching of operating aid represents the most problematic matching case. That is because there is a real risk that the matching of operating aid might constitute a prohibited de facto export subsidy – particularly where it is granted to an industry that is heavily export-oriented.

In addition, operating aid is actionable and may very well cause injury. If that were the case, operating aid would probably be attacked through dispute settlement in the WTO. Such operating aid is also likely to give rise to the imposition of CVDs by third countries, notably the US.

144 It is to be recalled that according to the Panel Report in Canada – Aircraft (21.5), Brazil – Aircraft (21.5 II) and Canada – Aircraft II, the matching clause of the OECD Arrangement is not covered by the safe haven of item (k) of the Illustrative List.

V. Conclusion

We have seen that, because of the requirement of a 'charge on the public account', the concept of State aid under EC law is narrower than the concept of subsidy under WTO law, leading to the risk that certain measures will be subject to the SCM Agreement's disciplines but not to EU State aid control. As we have noted, this is a somewhat counterintuitive result. One would indeed expect the smaller 'club' – the EU – to have stricter rules than the larger organisation, i.e. the WTO. This seems even more logical as the EU has by far more ambitious goals, such as the internal market, economic and monetary – and even political – union.

The situation seems to be more normal with respect to the concept of specificity, where EC and WTO rules are similar, but EC law appears to be stricter than the rules of the WTO. However, there is so far little guidance from panels or the Appellate Body on the interpretation of specificity provisions of the SCM Agreement. In practice, the degree of divergence between (or convergence of) the two legal systems is difficult to assess at this stage.

However, the most significant difference between the two systems relates not to the definition of State aid and subsidy, but what happens once a measure meets to such a definition.

Under WTO law, all measures meeting the definition of subsidy are, in principle, actionable and countervailable where they produce adverse trade effects. WTO law does not, since 2000, provide for any exemption from its disciplines based on the objectives of a measure. Export and import-substitution subsidies are even prohibited outright. Whether a measure constitutes a subsidy, whether it produces adverse effects, whether it is an export or import-substitution subsidy will all be assessed ex post facto. Potentially problematic subsidies in the WTO are only subject to (poorly enforced) notification requirements, to (inconsistent) challenges by governments (often acting on private parties' behalf, it is true) under Track II, and to countervailing duties under Track I. The practical consequences of the WTO disciplines are therefore relatively unpredictable: support granted under the bona fide assumption that it is not a de facto export or import-substitution subsidy, or that it does not produce adverse trade effects may ultimately be sanctioned by the WTO 'judicial' instances or give rise to countervailing duties by other WTO members.

By contrast, EC law provides for an ex ante assessment of planned State aid by the Commission. Potential State aid is therefore subject to extensive scrutiny prior to implementation. Private parties can enforce the respect of the notification requirement. But the EC Treaty provides for flexibility with respect to the authorisation of notified State aid. The Commission has the power to authorise, as compatible with the common market, measures that constitute State aid on the basis of their objectives (see in particular Article 87(3) EC).

It follows that there is a real risk that EC State aid measures authorised on the basis of Article 87(2) or (3) run counter to the SCM Agreement's disciplines. If it has not already done so implicitly in the past, the Commission may therefore want to incorporate an 'adverse effect on international trade' requirement into its assessment of whether a measure should be declared compatible with the common market, so as to minimise the risk of conflict between the internal subsidy regime of the EU and the WTO subsidy discipline to which it has subjected itself.

The risk of conflict would obviously increase if the Commission would yield to the temptation to allow Member States to match third country subsidies more generously than they are allowed to do already today. As we have explained above, the risk is not the same for all types of subsidies: certain subsidies are more susceptible to fall foul of the SCM Agreement than others.

However, the real reason for our aversion against relaxing the existing State aid discipline is the risk of distortions of competition among Member States. The EU is composed of 25, soon 27, Member States. State aid is – by definition – granted by these Member States. Allowing the matching of subsidies given by third countries would not only create the risk of subsidy wars between the EU (and its Member States) on one side and third countries on the other. It would also entail the risk of creating distortions of competition between richer and poorer Member States, as well as between prosperous, attractive and less prosperous, unattractive regions in the EU. In other words, authorising the matching of third country subsidies could easily run counter to another fundamental objective of the EU, i.e. the need to strengthen economic and social cohesion between the Member States. In the end, allowing individual Member States to match subsidies granted by third countries could destroy the solidarity among Member States and their citizens, thus undermining the very foundation on which the EU rests.

Instead, the EU might want to fight more actively than in the past against subsidies granted by third countries in using the instruments which international agreements to which it is a party put at its disposal. The SCM Agreement is of course the broadest and most detailed of these agreements. That, so far, the EU has not used the SCM Agreement more often is perfectly explainable, taking into account its traditional inclination to solve EU internal problems by granting subsidies itself or by allowing Member States to grant State aids. However, if only because of the continuing reforms of the common agricultural policy, the EU's hesitation, explainable by the popular wisdom that it is not advisable to throw stones if one sits in a glass house, could have diminished and might continue to decrease further. Fighting against the waste of tax payers' money, wherever this waste takes place, is certainly a greater contribution to the healthy development of the world economy than to 'match' such waste through additional public spending in the EU.

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Lexxion Verlagsgesellschaft mbH · Güntzelstraße 63 · 10717 Berlin
Telefon: 030/81 45 06-0 · Fax: 030/81 45 06-22 · info@lexxion.de · www.lexxion.de · ISSN 1619-5272