

The many facets of export subsidies in WTO

[A study of indirect export subsidies]

Pamela Finckenberg-Broman

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Mentor
Cécile Brokelind



LUNDS UNIVERSITET
Ekonomihögskolan

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Forewords

"When once you have tasted flight, you will forever walk the earth with your eyes turned skyward, for there you have been, and there you will always long to return." -- Leonardo da Vinci

I would like to thank the people who inspired me to write this thesis, Boel Flodgren for igniting my interest in International Public Law, especially in the area of WTO Law. My mentor Cécile Brokelind who has been a great support through the process of developing this thesis by providing a sounding board for my ideas and giving me guidance in filtering and staying focused.

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Abstract

To be able to improve a law, one has to understand it. The World Trade Organization (WTO) Treaty and Agreement on Subsidies and Countervailing Measures (ASCM) specifically have become important in recent years mainly due to the massive subsidies and bailouts resulting from the on-going financial crisis that began in 2008. With the member states governments increased use of different relief and stimulus packages, as tools to help their domestic production through this crisis, many member states have started to ask for changes in the ASCM so as to establish clear, consistent and fair rules for all types of export financing.

This paper investigates, discusses and analyses the problem that causes legal uncertainty. The focus of this paper is the indirect aspect of “*export subsidies*” due to their hidden and implicit nature. It examines measures that fall within the scope of article 3.1a) of the ASCM which covers prohibited export subsidies, as they are today within the WTO-context. Instruments used are the text of the ASCM and WTO Customary Law. After the identification of the issues causing the legal uncertainty and therefore unpredictability is accomplished, the different *indirect export subsidizing* methods found are summarized. By pinpointing these measures some possible solutions for a change in the ASCM might be found.

Abbreviations

GATT/WTO (World Trade Organization)

AB	Appellate Body
ASCM	Agreement on Subsidies and Countervailing Measures
BISD	Basic Instruments and selected documents
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
GATT	General Agreement on Tariffs and Trade
WT/DS	WTO Document relating to dispute settlement

THE EUROPEAN UNION (EU)

EC	European Communities /European Commission
ECR	Reports of the Court of Justice of the European Communities
O.J	Official Journal of the European Union (previously of the EC)
TFEU	The Treaty on the functioning of the European Union

THE UNITED STATES (US)

AJCA	American Jobs Creation Act
DISC	Domestic International Sales Corporation
ETI	Extraterritorial Income Regime
FSC	Foreign Sales Corporation
IRC	Internal Revenue Code
NASA	National Aeronautics and Space Administration
TIRPA	Tax Increase Prevention and Reconciliation Act of 2005
USC	United States Code

GENERAL

CVD	Countervailing Duty
R&D	Research and development
USDOC	US Department of Commerce
USDOD	US Department of Defence
VTCL	Vienna convention of Law of treaties

1. Introduction

1.1 Background

The WTO is the only existing multilateral international organization that deals with the global rules of trade between nations. One of these rules is the restriction of governmental usage of *export subsidies* due to their potential to distort trade flows by giving an artificial competitive advantage to exporting industries. The early General Agreement on Tariffs and Trade (GATT) Article XIV contained rules for *export subsidies* by providing countervailing measures. These subsidy rules were however neither well developed or imposing, therefore a need to modernize rules around the issue of *export subsidies* lead to the creation of the current ASCM of the Uruguay round.¹

The ASCM has added precision to the previous rules by categorizing subsidies, developing definitions and methodologies to recognize them related to their nature, adverse effects and established procedural rules for multilateral remedies.² Subsidies according to the “*traffic light*” system can be red, amber or green. The two categories regulated in the ASCM are red, the prohibited ones and amber, the actionable ones. All the subsidies deemed “specific” fall into one of these two categories. The previous Article XIV of GATT still remains though and is referred to by Article 1.1 (a)(2) of the ASCM.

Even though the ASCM is an improvement, having enhanced provisions on notification and surveillance, it still lacks clarity and predictability in identifying the prohibited *export subsidies*, regulated by Article 3.1a) ASCM due to several ambiguities still existing in the law text.³ This leads to arbitrary assessments, especially regarding which government measures actually belong inside the framework of the indirect export subsidies,⁴ and to a lack of transparency in the usage of countervailing methods. To ensure that such measures, causing huge economic burdens and even possible conflicts between the domestic fiscal laws and the World Trade Organization (WTO) law for the Countries involved, are only used when justified, some further illumination in the area of prohibited *indirect export subsidies* is needed.

1.2 Purpose and research question

To be able to improve a law, one has to understand it. From that perspective a good paper should raise a question dealing with the problem which comes from a lack of clarity of the rule. One should then use the source of Law and jurisprudence to identify, examine

¹ WTO, “Seeking answers to global trade challenges”, 2011, p. 133

² WTO, Report, Subsidies and WTO, 2006, p. 190 et seq.

³ Sykes, Fall 2010, p. 474 and P.Steger, 2010, p. 785 et seq. and Draft consolidated chair texts of the AD and ASCM, 2007, p.41 et seq.

⁴ Doha, 2001 p.26 and 28, WTO, Doha work programme DEC, 2005, para. 6 and Communication from the Chairman, 2011 p.37 para 2 et seq.

and resolve what the issues are with the lack of clarity. What remains is to propose possible solutions. Therefore the problem that causes legal uncertainty, how the key terms and definitions of Articles 1, 2 and 3.1a) shall be interpreted as they are currently to enable identification of indirect measures that fall within the scope of article 3.1a) i.e. prohibited export subsidies, is done as described above. After this is accomplished the different methods that qualify for indirect export subsidies found are summed up.

This will be accomplished in this study by the key research question: *How do domestic internal actions of a state qualify for indirect prohibited export subsidies?*

Since no similar research, through the available sources, has been located the contribution is to add another dimension to an improved understanding of *indirect subsidies* in general and *indirect export subsidies* specifically. This is done by identifying the different indirect aspects of prohibited export subsidies restricted by article 3.1a) of the ASCM. Further, by pinpointing the existing issues of identification, some direction for how the ASCM could be changed relevant to these matters might be found. This paper is written in English due to the fact that this is the original language of the WTO treaty and to avoid any valuable details lost in translation that could distort literal interpretation, which is the most common way to interpret international public Law.

1.3 Delimitation

Based upon careful consideration and keeping in mind the most likely target audience for this paper will be peers or researchers, the issue/study is represented assuming that readers masters the terminology and major sources within the topic of International Public Law, especially WTO. That is why *inter alia* terminology used is not explained nor does the bibliography contain either International conventions or the special agreements under the WTO. The subject of this study is indirect export subsidies as understood by the definition in a WTO-context, explicitly in the rules of the Article 3.1a) of the ASCM, and identifying the current provisions around the transformation process from a domestic subsidy to a prohibited export subsidy. Therefore rules and statutes brought up will mainly be WTO related. Also for the comparative parts to demonstrate effects only United States (US) and European Union (EU) will be used to keep the focus of this paper.

Remedies and countervailing measures will not be discussed in a wider scope, even though they are mentioned, since they not contribute anything relevant to the answer for the key question of this paper. Furthermore, to stay within the focus of this study, only products related the ASCM will be brought up. This means *inter alia* that the Most Favoured Nation (MFN) principle in GATT 1994 Article I, National treatment(NT) principle Article III and exceptions for environment in article XX etc. will not be discussed. Neither will products regulated by special agreements with the exception of the SCM be mentioned.⁵ The special rules to developing country Members in Part VIII of the ASCM and Members in transition to a market economy in Part IX of the ASCM will also be outside of the scope of this study. Since no case law has been seen about indirect

⁵ This will exclude i.e. SPS-agreement, the Agreement for Agriculture etc.

subsidies that successfully use another interpretation than within the ordinary meaning of words within WTO practice as explained in the next chapter, no alternative interpretation methods will be pursued by this paper. Additionally only the most relevant publications needed for answering the research question have been chosen. The same reasoning applies to case law presented. The legal analysis and suggested improvements presented here reflects the author's own understanding of the ASCM and *indirect export subsidies* and is not necessarily established or supported by others.

1.4 Method and material

The basis for this research is in traditional legal dogma, with the emphasis on doctrine and praxis to understand the conceptual context of indirect export subsidies. The WTO-treaty is a multilateral⁶ contract between states, regulated by the Vienna Convention 1969 on international treaties (VCTL); it is part of international public law where the legal hierarchy and legal sources differ a bit from the Swedish domestic sources of law.

The WTO's rules are soft law, therefore they are not legally binding as such and do not provide legal remedies for individual rights. The WTO discipline solely rest upon the threat of economic sanctions. Any member state breaching the provisions relevant of the Agreements risks becoming a target of economic remedies which impacts the country's exports. However WTO rules do influence the laws of its member states e.g. The European Union (EU) which are binding. The sources of international law are in order of precedence; 1) International treaties, 2) General customary international law, 3) General principles of law.⁷ Naturally doctrine is also used to assist in interpretation of the WTO treaty text, international and domestic laws. Furthermore, customary Law in WTO is a combination of jurisprudence created by rulings of Panels, the Appellate Body (AB) and National courts and the customs created by actions taken of the member states and WTO.⁸ Dispute Settlement Understanding (DSU) Article 3.2 refers to VCTL Articles 31-33, thus the legal text of WTO shall be interpreted according to the ordinary meaning of words. There have also been few attempts to interpret WTO agreements beyond the ordinary meaning of the words however; all of these attempts have failed.⁹

Empirical observations of relevant case studies of the Panels and the AB's "decisions" have been used, since their "judgements" create jurisprudence. Of approximately 400 cases handled by the Dispute Settlement Body (DSB) during the last 15 years, 89 concerning the ASCM were found. 52 of the complaints involved Article 3, 3.1 and 3.1a), but only nine of them were listed under article 3.1 a).¹⁰ To pinpoint the cases relevant for the key question of this paper the ones not constituting of subsidized exports were eliminated as presented in table 1 of Annex 1 of this thesis. Thereafter the indirect were separated from the direct ones. Only cases which had a Panel established were chosen, since they provide more relevant research material. This enabled the identification of

⁶ VCTL Part I article 2

⁷ The International Court of Justice (ICJ), Article 38 §1.

⁸ See Lester, p. 104 for customary law.

⁹ Benitah, p. 199 see also US-Large Civil Aircraft(second complaint) AB para.55

¹⁰ WTO homepage, DSU gateway

cases confirmed by the Panel or AB, as a breach of Article 3.1.a) as can be seen in table 2, Annex I of this paper. After the elimination process only DS108 (US-FSC), DS126 (Australia- Automotive Leather II), DS139 (Canada-Autos) and DS353 (US- Large Civil Aircraft 2nd complaint) remained. The process revealed that more than half of the indirect cases were tax related including three of the four relevant found.¹¹ Two cases, the US-Large Civil Aircraft (2nd complaint)¹² and US-FSC,¹³ had as a common factor indirect export subsidies caused by FSCs. Thus, US-FSC was chosen to be used as the main reference case. However the chronologically more recent case US-Large Civil Aircraft (2nd complaint) will initiate the examination of jurisprudence, followed by a more in depth study of the US-FSC. In addition parts of several cases will be used to shed light upon various definitions since no single case representing all the different aspects of indirect export subsidies could be found.

Both primary and secondary sources, updated on May 12th, 2012, will be used. Primary sources include WTO-treaty text, reports from the panels and AB (WTO homepage), EU publications from O.J, US laws and rules. Secondary sources include summaries from panels and AB reports and doctrine in the form of articles and other relevant literature. A large part of the material is from Internet sources, primarily the homepages of WTO and EU. Sources for doctrine are articles e.g. from the university library in Lund and Summon as well as other relevant literature to support an explanation for the nature of the interpretations of the WTO's definition of export subsidies.

1.5 Disposition

This paper is divided in seven main chapters with subchapters to present the material in a logical order. Chapter one introduces the background, the purpose and the research question and even establishes the framework of this paper. Further it explains the method and material used. Chapter two explains the function of the ASCM and the motive for prohibition of export subsidizing. In addition the hierarchy of sources in Law, in both WTO/international and WTO/domestic context, shall be discussed to establish how the WTO-law, being soft law, influences hard law. In Chapter three a short introduction of the SCM is done to provide an overview of the Agreement, followed by a closer look at the relevant rules in the ASCM and what a subsidy is in this context is established. In the fourth Chapter indirect subsidies are defined and isolated. The fifth Chapter studies export subsidies in depth, vis-à-vis the current rules in GATT 1994 and SCM relevant. A regulatory structure called the "*Traffic light system*" is used to visualize the tree different categories of subsidies.¹⁴ Chapter six provides more insight into WTO custom law, mainly in form of jurisprudence, by investigating the US-FSC case. Chapter seven combines all these elements, with argumentation about some of the inherent problems of the ASCM regarding identification of subsidies and lack of transparency followed by an analysis and the conclusion.

¹¹ DS 108, DS127, DS128, DS129, DS130, DS131, DS139, DS273, DS317 and DS353

¹² US- Large Civil Aircraft (Second Complaint) DS353

¹³ US-FSC and US-FSC (Article 21.5 – EC) DS108

¹⁴ WTO, Report, Subsidies and WTO, p. 196 and Lester, p. 403

2. The role of WTO Law and the purpose of the ASCM

2.1 The WTO Treaty and International public Law

The WTO is the only existing multilateral international organization that deals with the global rules of trade between nations. WTO's main function is to guarantee that trade flows as effortlessly, predictably and freely as possible. According to the WTO Glossary this is done transparently, referring thus both to generating information and to generating agreed interpretations of the information.¹⁵ The WTO's rules are the result of member negotiations in the form of agreements. The Uruguay Round of negotiations held between the years 1986-94, included a major revision of the original GATT and resulted in the current set i.e. the Marrakesh Agreement.¹⁶

All decisions taken are virtually made by consensus among all member countries and they are ratified by the members' parliaments. WTO's agreements are the legal ground-rules for international commerce, guaranteeing member countries important trade rights. They also bind the government's *pacta sunt servanda* to keep their trade policies within agreed limits.¹⁷ The ASCM which all WTO members will automatically be subject to is one of these contracts.¹⁸ The WTO as part of the international public Law is soft law i.e. voluntary. All treaties derive from the agreement of the nations involved and thereby are equally binding in nature, thus making International law a law of cooperation, not subordination. The supranational WTO-treaty is not legislative as such and lacks an executive power. A well-known quote expresses this well,

*"...the WTO has no jailhouse, no bail bondsmen, no blue helmets, no truncheons or tear gas. Rather, the WTO-essentially a confederation of sovereign national governments."*¹⁹

As it follows bilateral and other multilateral agreements between states i.e. free trade areas, EU and OECD are considered *lex specialis* in their relation to the WTO Law and are thereby not bound by the WTO/ASCM rules.²⁰

The WTO's procedure to administer the DSU in Annex 2 of the Agreement is essential for resolving trade quarrels, enforcing the rules and hence ensuring that the trade flows smoothly. Member States turn to the DSU if they consider their rights under the

¹⁵ Wolfe, 2010, p. 551 et seq.

¹⁶ WTO homepage The WTO in brief part 1

¹⁷ Marrakesh Agreement Article II

¹⁸ URAA, summary of provisions

¹⁹ Bello 1996, p.417

²⁰ GATT Article XXIV and Marrakesh Agreement Article XIII, see also the consensus agreement on civil aircraft that grants members of the OECD exception from certain rules on export credits in the ASCM updated March 2011 Arrangement on Officially Supported Export Credits

agreements are being infringed. The DSB provides a service to the Member states on how the WTO Agreements should be interpreted.²¹ Though, as the founders of these agreements are the member governments themselves, the ultimate responsibility for settling disputes also lies with them. The preferred way to settle differences between Member states is through consultation as stated in Article 4 DSU. If this fails a stage-by-stage procedure is available that includes the possibility of a ruling by a Panel under Article 7, which might be assisted by an assembly of especially appointed independent experts, i.e. a Permanent Group of Experts in matters concerning the ASCM.²² The Panel's ruling can be appealed to the AB according to Article 17 DSU.

The Panel's jurisdiction goes no further than the WTO context and has a duty to ascertain that the Law be applied so as to resolve the WTO claims concerned. The jurisprudence is not binding as such, as can be seen by the example by the rejection of a Panel ruling in Australia-Automotive Leather Article 21.5. However, the DSB Panel's limitation of jurisdiction to claims under WTO covered agreements does not mean that the applicable Law available to a DSB Panel is necessarily limited to WTO covered agreements.²³ The WTO jurisprudence confirms this. Both the Panels and the AB have often applied other rules of international Law in inspecting WTO claims independently of interpreting a given WTO provision.²⁴ Clarification of the meaning of WTO covered agreements by the WTO panels, while exercising their juridical functions may occur but the rules agreed upon by the WTO members must apply. The panels may not instigate new rights and/or obligations.²⁵

2.2 The ASCM and domestic Law

The WTO treaty and the Agreements under it, like the ASCM regulating subsidies, is soft law. The effects it has on a specific country's domestic Law depends entirely on the effect of international Law has in general in the legal system on that country. Some specific aspects of trade agreements that may also influence these issues exist. In cases where it is obvious a conflict is present a Court has to decide whether a national or the international legal norm i.e. in this case WTO rules shall prevail.²⁶ To simplify the proper appliance of the WTO treaty the member states have harmonized their national Laws to various degrees with the different Agreements including the ASCM.²⁷ WTO doctrine has had extensive debates forth and against a possible direct effect of GATT.

The three legal systems that have confronted the problem of subsidies over the longest period of time are GATT/WTO, EU and the US. While some similarities exist, a great deal of divergence nevertheless can be found among them on the substantive and

²¹ The Article 2.1 of DSU establishes the forming of DSB.

²² Establishment of a panel Article 6 DSU and Permanent Group of Experts Article 4.5 ASCM

²³ Lester, p. 104 et seq.

²⁴ Lester, p. 108 et seq.

²⁵ DSU Annex 2 DSU Article 3 p.2 last sentence states "*Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.*"

²⁶ Lester, p. 125 et seq.

²⁷ the entry of the ASCM into force in EU context was published in O.J L 336, 23.12.1994, p. 156–183 article 235 in EEC Treaty

procedural rules respecting subsidies.²⁸ The U.S congress has not amended the Uruguay Round Agreement (URAA) section 102(a) to their national law; thereby no provision of the WTO will have a direct effect in the US.²⁹ The Charming Betsy doctrine of interpretation is reflected in the context of Chevron defences³⁰. This can be seen in US jurisprudence i.e. Hyundai Electronics³¹ and Corus steel³². Thereby, a certain indirect effect exists based on the Charming Betsy doctrine.³³ The US domestic Law vis-à-vis subsidies differ from the WTO Law. In most cases the U.S Supreme Court of Justice has declined to interfere with decisions made by the individual US member states to subsidize in-state firms through direct payments. Also the Court's precedents through the years along with the US constitutional commentators give an indication that state subsidies, that by appearance are not tax discrimination, are permissible.³⁴

The international trade law rules in the ASCM mainly follows the same pattern as the EU rules on subsidies in 107-109 TFEU.³⁵ The European Court of Justice (EJC) has two main arguments for denying the direct effect of the GATT. The GATT is considered as an instrument of negotiation, rather than adjunction, and the GATT's provisions are not considered to be precise enough for the purpose of the direct effect. This assessment is not purely functional in order to determine direct effect in terms of rights of individuals before the EJC, but also in the framework of disputes though a EU member state against the Union wherever principles of refuting direct effect is not in place.

Based on jurisprudence from the European Court of First instance in cases Chiquita³⁶ and FIAMM³⁷ and EJC in Van Parys³⁸ WTO Law cannot be invoked to challenge a measure adopted by the EU, not even after the DSB has issued a ruling declaring the inconsistency of the EU measure with WTO Law.³⁹ It should be kept in mind that The Treaty on the functioning of the European Union (TFEU) aims at a complete integration in an internal market and, therefore, includes the free movement of persons, goods, services and capital.⁴⁰ The WTO, by contrast, seeks solely to guarantee the undistorted import and export between various national markets. Besides, the WTO stands only for goods and

²⁸ Sykes, Fall 2010, p. 747

²⁹ Lester, p.130

³⁰ Murray v. The charming Betsy , 1804 and Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984)

³¹ Hyundai Electronics Co. v. United States, (2005), CIT products

³² Corus Staal BV v. United States, (2005), Holland steel producers against US

³³ Lester, 2008, p.129

³⁴ Sykes, Fall 2010, p. 748

³⁵ Schön, 2004, p. 284 O.J. C 83 Volume 53 30 March 2010 old Arts. 87 and 88 EC Treaty

³⁶ Chiquita - United Brands Company and United Brands Continentaal BV v Commission of the European Communities

³⁷ FIAMM Joined Cases C-120/06 P and C-121/06 P

³⁸ Léon Van Parys NV v. Belgisch Interventie- en Restitutiebureau C-377/02

³⁹ Emch, 2006, pp. 566-9

⁴⁰ Articles 2, 3, 21, 26, 34, 56 and 63 of the TFEU

services; the free movement of capital and the free movement of workers are beyond its scope.⁴¹

Unlike the WTO, the EC Treaty largely eliminates countervailing duties on internal trade. Those are prohibited by Article 107 TFEU, unless the EC Commission has approved them for a “*limited time*.” The U.S. federal system has no countervailing duties. The EU restrictions on state aid bear some major similarities to WTO rules but, the enforcement is far more aggressive.⁴²

2.3 Purpose of the ASCM and the inherited risks

To be able to comprehend the legal basis for the prohibition of *export subsidies*, the purpose behind the provisions should be understood. Due to lack of an International law on competition⁴³ the ASCM promotes fair competition among member states by disciplining the possibility of improper price competition and deals with the potential trade-off between trade-distorting and welfare-enhancing effects of subsidies. The Antidumping agreement⁴⁴ regulates private players within the international market in the same manner. As such, subsidies are not barriers to the trade, but can even contribute to the increase of international trade⁴⁵, which is in line with WTO goals. Then again, subsidized exports have a potential for generating dumping within a country’s market, which diminishes access to the market by other countries. This leads to a skewed access to resources and increases the risk for trade being skewed, which in turn leads to a negative influence on competing business(-es) which lacks access to subsidies, which in the long term will have a negative effect on trade. The Subsidizing agreement is a tool for the member states to protect themselves against damaging import of goods that are subsidized in the exporting country.⁴⁶

The ASCM has a dual purpose: To regulate a member’s national use of government subsidies and to thoroughly describe how subsidies, which either directly or indirectly can be seen to interfere with another member states industrial and/or trade interests, can be countered.⁴⁷ To enable this purpose the ASCM contains two sets of rules, individually referred to as ‘Track I’ and ‘Track II’. Track I, is defined as; when a subsidy harms the domestic industry of a WTO Member imposing countervailing duties on imports from a subsidy-granting Member. Track II, is defined as; the rules, referring to the multilateral disciplines, a WTO member must abide by so as to not find itself in violation of the Agreement or else risk becoming the subject of a complaint to the judicial instances of the WTO (Panel and, on appeal, AB).⁴⁸

⁴¹ Schön, 2004, p. 284

⁴² Sykes, Fall 2010, p. 14-15

⁴³ Bhala, p. 9 and WTO, Report, Subsidies and WTO, p. 195

⁴⁴ Agreement on implementation of article VI of the general agreement on tariffs and trade

⁴⁵ Bagwell, 2006, p. 893

⁴⁶ WTO, Report, Subsidies and WTO, 2006, p. 195 et seq.

⁴⁷ Understanding the WTO: The agreements

⁴⁸ WTO homepage, Subsidies and Countervailing measures: Overview, Trade policy review, 2004 p.127 and Goyette, 2006, p. 696

The ASCM is controversial by nature; it allows a Member State to take actions that actually crosses the border of a state's sovereignty against another Member State through the WTO framework as these national measures affect the trade of another Member State.⁴⁹ However, the ASCM goes no further than remedies in form of recommendations as well as detailed rules for the procedures for an anti-subsidy investigation and how the introduction of countervailing measures is done. The existence of a forbidden subsidy must be proven first *prima facie* by the complainant and in the case that this is accomplished the defendant country is given a chance to rebut the accusations.⁵⁰

If a member grants prohibited subsidies, other Member States can choose the unilateral remedy to either impose Countervailing Duties (CVDs), to counter their effects on their domestic market under Track I or challenge the subsidies granted under Track II.⁵¹ CVDs may be imposed if the conditions of Track I are fulfilled, i.e. the export subsidy have been proven to have caused injury to import-competing firms in another member country and causality between the two must have been established. Article 15 of the ASCM describes the determination of injury and Part V of the ASCM governs the CVDs.

They can alternatively adopt appropriate countermeasures, following a dispute-settlement procedure in line with Track II. In context of Track II, injury is deemed to exist under an irrefutable assumption.⁵² Both procedures may be started parallel, however, under the agreement in Article 10, note 35 only one form of relief can be used. Within the frame of Track 2 action vis-à-vis export subsidies, the ASCM provides an accelerated DSU process in Article 4 which is much faster than the normal DSU timetable for dispute settlement proceedings. The unilateral remedy is likely to be the preferred option, since it avoids the need to bring a case to the DSB saving time, and captures revenue for the treasury of the importing nation to boot.⁵³

If Track II is chosen, and the subsidy in question has been qualified being an export subsidy, the subsidizing Member is recommended by a panel to withdraw the subsidy immediately in accordance to Article 4.7 of the ASCM. This can naturally cause adverse effects for the companies having included the subsidy in their budgets. If the subsidizing State does not follow the recommendation within the time-period specified by the Panel, the DSB can, as stated in Article 4.10 of the ASCM, authorize the complainant to take appropriate countermeasures.

The *ex ante* control of subsidies is left to the Members. It is up to the subsidizing Member to decide what steps, domestic or within WTO-context, it will take from there. The member states are however, by Articles 25 and 32.6 of the ASCM for transparency reasons, supposed to notify which subsidizing programmes they grant and additionally any countervailing duty laws and rules steps they have taken against other member states.

⁴⁹ Seth, p. 248 et seq.

⁵⁰ Appendix 3 of the DSU: Working Procedures and WTO homepage, burden of proof

⁵¹ WTO homepage, understanding the WTO: The agreements and Goyette, 2006, p. 696

⁵² Didier, p. 248

⁵³ Sykes, Fall 2010, p. 483

WTO is soft law; the DSB has no jurisdiction to demand the Members to act beyond what they have agreed to and is therefore limited to recommendations. It is also apparent that countries can *in actu* be slow in withdrawing the subsidizing measures, to provide the government time to replace the subsidies with a new system e.g. US-DISC, it took almost 14 years before US withdrew the DISC Law.⁵⁴ As a consequence the WTO Member States do not have a similar obligation to recover the given state aid in form of export subsidies like EU⁵⁵. This is a potential area of conflict between the WTO and EU rules, as article 4 of the ASCM only requires a withdrawal of the prohibited subsidizing method, not any other consequences.⁵⁶

Compensation has quite a different meaning vis-à-vis WTO rulings. The term compensation in the WTO context does not refer to payment for trade lost, but is rather a forward-looking remedy to ensure a rebalancing of trade concessions, economic injury caused is recuperated mainly⁵⁷ by utilizing CVDs till the monetary loss has been recovered. CVDs must be removed after this has been achieved according to Article 19.4 of the ASCM. It should be noted, that in Australia-Automotive Leather Article 21.5, the panel actually came to a conclusion that Article 4.7 of the ASCM encompassed repayments as “*anything less than full payment would satisfy the requirements of article 4.7*”, if the subsidizing state has not complied with the recommendations and the rulings of the DSU.⁵⁸ This ruling was criticized by the panel in Canada-Aircraft Article 25.1⁵⁹ and rebuked by several countries.⁶⁰

Sadly WTO trade disputes are lengthy processes and the costs are of a massive proportion. Paradoxically, at the end of the day the final bill is highly likely to end on the table of the taxpayers of the conflicting Member states, both as the original financers of the export subsidies in their Country and as the ones having to bear the final burden of the negative economic effect, in form of higher prices and lost jobs, of the countervailing measures targeted against the subsidizing Member State. In US-FSC it was the small businesses, since 60 percent of the users were small companies, and for them “*a little wage-tax credit*” is of greater importance than to large corporations.⁶¹ An additional effect is that the importing country’s consumer’s access to cheaper imported products is denied by its own raised tariffs and countervailing duties.

⁵⁴ See chapter 6.2 below

⁵⁵ TFEU 108(2), see France Télécom vs. Commission, 2011 point 184 et seq.

⁵⁶ Luja, 1999, p. 223

⁵⁷ See ASCM Articles 18 for provisional measures and Article 19 for CVDs. See also DSU Article 6.7 for possible mutually agreed non-monetary compensation.

⁵⁸ Australia-Automotive Leather, Recourse to Article 21.5 of the DSU, 2000 Under A3, the meaning of “*withdraw the subsidy*”

⁵⁹ Canada-Aircraft, Recourse to Article 21.5 of the DSU, Panel report, 2000 para. 5.47

⁶⁰ Australia: Compromise Averts U.S.-Australia Dispute Over subsidies to Automotive Leather Maker, 2000

⁶¹ Congress to Attempt Revamp of Export-Tax Subsidy, 2002

3. The ASCM, “subsidy” and “specificity”

3.1 The basic structure of the ASCM

The first step of the process of understanding how an action of a state within its own national boundaries qualify as a forbidden indirect export subsidy, is to define what a subsidy is and contains in WTO-treaty context. Only subsidies that have a potential to create trade distortion need restricting, therefore the ASCM attempts to identify these types of subsidies. This is done first on the basis of the recipients, thru the specificity rules, and second on the basis of how direct their effect is on the trade flows. The ASCM includes six parts and seven annexes and follows a logical order presented in this chapter. The ASCM relates only to subsidies explicitly provided to an enterprise or industry or group of enterprises or industries,⁶² the key the entire Agreement being the term “subsidy” and concept “specificity”, found respectively in part I, Articles 1 and 2.⁶³ These two define all the measures that are subject to the multilateral subsidy disciplines. Article 1 of the ASCM states that only a measure which is a “specific subsidy” within the meaning of Part I is subject to multilateral disciplines and can become a target for countervailing actions. The reasoning covers respectively actionable subsidies and export subsidies.

The ASCM states that a subsidy is deemed to exist only if all these three elements are in place: i) financial contribution, ii) provided by a government or any public body iii) and a benefit is thereby conferred. Additionally such subsidy has to be “specific” to be subject to the Agreement. The definition of “specificity” can be found in Article 2, and is considered to exist when access to the subsidy is limited, explicitly or in fact, to certain enterprises.⁶⁴

All specific subsidies are divided into one of two categories in Parts II and III, and certain rules and procedures with respect to each category are established. These two categories, in given order, are called prohibited and actionable. The substantive and procedural requirements that must be fulfilled before a Member can apply a countervailing measure against subsidized imports are established in Part V followed by parts VI and VII which establish the institutional structure and notification/surveillance modalities for implementation of the ASCM.⁶⁵ Part VIII has particular rules for various categories of

⁶² In US-Softwood Lumber III para. 7.24 the Panel stated that “[t]he object and purpose of Article 1.1 SCM Agreement is to provide a definition of a subsidy for the purposes of the SCM Agreement”

⁶³ WTO, Report, Subsidies and WTO, p. 190 et seq. and The WTO in brief part 3

⁶⁴ WTO, Report, Subsidies and WTO, p. 191 Article 2.1(c) sets down the parameters for determining when subsidies that are not explicitly specific are specific *de facto*.

⁶⁵ WTO homepage, p. subsidies and countervailing measures, overview

developing countries. The statutes for developed countries and for former centrally planned economy members to transform into market economies are found in part IX. And the final Parts of the ASCM X and XI contain dispute settlement and final provisions.

3.2 The definition “subsidy”

A subsidy is grounded according to Article 1 para. 1.1(a) 1 when,

” ...there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as “government”), i.e. where: ”

either as a direct transfer of funds or potential transfers of funds or liabilities according to subpara 1.1(a)(1)(i), or indirectly, in line with subparas 1.1(a)(1)(ii-iv) or 1.1(a) 2, that refers to Article XVI of the GATT 1994, as will be explained closely in subchapter 4.1 below. Article 1 of ASCM has an extensive coverage of varying ways which governments might grant financial contributions under the definition of subsidies.

Traditionally the list of subparas, within the context of which measures constitute a financial contribution, has been thought to be exhaustive based on the way the term “i.e.” in Article 1.1(a)(1) is used.⁶⁶ But the rather broad wording of this Article indicates that this might not be absolute.⁶⁷ In US-Large Civil Aircraft, the AB stated that any type of measures found within the “NASA research programs” that falls within the meaning of the “chapeau”, Article 1.1 of the ASCM, would remove the need to tackle the issue of *purchasing services* being outside of the scope of Article 1.1(a)(1) (i).⁶⁸

The main types of financial contributions are found in Article 1.1(a)(1)(i)-(iv) of the ASCM and consist of direct or potential direct transfers of funds; foregone revenue; government provision of goods/services; and purchases of goods and have been subject to several disputes. Also according to different examples scattered in ASCM *inter alia*, grants, loans, equity infusions, loan guarantees and fiscal incentives. The direct transfers in Article 1.1(a)(1)(i) are fairly straightforward. Mainly all types of monetary transactions from a government to a private actor are covered.⁶⁹ The ASCM provides the following examples: grants, loans and equity infusions and jurisprudence have established *inter alia* that certain payments made in the form of bonds constitute direct transfers of funds.⁷⁰ Even a promise of a money transfer, under certain conditions, is considered a potential for direct transfer of funds: i.e. a direct transfer of funds potentially exists, if the action in question confers a subsidiary by giving rise to a benefit, irrespective of whether any payment occurs. Moreover, no dependency upon probability of the occurrence of a subsequent payment exists.⁷¹

⁶⁶ P.Steger, 2010, p. 781 et seq.

⁶⁷ Goyette, 2006, p. 697

⁶⁸ US-Large Civil Aircraft (second complaint), 2012, AB, paras. 590 and 613 et seq.

⁶⁹ See also Article 1.1(a)(1)(ii) of the ASCM and Lester, 2008, p. 424

⁷⁰ Brazil-Aircraft, Panel report, para. 5.22

⁷¹ Brazil-Aircraft, Panel report, paras. 7.68 and 7.70

3.3 A benefit conferred

For a subsidy to exist, two elements must be in place: 1) the financial contribution by a government or any public body and 2) confers a benefit for its recipient that exists as specified in Article 1.1(b) ASCM. In some cases, establishing a benefit may be difficult. Subsequently, in the lack of complete guidance on these issues in the ASCM, the AB in Canada–Aircraft⁷² ruled that the existence of a benefit is to be determined by comparison with the market-place. Article 14 of the ASCM, provides some guidance, employing a commercial benchmark, with respect to determining whether certain types of measures confer a “benefit”. The Appellate Body further confirmed that a financial contribution had to make the recipient “better off” than it would have been, and thus the measure to have trade-distorting potential in the sense of ASCM Article 1.1(b) to exist.⁷³ However, the issue of the meaning of “benefit”, in the context of multilateral disciplines is not fully resolved.⁷⁴

AB in US–Lead and Bismuth II⁷⁵ and in US–Countervailing Measures on Certain EC Products⁷⁶ interpreted that assets of a state-owned enterprise previously acquired by the latter with a “financial contribution” by the government, and subsequently sold at fair market value in the course of privatization are not presumed to confer a benefit on the purchasing firm.⁷⁷ A benefit does not necessary need to be established. As will be explained in chapter 5.3 below, the ASCM contains an Illustrative List of export subsidies in Annex I of the ASCM, i.e. a measure meeting the criteria of an item of the list constitutes per se a prohibited export subsidies; thereby benefit needs not be established separately.⁷⁸ However, the Illustrative List should not be used *a contrario* as framework to define the notion of subsidy under Article 1.

3.4 The concept of “specificity”

Only subsidies that can distort the allocation of resources within an economy should be controlled e.g. export subsidies. Therefore, unless a subsidy is “specific” in line with Article 2, it does not exist according to Article 1.2 ASCM. This is based upon the interplay between Article 1.2 and the “chapeau” of article 2 that reflects back to the “chapeau” of Article 1.1 in determining whether a subsidy, is “specific”⁷⁹.

“A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2”⁸⁰

⁷² Canada- Aircraft, AB report

⁷³ Canada-Aircraft, AB report para. 157.

⁷⁴ WTO homepage subsidies and countervailing measures > overview

⁷⁵ US-Lead and Bismuth II DS138

⁷⁶ US-Countervailing Measures on Certain EC Products DS212

⁷⁷ WTO, Report, Subsidies and WTO, p. 197

⁷⁸ LESTER, 2011, p. 700 See the Panel Report in Canada-Aircraft, at para. 9.117

⁷⁹ US-Large Civil Aircraft (second complaint), 2012, AB paras. 739 and 747 et seq.

⁸⁰ Article 1.2 of the ASCM

This may occur *de jure* or *de facto*; a *de jure* specificity exists, when the granting authority or a legislation run by it “*explicitly limits access to a subsidy to certain enterprises.*” A contrario, a *de jure* “*specificity*” does not exist, if eligibility of the enterprises is founded on objective criteria and neutral conditions,⁸¹ which are both economic in nature and horizontally applicable, and if the eligibility for the subsidy is automatic, since a distortion in the allocation of resources is presumed not to occur. Footnote 2 of the ASCM establishes that the conditions should be economic in nature and horizontal in application. *De facto* specificity *inter alia* can even be determined from how many companies actually use a government programme, as in the case of EC–DRAMs Chips,⁸² where the amount of companies using the subsidy programme (only six out of 200) was used as the basis for a assessing of “*specificity*”.

The ASCM contains four types of “*specificity*”: 1) Enterprise-specificity, i.e. government subsidization is aimed at a particular company or companies. 2) Industry-specificity, i.e. government subsidization is aimed at a particular sector or sectors. 3) Regional specificity, i.e. government subsidization is aimed at specific producers in certain parts of its territory. 4) Prohibited subsidies, i.e. government subsidization are aimed at export goods or goods using domestic inputs.⁸³

A subsidy programme may appear non-specific according to these principles, as noted by Article 2, but is implemented in such a way that it turns out “*specific*”. Thus, Article 2.1(c) pinpoints some of the factors that should be observed in that regard, e.g. that the subsidy program is used by a limited number of certain enterprises or the way in which discretion has been exercised by the granting authority in making the awards. Also the length of time the subsidy program has been operative makes is of importance.⁸⁴

Additional issues arise *inter alia* with respect to specificity is how the establishment in practice that the range of beneficiaries of a subsidy is “*specific*” to “*certain enterprises*” or to a particular region, as opposed to “*non-specific*”, will be done. Since “*certain enterprises*” refers to “*an enterprise or industry or group of enterprises or industries*” consequently it might be of importance to be able to identify an “*industry*” in establishing specificity in particular cases. The ASCM doesn’t define the term “*industry*”.⁸⁵ However, prohibited subsidies are considered specific, even if these subsidies are available to all enterprises, thus the disciplines of Parts II and V of the ASCM will apply. The Panel, in Korea-Vessels⁸⁶ held that a subsidy that is specific because of Article 2.3 ASCM (i.e. export contingency) is automatically specific for the purpose of Part II (prohibited export subsidy).

⁸¹ Article 2.2 of the ASCM

⁸² EC-Countervailing Measures on DRAM Chips DS299

⁸³ WTO homepage, subsidies and countervailing measures

⁸⁴ WTO, Report, Subsidies and WTO, p. 198 et seq.

⁸⁵ WTO, Report, Subsidies and WTO, p. 198

⁸⁶ Korea-Measures Affecting Trade in Commercial Vessels, para. 7.514

4. Indirect subsidies

4.1 Upstream/input subsidies

The ASCM classifies subsidies into direct and indirect categories in Article VI:3 of the GATT 1994. The term “*indirect subsidy*”, has raised several issues of identification and interpretation. The topic “*indirect subsidies*” within the framework of Article 1.1(a) is the main research field of this paper “*indirect export subsidy*”, i.e. indirect subsidy and export subsidy combined.

Article XVI of the GATT 1994, in subpara 1.1(a) 2, is the earliest rule on subsidies of GATT 1947 and regulates any support operating directly or indirectly to increase exports of any product from, or reduce imports into, a Member’s territory. The precise meaning of the definition of the notion of “*income and price support*”, within the scope of this article has been debated at various points related to subsidy elements in domestic support prices. I.e. subsidies financed by a non-governmental levy, export credit programs, internal transport charges, tax exemptions, multiple exchange rates and border tax adjustments.⁸⁷ Therefore, the first part of guidance, for what falls within framework of indirect subsidies, will be sought from early GATT /1947 jurisprudence. This case has been used as example for indirect subsidies e.g. by Benitah and Rubini.⁸⁸ As an important point to clarify the following case, the definition for *Upstream/input* subsidy in pre-WTO US countervailing duty legislation was almost identical to indirect subsidies i.e. they basically meant the same thing.⁸⁹

The definition for an indirect subsidy surfaced in the US-Chilled and frozen pork from Canada case,⁹⁰ wherein subsidies were paid explicitly only to producers of swine, not to producers of exported pork meat. The problem with classification as a *upstream subsidy* was that the US Department of Commerce (USDOC) would have had to demonstrate that pork meat producers received a “*competitive benefit*” in line of 19 USC § 1677-1 (a) (2) (1988),⁹¹ even though they did not receive any subsidy. Also any benefits received would have been eliminated to a relatively modest countervailing duty, as its amounts did not exceed this competitive benefit.⁹² To circumvent this obstacle, the department indicated the production of swine and the manufacture of pork meat was a single production process, thereby trying to present the indirect subsidy as a direct one. Thus, according to DOC, no indirect subsidy existed in this case, since the main purpose of live swine

⁸⁷ WTO, Report, Subsidies and WTO, p. 197 see also chapter 6.2, DISC programme

⁸⁸ Benitah, 2001, p. 206 et seq. and Rubini, 2010, p. 337 et seq.

⁸⁹ Rubini, 2010, p. 337 et seq.

⁹⁰ US-Chilled and frozen pork, 1991 DS7/R

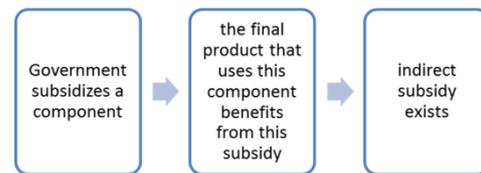
⁹¹ US countervailing duty laws 19 USC§ 1677-1(a)

⁹² Benitah, p. 269

breeding was the manufacture of pork meat.⁹³ After the issue was brought to a GATT /1947 panel, they decided *prima facie* this being an indirect subsidy, and focused on, if section 771.B provisions permitted the detection of an indirect subsidy. The conclusion they came to, was that an indirect subsidy is characterized by its disturbance of market mechanism in a national economy.

As it follows, the term *indirect* is used to define a subsidy granted to a product used in the manufacture of another product. I.e. the producer of the final product may still benefit from a direct subsidy to a producer of input necessary to manufacturing of the final product, creating a benefit from an indirect subsidy.⁹⁴ To illustrate this matter a following example will be provided;⁹⁵ a subsidy granted to a fabric manufacturer can become an indirect subsidy granted to shirt manufactures

that use the fabric as an input. Even though the shirt manufacturer does not directly receive any payment, it can nonetheless benefit from it i.e. if thanks to the subsidy it pays a lower price for the fabric. This way an upstream subsidy can become an export subsidy under Article 3.1.a) of the ASCM if tied to an anticipated export performance.



Picture 1

4.2 Passed through subsidies

There are several ways for subsidies to qualify as indirect. The legal terminology in ASCM Article 2 is unclear about whether “*specificity*” refers to the recipients or the beneficiaries, other than the direct recipients, of a subsidy. The beneficiaries may receive the benefit via an *input subsidy* being “*passed through*” to unrelated producers of subject merchandise.⁹⁶ The key is whether, and to what extent, the subsidy to an input product provides the benefit. The “*passed through*” concept provides the settings for the issue to occur in context of any of the Article 1.1(a)1 subparas of the ASCM as visualised in picture 2. The *input subsidy* is not explicitly written into GATT or the ASCM, but implied from the WTO member obligations.⁹⁷ The effect is that these “*passed through*” subsidies are considered indirect. Thus, one more way an indirect subsidy can be originated is the following; a company that has prior to the sale received subsidies, which benefits the new owners. This was brought up in US-Softwood Lumber IV.⁹⁸

“Where a subsidy is conferred on input products, and the countervailing duty is imposed on processed products, the initial recipient of the subsidy and the producer of the eventually countervailed product, may not be the same. In such a case, there is a direct recipient of the benefit—the producer of the input product. When the input is subsequently processed, the producer of the processed product is an indirect recipient of the benefit—provided it can be established that the benefit flowing from the input subsidy is passed through, at least in part, to the processed product.”

⁹³ Benitah, p. 269

⁹⁴ Benitah, p. 206

⁹⁵ See picture 1

⁹⁶ Roch, 2008, p. 549 see also chapter 3.4 above of this paper for “*specificity*”

⁹⁷ Roch, 2008, p. 557

⁹⁸ Appellate Body Report on US-Softwood Lumber IV para.143.

In US-Countervailing Measures on Certain EC Products which dealt with the “passed through” issue vis-à-vis privatisation of state owned enterprises. As in the chapter 4.1 above, albeit the subsidies were not export subsidies, the same subsidizing structure combined with contingency to an export performance should qualify as indirect export subsidies within the scope of Article 3.1(a) ASCM.



Picture 2

4.3 Revenue due foregone or not collected

Revenue due forgone or not collected is an indirect subsidy in line with Article 1.1(a)(1)(ii) of the ASCM.⁹⁹ The ASCM gives as an example a “*fiscal incentive*” such as a “*tax credit*” but fails to give a measuring method or a clarifying explanation. In jurisprudence it has been found to be a necessity to have a normative benchmark¹⁰⁰ to determine what constitutes an “*otherwise due*” foregone tax revenue, as defined in the ASCM Article 1.1(a)(1)(ii).¹⁰¹

In this case the subsidy consists of a government failure to impose a tax. To enable to classify this failure to act as expenditure a hypothetical tax has to be worked with, so that the failure to collect the hypothetical tax can be classified as expenditure.¹⁰² One has to keep in mind that it is not possible to derive the structure of the hypothetical tax from a unitary model of how the national tax systems ought to look like¹⁰³ i.e. a benchmark other than the tax rules of the Member in question cannot be used. To proceed in such a way would be an infringement of the fundamental principle that it is the sovereign right of a nation to decide how its tax system is structured.¹⁰⁴

A subsidy is deemed to exist if “*government revenue that is otherwise due is foregone or not collected*”¹⁰⁵. This definition could be interpreted as including only cases in which the tax administration has failed to collect a tax levied by law. However, essential subsidies in the area of taxation are built into the national tax systems themselves rather than being restricted to the area of tax administration¹⁰⁶ e.g. as when states seek to consider a person’s ability to pay and taxing them accordingly. Here, the transnational state aid and subsidy-controlling regimes set the limits of permissible support. Instead of focusing on whether the relevant legislation has become more favourable regarding exported goods in the course of time, one should rather concentrate on a specific norm and analyse whether it fits into the general structure of the tax system as devised by the country in question.¹⁰⁷

⁹⁹ See picture 3

¹⁰⁰ US-FSC Panel Report, 1999 and US –FSC, AB report, 2000

¹⁰¹ WTO, Report, Subsidies and WTO, p. 197

¹⁰² Schön, 2004, p. 292

¹⁰³ *idem*

¹⁰⁴ AB Report, Canada-Autos, 2000, Para. 89

¹⁰⁵ According to Article 1(1)(a)(1)(ii) of the ASCM

¹⁰⁶ Grave, supranote 74, at 233 et seq.

¹⁰⁷ Schön, 2004, p. 292 et seq.

The fact that a tax subsidy exists presupposes that a measure decreases the amount of tax due and that this advantageous tax situation has to be a breach of the fundamental principles of the national tax regime in question. Therefore no subsidy can be found to exist if;

- based on the principle that goods and services should be taxed at their destination the law first enforces an indirect tax on consumers.
- The law then provides that general or particular consumption taxes are deducted from exported goods.¹⁰⁸

This is true albeit the law, in the matter of exported goods, provides a refund of the consumption taxes already paid in the course of manufacture. A refund like this is the logical consequence of the decision to impose taxes on consumption based on the destination principle.¹⁰⁹ That is why Footnote 1 to Article. XVI GATT explicitly accepts the legitimacy of such refunds¹¹⁰ i.e. VAT removed for exported products is not an export subsidy in accordance with the ASCM.¹¹¹

Subsequently, although a refund of direct taxes for exports constitutes a prohibited export subsidy according the GATT and the ASCM, goods exported from the EU Member States to third countries exempted from excise taxes do not. Several



Picture 3

appendices in both agreements and GATT/WTO jurisprudence confirm this.¹¹²

Problems arise though when the result of the application of the destination principle to excise taxes means that EU goods can be exported to the US without being taxed while, simultaneously, US goods exported to the EU are burdened with an adjustment tax.¹¹³ US has for decades been trying to create within the US system of direct taxation, similar advantages for US exports as those granted to EU exports with regard to indirect taxes. These attempts have led to one of the longest proceedings of the GATT and the WTO history, the US- FSC case, which will be studied in more detail in chapter 6.2 below.

4.4 Providing goods or services or purchase of goods

A Government providing goods or services other than general infrastructure or purchase of goods in context of Article 1.1(a)(1)(iii) ASCM can contemplate two types of transactions:¹¹⁴ The first is a government providing goods or services other than general infrastructure.¹¹⁵ These kinds of transactions could artificially lower the cost of producing

¹⁰⁸ Schön, 2004, p. 293

¹⁰⁹ Schön, 2004, p. 292 et seq.

¹¹⁰ Footnote 1 of the ASCM

¹¹¹ Mutén, 2001, p. 589 et seq. see also footnote 60 of the ASCM

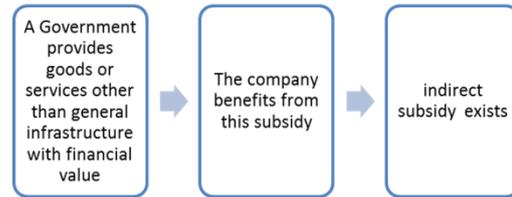
¹¹² Schön, 2004, p. 293 also see chapter 6.2 below of this paper for BISD 23S/114, BISD 23S/127 and BISD 23S/137

¹¹³ Annex I, Item (e), Illustrative list of export subsidies of the ASCM.

¹¹⁴ Appellate Body Report on US-Softwood Lumber IV, 2003 para. 53

¹¹⁵ US-Softwood Lumber III para.7.24.

a product by value to an enterprise and is an indirect subsidy. The second type is a government purchasing goods from an enterprise and could artificially increase the revenues gained from selling the product. The evaluation of if a financial contribution exists should be made by taking in consideration the nature of the transaction through which something of economic value is transferred by a government¹¹⁶ Inter alia, certain infrastructure measures provided could constitute indirect subsidies in the meaning of Article 1.1.(a)1(iii) as illustrated in picture 4.



Picture 4

In US-Softwood Lumber, a government allowing the exercise of harvesting rights to a company was actually deemed as providing goods within the meaning of Article 1.1(a)(1)(iii). The Panel’s motivation was as follows;¹¹⁷

“...from the tenure holder’s point of view, there is no difference between receiving from the government the right to harvest standing timber and the actual supply by the government of standing timber through the tenure holder’s exercise of this right”.

In casu the Panel came to a conclusion that the ordinary meaning of the word ‘goods’ is wide and does not seem to be limited to “*tangible or movable personal property, other than money*” that could be considered a “good”, *i.e. timber is “goods” in the sense of article 1.1(a)(1)(iii).*¹¹⁸ Furthermore the word “goods” in the context of “goods or services” intended to ensure that the term “*financial contribution*” encompasses in-kind transfers of resources, with the exception of general infrastructure.¹¹⁹ The EC-Large Civil Aircraft clarified that *inter alia*, the lease of land at the Mühlenberger L industrial site in Hamburg and the lengthened runaway at the Bremen Airport provided to Airbus were specific subsidies.¹²⁰

In US-Large Civil Aircraft, the fundamental question which arose was whether or not the research and development (R&D) transactions at issue were outside the scope of Article 1 of the ASCM as “*purchases of services.*”¹²¹ Some of the support provided to Boeing under some of the NASA and US Department of Defence (USDOD) R&D programmes containing access given to NASA and USDOD facilities, equipment, and employees to Boeing constituted the provision of goods or services within the meaning of Article 1.1(a)(1)(iii) of the ASCM.¹²² These subsidies were found to have being a financial contribution conferring a benefit to Boeing within the meaning of Article 1.1(b) of the ASCM.¹²³ They were also found specific within the meaning of Article 2 of the ASCM. A new market benchmark was created for financial contributions to conduct R&D

¹¹⁶ Appellate Body Report on US-Softwood Lumber IV, 2003 para. 52

¹¹⁷ US-Softwood Lumber III, paras. 7.16 -7.18

¹¹⁸ US-Softwood Lumber III, paras. 7.22-723

¹¹⁹ US-Softwood Lumber III, paras. 7.22 - 7.24

¹²⁰ EC-Large Civil Aircraft DS316

¹²¹ US-Large Civil Aircraft (second complaint), 2012, AB, para. 550 et seq.

¹²² US-Large Civil Aircraft (second complaint), 2012, AB, paras. 611 and 624

¹²³ US-Large Civil Aircraft (second complaint), 2012, AB, paras.662 and 699 et seq.

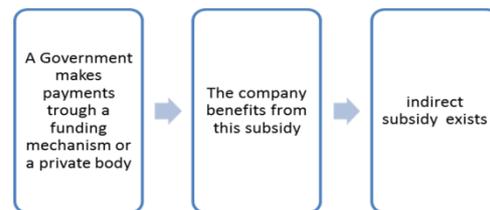
programmes, based on the terms of the commercial transaction between entities.¹²⁴ In addition, allocation of patent rights under the NASA and USDOD measures at issue were found to be subsidies.¹²⁵

4.5 Payments to a funding mechanism, or via a private body

The last type of indirect subsidy is slightly different. While the first three subparas i-iii are about the form the subsidies are granted in, Article 1.1(a)(i)(iv) ASCM regulates the identity of the actor, i.e. it can be given in any of the methods presented above.¹²⁶ As an important note, a subsidy is deemed to exist only if it is granted by or at the direction of a government or any public body within the territory of a Member. Thus, Article 1.1(a)(i)(iv) ASCM applies mutually to measures of national governments, subnational governments and publicly owned bodies such as state owned companies.

The purpose of expansion of the rules within this context is according to the Panel on US-Export Restraints¹²⁷ to avoid circumvention of the definition of a governmental body by a government operating through a private body. Furthermore they stated that the term “*private body*” in Article 1.1(a)(1)(iv) provides a counterpoint to the terms “*government*” or “*any public body*” as used in Article 1.1, i.e. the companies or other entities either affected by or reacting to an export restraint could be “*private bodies*” in this sense.

The essence of the terms “*entrustment*” and “*direction*” is to ensure that the financial contribution is not distorted by complex triangular transfers.¹²⁸ The Panel in Korea-Commercial Vessels, where certain granting bodies were government-owned financial institutions, found that control of a body is an important factor in determining whether an entity is a public body in the sense of Article 1.1(a)(1). According to the panel an entity controlled by the government or other public body any action by that entity should be considered attributable to the government, and therefore fall within the scope of Article 1.1(a)(1) of the ASCM.¹²⁹ In US-Export Restraints, the panel differentiated “*entrustment or direction*” from the circumstances in which the government “*intervenes in the market in some way*”, which might or might not have a specific result “*simply based on the given factual circumstances and the exercise of free choice by the actors in that market*”¹³⁰ making it clear that Article 1.1(a)(1)(iv) requires a potent element of State authority and that a regulatory intervention does not fall within Article 1.1(a)(1)(iv).



Picture 5

¹²⁴ US-Large Civil Aircraft (second complaint), Panel Report, paras. 7.1039 and 7.1184.

¹²⁵ US-Large Civil Aircraft (second complaint), 2012, AB, paras. 740 and 789

¹²⁶ See picture 5 and Rubini, 2010, p. 117

¹²⁷ US-Export Restraints, Panel Report, para. 8.53

¹²⁸ Rubini, 2010, p. 117

¹²⁹ WTO, Report, Subsidies and WTO, p. 197

¹³⁰ US-Export Restraints, Panel Report, paras. 8.31 and 8.29

5. Export subsidies in the ASCM

5.1 Subsidy categories

Subsidies according to the “*traffic light*” system can be red, amber or green. The two categories regulated in SCM are red, the prohibited ones and amber, the actionable ones. All the subsidies deemed “*specific*” fall into one of these two categories.

Most subsidies fall in the “*actionable*” category that is defined in part III of the ASCM. Actionable subsidies are not prohibited,¹³¹ nonetheless they are subject to challenge in the WTO or to countervailing measures and exist when subsidies provided by one member state causes adverse effect¹³² or serious prejudice to another member state concerning like products. Amber light subsidies also cover the built in system in GATT 1994 condemning actions against another member states causing nullification or impairment of benefits accruing regarding like products i.e. MFN principle in article one and NT principle in article three. Typically it is when improved market access that is presumed to flow due to a bound tariff reduction is undercut by subsidization that nullification and impairment occur.¹³³ Since the focus of this paper are adverse “export subsidies” as understood in WTO context the actionable subsidies fall outside of the scope and shall not be discussed further.¹³⁴

The former exceptions for certain subsidies which, while specific, were non-actionable are no longer valid. This special treatment was aimed at socially beneficial policy objectives but ended as of 1 January 2000,¹³⁵ causing the effect that all specific subsidies covered by the ASCM that are not prohibited are actionable.¹³⁶ The green light subsidies can though still exist in spirit by other exemptions in the SCM-agreement by the subsidy not being prohibited by an exemption in Article 3(for red) or part III (for actionable). There are also additional exclusions stated in GATT 1994 and other special agreements under GATT i.e. environment and agriculture.¹³⁷

5.2 Prohibited export subsidies

The prohibited subsidies can be found in Article 3 of the ASCM which states:

¹³¹ WTO homepage, subsidies and countervailing measures, overview

¹³² Articles 5 and 6 SCM in given order

¹³³ WTO homepage, subsidies and countervailing measures, overview

¹³⁴ See chapters 1.3 and 3.1

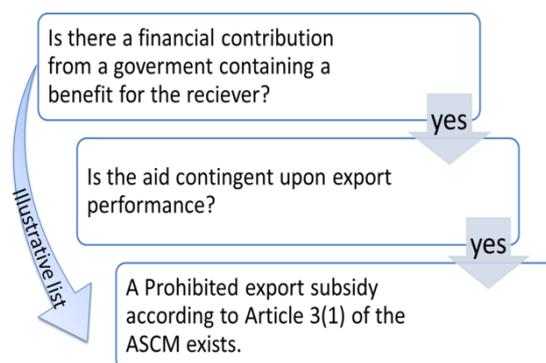
¹³⁵ The non-actionable provisions in ASCM Articles 8 and 9, existed for five years per ASCM Article 31, and were not extended.

¹³⁶ WTO, Report, Subsidies and WTO, p. 200 et seq.

¹³⁷ SPS Agreement, article XX of GATT 1994 and the Agreement of Agriculture

“3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I.”



Picture 6

These subsidies are divided in two categories that both set a sharper tone than the rest of the ASCM by being prohibited *per se*, without any requirement for effect in Article 3.2,¹³⁸ as they are most likely to have adverse effects on the interests of other Members. The rules are not a major change from the earlier GATT, except that the prohibition has expanded to cover former exceptions.

Export subsidies in Article 3.1 are targeted to directly affect exports by assisting the domestic producer against its competitors in foreign markets by inherently favouring domestic goods that are exported over competing foreign goods in export markets. I.e. by their nature they discriminate goods made by foreign competitors, thereby giving an advantage to the domestic goods.¹³⁹ This is based upon the economic theoretical assumption that market failures are normally not related to the activity of exporting or of competing against imports, exceptions to this assumption may exist.¹⁴⁰ The second category i.e. “*local content subsidies*” contains subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.¹⁴¹ This category is not within the scope of this paper so shall not be discussed further.

As mentioned in chapter 3.4 above, specificity requirements are not present for prohibited subsidies defined in Article 3. Vis-à-vis prohibited subsidies; the central concept is Article 2.3 ASCM, which establishes that all subsidies listed under Article 3 are deemed to be specific. In practice this leads to the following. An export subsidy available to all companies would not be specific under the terms of Article 2.1, but is deemed to be specific by a rule of assumption under the terms of Article 3¹⁴² therefore they can either be countervailed or challenged as illegal measures.

Article 3.1a) sets the first category by prohibiting subsidies “*contingent*”, in law or in fact, whether wholly or as one of several conditions, on export performance i.e. “*exports subsidies*” as illustrated in picture 6. Since the wording of the relevant legislation expressly makes a subsidy contingent on exporting, the situation is relatively clear and requires no detailed analysis. However, the interpretation of “*de facto*” contingency,

¹³⁸ Article 3.2 states “A Member shall neither grant nor maintain subsidies referred to in paragraph 1” and Seth, p. 257 et seq. also Lester, 2008, p. 430

¹³⁹ LESTER, 2011, p. 351

¹⁴⁰ WTO, Report, Subsidies and WTO, p. 199 et seq.

¹⁴¹ WTO homepage, subsidies and countervailing measures, overview

¹⁴² Lester, p. 429

footnote 4 after the word fact clearly defining the quintessential meaning of “*de facto*” within this Article, has been much debated by Panels and AB. Just the fact that a subsidy is granted to corporations which happen to export is not enough to constitute an export subsidy within the meaning of this term.¹⁴³

Thus even though the term “*export subsidies*” is commonly used for the subsidies under this paragraph, a precise description of the subsidies at issue is provided in the Article 3.1a) that focuses on the concept of export contingency. This contingency requires that the grant of a subsidy has some amount of link or relationship to export performance.¹⁴⁴

5.2.1 Export “contingency”

The extensive case law on establishing whether subsidies are contingent in fact on exporting, illustrates that the matter is not a straightforward exercise in practice. The overtone of “*contingent*” is “*conditional*” and “*contingent... upon export performance*” signifies that the granting of the subsidy has to be somehow linked to actual or anticipated exports.¹⁴⁵ Both the Panel and the AB in Canada-Aircraft expressed a view that a measure should not be classified as an export subsidy simply because it is a financial contribution to a firm with high export propensity.¹⁴⁶ The panel proposed a “*but for*” test for *de facto* export contingency, signifying that for a subsidy to be counted as *de facto* contingent on exportation it would not have been paid out “*but for*” the anticipation that it would result in export.¹⁴⁷

The Panel in Australia-Automotive Leather II held a similar view when they passed judgment on a grant by the Australian government to a firm on the condition that it reached specified sales targets. Due to the total domestic market being much smaller than the size of the sales targets, the Panel came to a conclusion that the grant was, *de facto*, contingent on exportation, since international sales was the only revenue by which the firm could meet the set sales targets. According to the Panel this links the grant of the subsidies and the government’s “*anticipation*” of exportation.¹⁴⁸ Additionally, the ruling in US-FSC postulates that it makes no difference to the export contingency that foreign produced goods are also eligible for a certain subsidy. What does matter is that among the domestically produced goods; only the ones that are exported are eligible.¹⁴⁹ In Canada-Autos the measure in question was a *de jure*¹⁵⁰ contingency. The manufacturers had to fill i.e. “*ratio requirements*” to receive the subsidy in form of import duty exemption in subpara 1.1(a)(1)(ii). Based on the way the “*ratio requirements*” were constructed, the AB deemed that the duty exemption for the vehicles, which had to be made in Canada,

¹⁴³ WTO, Report, Subsidies and WTO, p. 199 et seq.

¹⁴⁴ US-FSC, AB report para.111, see also Lester, p. 430 et seq.

¹⁴⁵ Canada-Aircraft, AB Report, paras.107 and 166 et seq.

¹⁴⁶ Canada-Aircraft, Panel Report, para. 9.339.

¹⁴⁷ “[W]e consider that the factual evidence adduced must demonstrate that had there been no expectation of export sales (i.e., “*exportation*” or “*export earnings*”) “*ensuing*” from the subsidy, the subsidy would not have been granted.” Canada-Aircraft, Panel Report, para.9.339.

¹⁴⁸ Australia-Automotive Leather, Panel Report para. 951

¹⁴⁹ WTO, Report, Subsidies and WTO, p. 199 et seq.

¹⁵⁰ Appellate Body Report, Canada-Autos, DSR 2000:VI, 2985, 200 para. 99

was in conjunction with the ratio requirements.¹⁵¹ The most recent case about the *de facto* export contingency was EU-Large Civil Aircraft, which shed light upon the interpretation of the term “*de facto contingency*” vis-à-vis “*export subsidies*” in particular.¹⁵² *In casu* the AB maintained that the standard should involve observing at whether the subsidy generates an incentive to export as compared to selling domestically:

*Where the evidence shows, all other things being equal, that the granting of the subsidy provides an incentive to skew anticipated sales towards exports, in comparison with the historical performance of the recipient or the hypothetical performance of a profit-maximizing firm in the absence of the subsidy, this would be an indication that the granting of the subsidy is in fact tied to anticipated exportation within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement.*¹⁵³

The AB observed that conditional relationship between the granting of the subsidy and export performance must be proven, permitting the subsidy to be geared to induce the promotion of future export performance by the recipient.¹⁵⁴ The issue has to be determined by evaluating the subsidy itself, in the light of the *ad rem* factual circumstances instead of a government’s motive(s) for granting a subsidy. Nonetheless, AB recognized that while a subjective intent can play a limited role; the objective intent can be quite relevant.¹⁵⁵

On the authority of the AB, the key to the legal standard, when export contingency *de facto* exists, are the incentives created by the subsidy¹⁵⁶ i.e. if the subsidy encourages producers to export instead of sell domestically. This nepotism of domestic products, where export sales are favoured over domestic sales, and domestic products that are being exported are given such a clear and significant advantage over foreign products, is where a violation of the ASCM article 3.1 (a) will be found in the ABs point of view.¹⁵⁷ It is made clear by a general statement of the AB regarding *de jure* contingency that; within the meaning of Article 3.1(a) of the ASCM a neutral, either on its face or by necessary implication, subsidy that lacks a differentiation between domestic sales and the recipient’s exports, cannot be considered contingent on export performance.¹⁵⁸ The AB’s comments on “*neutrality*” and “*differentiation*” between export and domestic sales, does indicate that the idea of discrimination exists between the two.

Regrettably the AB did not complete their analysis regarding if other financing subsidies at issue were export subsidies.¹⁵⁹ Therefore the legal status of this type of subsidies is still uncertain. No finding on whether any such measures are export subsidies has been made

¹⁵¹ Benitah, 2001, p. 197 et seq.

¹⁵² WTO homepage. 2011 News items, 1 June 2011, WTO adopts Airbus reports

¹⁵³ EC-Large Civil Aircraft AB-2010-1, 2011 paras.1040–1055

¹⁵⁴ EC-Large Civil Aircraft AB-2010-1, 2011 para.1050

¹⁵⁵ The AB cautioned that this does not mean ‘*that evidence regarding the policy reasons of a subsidy is necessarily excluded from the inquiry into whether a subsidy is geared to induce the promotion of future export performance by the recipient*’ EC-Aircraft AB-2010-1, 2011 para. 1051

¹⁵⁶ EC-Large Civil Aircraft AB-2010-1, 2011 para. 1044

¹⁵⁷ LESTER, 2011, p. 366 et seq.

¹⁵⁸ EC-Large Civil Aircraft AB-2010-1, 2011 para. 1056

¹⁵⁹ EC- Large Civil Aircraft AB-2010-1, 2011 paras. 1085–1101

so far, thus, it is highly likely that such a finding might only be completed by a new proceeding.¹⁶⁰

5.3 The Illustrative List

The Illustrative List of export subsidies that Article 3.1a) of the ASCM refers to, can be found in Annex I. The List was created during the Tokyo Round and has carried over with barely any changes from the GATT era to the Uruguay round ASCM. The List purpose is to clarify the ASCM text for what is considered an “*export subsidy*”. The List provides a shortcut for an aggrieved forbidden export subsidy.¹⁶¹ If the measure at issue is banned by the List, a Member does not have to demonstrate that the measure falls within the scope of Article 3.1(a) ASCM¹⁶² as was proved by Brazil-Aircraft.¹⁶³ However, the List cannot be used for the interpretation of the general definition of subsidy contained in Article 1,¹⁶⁴ then again, of its twelve non-exhaustive points most are either obvious or not especially problematic.

Besides giving examples for measures constituting “export subsidies” Annex I, referred to by footnote 5, also contains exceptions that shall not be prohibited under any provision of the ASCM. However, this only applies, when the List clearly indicates that the measure in question is not a prohibited export subsidy. The simple fact that a measure does not meet the conditions, listed in one of the Items, is not enough for it to constitute a prohibited export subsidy.¹⁶⁵

Of the twelve items in the List only a few are of interest for this paper as they may constitute *indirect export subsidies*. Only a few of these items have been debated in jurisprudence, and warrants further discussion. For example, Item i) of the List¹⁶⁶ covers an *input subsidy* for imported input used in production of an exported product through the remission or drawback of import charges beyond those normally levied.

Item k) of the List¹⁶⁷ provides a “safe harbour”, i.e. “export subsidies” are not prohibited, for the OECD Arrangements for export credits granted at rates below market value. The Panels and the AB in Brazil-Aircraft have established though that this does not apply to export guarantees, risk premiums and “matching arrangements”,¹⁶⁸ therefore it does not apply on indirect export subsidies.

¹⁶⁰ LESTER, 2011, p. 358 et seq.

¹⁶¹ Report of the Panel, Brazil-Aircraft (21.5), para.6.42, see also picture 6

¹⁶² Report of the Panel, Brazil-Aircraft (21.5), para. 6.31.

¹⁶³ Brazil-Aircraft DS46

¹⁶⁴ Goyette, 2006, p. 707

¹⁶⁵ On this point, see, *infra*, note 93.

¹⁶⁶ item i, Annex I

¹⁶⁷ item k, Annex I

¹⁶⁸ Goyette, 2006, p. 707 et seq., this matter was discussed by Brazil-Aircraft Panel and Brazil-Aircraft AB Reports in Canada – Aircraft (21.5), at paras. 5.137-5.139

The interesting Items relevant for export-tax subsidies are (e) and (f)¹⁶⁹, for direct taxes whereas (g) and (h)¹⁷⁰ are for indirect taxes. The meaning of Item (e) was discussed thoroughly by the AB in US-FSC (Article 21.5). It was done within the context of the meaning of the fifth sentence footnote 59 of the ASCM as presented in chapter 6.2 below and its subchapter 6.2.1. The AB noted that in the context of footnote 59, the ASCM explicitly provides that measures used by a Member to eliminate double taxation are not subject to the legal provisions governing subsidies.¹⁷¹ To be precise, it makes no difference which method the WTO member states choose to avoid double taxation, as long as they comply with WTO obligations.¹⁷² Accordingly, Members do not have an unfettered discretion to avoid double taxation of *'foreign-source income'* through the grant of export subsidies. The AB on US-FSC, based on its analysis of footnote 59 rejected the argument that as there is no requirement to tax export-related foreign-source income, a decision not to tax that income cannot be held to constitute revenue *"foregone."* According to the AB if this approach was to be followed, there could never be *"a foregoing of revenue otherwise due"* since WTO law doesn't require the collection of any particular category of revenue.¹⁷³

5.4 Mutually satisfactory solution

Negotiations and consultations are the heart of the DSU, as established earlier in chapter 2.1 of this paper, therefore one should not disregard the mutually agreeable solutions. The mutually satisfactory solution can exist in form of withdrawal or on implementation notified and is based upon Article 3.7 of the DSU which establishes that the preference is clearly for the parties of a dispute to come to a mutually acceptable solution, consistent with the covered agreements. This does not really resolve the dispute by referring to norms. What this means is that subsidies can also exist in the form of a mutually satisfactory solution, which is basically a shortcut to any result that the disputing member states agree upon. The mutually satisfactory solution was reached in Australia-Automotive leather I.¹⁷⁴ The mutually satisfactory solution can also be seen to happen in most WTO disputes and can show up at any stage of the DSU.¹⁷⁵ This procedure can be argued to escape "legalism" to some extent¹⁷⁶ then again it does make sense considering the nature of the WTO.

¹⁶⁹ Items e and f, Annex I of the ASCM

¹⁷⁰ Items g and h, Annex I of the ASCM

¹⁷¹ AB Report, US- FSC, Recourse to Article 21.5 of the DSU para.121 et seq.

¹⁷² AB Report, US- FSC, Recourse to Article 21.5 of the DSU para. 139.

¹⁷³ US-FSC, AB report para. 98.

¹⁷⁴ See chapter 6.3 below

¹⁷⁵ Australia-Automotive leather I DS106 see also Australia-Automotive leather II DS126

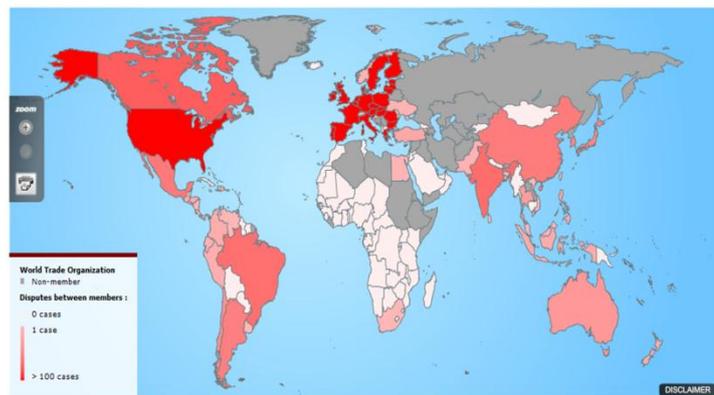
¹⁷⁶ Benitah, p. 55 et seq. see also chapter 2.3 above

6. Export subsidies in WTO Practice

6.1 US-EU/ Boeing-Airbus

To be able to develop a better understanding of the ASCM texts, a closer look at WTO practice is necessary. Therefore a dispute involving the United States and European Union, both major players in world trade and also the most active users of the DSU, as can be seen in picture 7¹⁷⁷, is a logical choice for a sample case. The WTO conflicts between the United States and the European Union on subsidies has been subject to terms like the “*nuclear trade war*” and the widely known “*mini trade wars*”.¹⁷⁸ The tit-for-tat on subsidies to their respective aircraft manufacturers, Boeing and Airbus, has been the origin of the several WTO cases. The most recent case deals with a number of important legal interpretations of the ASCM, *inter alia* indirect subsidies in Article 1.1 and export subsidies in context of Article 3.1a.

The latest dispute round between Airbus and Boeing has been going on since October 2004, when the US terminated the bilateral agreement of 1992.¹⁷⁹ This was followed by filing of a complaint to the WTO, on behalf of Boeing, against the European Union's conglomerate Airbus; instigating the DSU against the EU and the four nations with Airbus stakes.¹⁸⁰ The US claimed that the payments to Airbus, made by the EU, were illegal subsidies which violated the ASCM. Next day after Boeings claim, the EU retaliated, filing a counterclaim.¹⁸¹ Both of these cases consist mainly of similar complaints, even though the sparring partners have taken totally different approaches. However, whereas the US concentrated on *direct subsidies* that had benefited Airbus in the past, the EU focused on restraining the *indirect subsidies* for Boeing through US military and space agencies. According to EU's allegations *indirect export subsidies* existed in form of the FSC/ETI/Jobs act and follow-up acts and other tax reliefs given by some states. The WTO homepage states that regardless of the Airbus–Boeing dispute originating about 30 years back, the jurisprudence created by these cases could potentially shape the WTO's subsidy rules in a number



Picture 7

¹⁷⁷ WTO homepage, disputes map, see picture 7 of this paper.

¹⁷⁸ Schön, 2004, p. 293 the term “nuclear trade war” and “mini trade wars” comes from Breuss, WTO Dispute Settlement: Four EU-US Mini Trade Wars-A Rejoinder, 2004, p. 373 et seq.

¹⁷⁹ Bilateral EU-US Agreement on Trade in Large Civil Aircraft, 1992

¹⁸⁰ Kommission, 2012, p. 1

¹⁸¹ Kommission, 2012, p. 1 et seq.

of areas. Therefore this dispute might have an impact on both the recent financial crisis-related subsidies, and on the international subsidies regulation.¹⁸²

The US-Large Civil Aircraft (Boeing case) addressed many important issues regarding the interpretation of the ASCM¹⁸³ ;

- Articles 1 and 2, definitions of subsidy and specificity
- Article 3.1(a), prohibited export subsidies
- Articles 5 and 6, adverse effects

The 23 March 2012, the DSB adopted both the AB and Panel reports related to this case. The essential facts about the Boeing case can be seen in Annex 2 of this thesis.

6.2 US-FSC, background

In the opinion of some doctrine, the US-FSC case caused the US to actually change its legislation for the first time in history on behalf of a request from an International organization.¹⁸⁴ The US-FSC was handled in a separate case, but resurfaced in US-Large Civil Aircraft.¹⁸⁵ We will now study the US-FSC measures¹⁸⁶ constituting *indirect export subsidies* more in-depth.¹⁸⁷ The measure at issue was a part of the U.S. tax law, establishing special tax treatment for “*Foreign Sales Corporations*” (FSC) that provided a tax exemption on certain income earned abroad. This wrestling match between the titans of trade, US and EU, is now on its seventh round.

The dispute backdates to the early-70s when United States adopted the Domestic International Sales Corporations (DISC) legislation to promote US export industries by lowering income taxes on profits connected to these exports. DISC was a tax-haven export subsidy, with the purpose to correct the relative disadvantage of US exporters in having to pay greater income taxes on their exports than the tax-heaven exporter from countries following a territoriality principle. A Panel was established on the EC’s request to investigate if the rules were contrary to GATT 1947.¹⁸⁸ The US reacted by making three counterclaims of their own; against France, Belgium and Holland.¹⁸⁹ These four cases were handled as one by the same Panel. However, unlike to the DISC program, the Panel concluded that the European VAT-based territoriality system was not inconsistent with GATT1947. Unfortunately the US misinterpreted this as being true for all cases, including DISC, due to the way the Panel phrased the ruling. As a result, the US conducted a unilateral explanation that the Panel finding was; DISC was not in violation

¹⁸² LESTER, 2011, p. 346

¹⁸³ WTO homepage, See also dispute DS317

¹⁸⁴ Mutén, 2001, p. 589 et seq.

¹⁸⁵ US-Large Civil Aircraft DS317

¹⁸⁶ Komission, 2012, pp. 2-4, see Annex 2 of this paper for complete list of complaints

¹⁸⁷ US-FSC and US- FSC (Article 21,5) DS108

¹⁸⁸ US-DISC, Panel Report November 12, 1976

¹⁸⁹ See Luja, 1999, p. 211 and the three cases, income tax practices maintained; by France (BISD 23S/114), by Belgium (BISD 23S/127) and by the Netherlands (BISD 23S/137)

of article XIV: 4 of GATT 1947.¹⁹⁰ This explanation was immediately protested by the EC and Canada and the proceedings continued. The award was adopted by the GATT Council after a bilateral agreement with the EC. Still, even as late as 1981, a total of around 13,800 DISCs were operating in the US.¹⁹¹

Eventually U.S replaced the DISC program with the foreign sales corporations (FSCs), a new type of tax-haven export subsidy following a territoriality principle in 1984.¹⁹² The concept of FSC was; foreign based corporations that exported US goods to third countries received special treatment rules in US tax law i.e. the profits derived by FSCs from exports were exempt from US income tax.¹⁹³ The FSC program offered additional advantages: provisions on controlled foreign corporations did not apply; US shareholders of FSCs were exempted from income tax on dividends received from FSCs. It was even possible to inflate the percentage of profits attributed to the FSC due to a special regime. Owing to the profitability of the FSC system, by 2004, around 7,000 FSCs had been established by US companies (e.g. Boeing, General Electric, Mars, Nike and Procter & Gamble).¹⁹⁴

The end of 1997 the EC asked for consultations with the US in regard to Sections 921-927 of the US Internal Revenue Code (IRC) and related measures, establishing special tax treatment for FSCs. The following year the EC requested the establishment of a Panel. The Panel confirmed that the United States, through the FSC scheme, had acted inconsistently with its obligations under Article 3.1(a) of the ASCM and Articles 3.3 and 8 of the Agreement of Agriculture,¹⁹⁵ subsequently FSC measures constituted prohibited export subsidies. The AB upheld the Panel's finding, and moreover rejected the US attempt of a defence, based on the last sentence of footnote 59 of the ASCM allowing measures for avoidance of double taxation, since it had not been raised before the Panel.¹⁹⁶

On the subject of the FSC measure constituting a forbidden subsidy, AB's reasons were; for the fiscal treatment of income, subject to the contested measure, it needed to be compared to how comparable legitimate income is treated. The AB, for the purpose of this comparison, also confirmed that in the absence of a contested measure that would apply to the revenues in question an applicable general tax rule might not always be possible to identify.¹⁹⁷

A matter of great importance was that the AB made it quintessentially clear that the ruling did not indicate that a Member must choose one kind of tax system over another to be in line with its WTO obligations.¹⁹⁸ It is the Member's choice to tax or not to tax any

¹⁹⁰ Benitah, 2001, p. 320 et seq.

¹⁹¹ Benitah, p. 318 et seq. and Schön, 2004, p. 293

¹⁹² Benitah, p. 318 et seq.

¹⁹³ Schön, 2004, p. 293 et seq.

¹⁹⁴ Schön, 2004, p. 293 et seq.

¹⁹⁵ US-FSC, Panel Report, October 8, 1999.

¹⁹⁶ US-FSC, AB report, 2000 and Martin.B.Tittle, 2003, p. 811

¹⁹⁷ US-FSC, AB report, 2000, paras. 89-91.

¹⁹⁸ AB Report, US-FSC, Recourse to Article 21.5 of the DSU, 2002, paras. 89-90 and 98.

particular category of revenue. However, once the income derived from a particular source is subject to tax, favouring export-oriented corporations over other corporations within the same category is illegal. Since the U.S had set its own benchmark, vis-à-vis taxation of the worldwide income of both corporations and shareholders, any measures taken by US to facilitate exports had to be measured against that benchmark. The same reasoning applies with regard to the other rules in regard to governing the allocation of profits between a corporation and its subsidiary.¹⁹⁹

The US-FSC case sets a benchmark for the treatment of *indirect subsidies* in the form of tax incentives,²⁰⁰ thereby illuminating the most disputed area of indirect prohibited export subsidies in scope of Article 3.1(a) ASCM.

6.2.1 FCS/ETI

Following these decisions by the GATT Panel and AB, the U.S amended the FSC legislation replacing it with the Extraterritorial Income Exclusion Act (ETI).²⁰¹ However, the EC once again initiated proceedings in December 2000, by notifying the DSB of failure of consultations to settle the dispute, hence requesting the establishment of a Panel pursuant to Article 21.5 of the DSU. The DSB agreed and a Panel was composed that concluded that the FSC Repeal and ETI Act of 2000 (the amended FSC legislation) was still inconsistent with Articles 3.1(a) and 3.2 of the ASCM. An appeal by the US did not bring any change, as the AB upheld the Panel's ruling.²⁰²

The measure creating the issue this time was that the combined appliance of IRC Sec. 114(a) and (b) made it possible to escape taxation, when the ETI was derived from the sale, lease or rental of goods whose value was predominantly created in- or outside the U.S and which were to be used outside the U.S. The ETI/FSC tax exemption was available for:

- products manufactured in the U.S and sold abroad i.e. export
- products manufactured and sold outside of the USA

The U.S plan was that the ETI taxation would be considered the exception rather than the rule. The ETI exclusion from a taxable income was a general rule; still the section 5(c) 1 of the ETI act also exempted FSCs.²⁰³ This was *de facto*, according to the GATT panel, a “*prevailing domestic standard*” of taxation of worldwide income in the United States.²⁰⁴

Due to IRC Sec. 114 differentiating products manufactured “*in*” the U.S and “*outside*” the USA, the AB decided to examine these as two isolated situations. From this point of view, it came to a conclusion that to receive the ETI tax exemption for the products

¹⁹⁹ Schön, 2004, p. 294 et seq.

²⁰⁰ SCM art1.1(a)(1)ii and chapter 4.3 and 5.2.1

²⁰¹ Peckron, 2001, p. 25

²⁰² WTO homepage, summary US-FSC, DS108

²⁰³ Schön, 2004, p.294 et seq.

²⁰⁴ The US-FSC (Article 21.5 – EC) Panel Report, para.8.37 et seq.

manufactured within the U.S, the goods had to be exported to enable the demand of “to be used outside” the United States. I.e. regarding the goods mentioned above the demand of “to be used outside” the United States were contingent of export and thereby in violation of Article 3.1(a) of the ASCM.²⁰⁵

To define a general rule is not a necessity according to the AB, but rather, a necessity of comparing a set of facts and identifying the appropriate set of facts for that purpose.²⁰⁶ The AB didn’t get persuaded by either the exceptions in IRC Sec. 115 or the arguments by the U.S by pointing to footnote 59 to the ASCM, legalizing the introduction of rules seeking double taxation avoidance.²⁰⁷ The requirement to use the arm’s length principle i.e. the evaluation of each transaction should be done as if unrelated parties had carried it out while acting in their own interest, did not authorize the type of export contingent tax exemption that had been consigned by the US.²⁰⁸ Instead, the AB pointed out, the ETI allowed firms to shift the domestic income to foreign subsidiaries in an artificial manner. This was deemed to be outside the scope of the provisions of the ASCM which allows measures intended to avoid double taxation.²⁰⁹

6.2.2 The FSC/ETI Successors

After yet another legal defeat, EC imposed countervailing measures in form of punitive customs duties in the amount of USD 4 billion per year, based on the value of the subsidy granted by the U.S under the FSC program.²¹⁰ Even its successor, the American Jobs Creation Act of 2004 (AJCA), in particular the section 101 containing transitional provisions which allowed US exporters to continue to benefit from the WTO incompatible FSC/ETI, was deemed inconsistent with the WTO Agreement the same way as its predecessors by a Panel and AB. After a long period of consultations, complainants and countervailing methods the US enacted the Tax Increase Prevention and Reconciliation Act of 2005(TIRPA) on May 2006. Section 513 of TIRPA, entitled “*Repeal of FSC/ETI Binding Contract Relief*” finally accomplished a mutually acceptable solution on implementation of the FSC/ETI case.²¹¹

Owing to the fact that EC complaint dates back to 2004, the new generation FCC/ETI i.e. TIRPA, had not yet been implemented. As the case was postponed and reopened in US-Large Civil Aircraft (2nd complaint) the FSC/ETI matter had already been dealt with in the separate US-FSC case.²¹² Therefore both the Panel²¹³ and the AB, while upholding EC

²⁰⁵ The US-FSC (Article 21.5 – EC) Panel Report para 7.1383 and AB Report, US- FSC,Recourse to Article 21.5 of the DSU, 2002 paras 107-120

²⁰⁶ US–FSC, AB report, supra note 92 paras. 81 et seq. and 91 et seq

²⁰⁷ US–FSC, AB report, supra note 92, para. 121 et seq.

²⁰⁸ US–FSC, AB report, para. 99

²⁰⁹ AB Report, US – FSC, Recourse to Article 21.5 of the DSU, 2002 supra note 92, para. 121 et seq. and Schön, 2004, p. 295

²¹⁰ WTO sanctioned these measures Breuss, Economic Integration, EU-US Trade Conflicts and WTO Dispute Settlement Vol. 9 (2005) N° 12;, 2005, p. 12

²¹¹ US-Large Civil Aircraft (second complaint), Panel Report para. 7.1385. AB para. 455

²¹² WTO homepage, p. summary DS108

²¹³ US-Large Civil Aircraft (second complaint), Panel Report, paras. 8.6, 7.1452 and 7.1463

claims that the FSC/ETI constituted prohibited export subsidies, decided against further recommendation apropos those measures. The Panel concentrated instead on adverse effects of FSC/ETI benefits related to large civil aircraft during the period 1989-2006. The US was recommended by the Panel to take appropriate steps to remove the adverse effects. The AB upheld the Panel's recommendations.²¹⁴

Due to the same issue arising over and over again it seems quite clear that the matter was never properly resolved. A closer examination reveals the changes have been more in form than substance; the values of subsidies granted did not change much, and the DISC and the ETI requirements were easy to meet.²¹⁵ Since FSC's did not have to be independent foreign permanent establishments in contrast to most territorial systems, an agent under contract was sufficient to perform all of FSC's earning activities.

The fact that the US in the US-FCS dispute did take actions to remove the forbidden subsidies is significant since the WTO treaty customary law is very much dependent of the reactions of member states; as pointed out, in chapters 2.1 and 2.2, a rebuttal of a Panel ruling by several Member states diminishes or even eradicates the validity of the ruling due to the nature of the WTO treaty. Above all DSU rulings are recommendations, not orders, consequently the impact of the DSU rulings are directly assessable by which measures the member states take to follow the recommendations

Despite both the Panel and the AB establishing that no taxation system is favoured over the other²¹⁶ this case does trigger the thought that the territorial VAT based system applied by the EU might have an advantage in matters regarding export-tax subsidies.

²¹⁴ US-Large Civil Aircraft (second complaint), Panel Report, para. 7.1418, Article 7.8 of the ASCM and US-Large Civil Aircraft (second complaint) AB paras. 1350. and 1352

²¹⁵ Benitah, p. 321 et seq.

²¹⁶ WTO homepage, disputes, DS108, US-FSC

7. Discussion, analysis and conclusion

7.1 Problems related to identification of subsidies

It is fairly impossible to fashion general principles for the identification, let alone measurement, of undesirable subsidies due to the complexity of the modern economy and the wide array of government activity that both encourages and discourages the activities of business enterprise.²¹⁷ As can be seen from WTO jurisprudence represented in the EC-Airbus and US-FSC case, it is no simple matter to establish a *de facto* contingency on export performance as set by footnote 4 of Article 3 ASCM. However, since it seems clear that subsidizing exporting firms may divert business from more efficient competitors, and in the worst case even triggers subsidy wars in which exporting nations waste resources competing with each other to confer a competitive advantage on export,²¹⁸ it is important to have proper ways for identifying the harmful ones. Subsidies even have a potential to enhance trade distortions in domestic and international markets.

Export subsidizing encourages export rather than selling in the home market. This has been criticized based upon a theory that no apparent non-financial external costs seem to warrant a stimulus to exports. However, the problem with this argument is that *inter alia* export subsidies do in fact expand trade, thus, the volume of trade could otherwise be less due to trade barriers. It is important to also remember that export subsidies have long been regarded as “*unfair*” in the political arena, and laws authorizing countermeasures date back to the late 1800s.²¹⁹

Economically though, subsidized export often improve production, and thus confer a national welfare gain by improved job situation. Also the terms of trade for the importing nation consumers are improved.²²⁰ *Inter alia*, negative effects of WTO level subsidizing interference of the Airbus/Boeing subsidizing will eventually be felt globally as the airlines will compensate the higher cost of airplanes with raised ticket fares. Besides, some of the Boeing components are manufactured in EU countries by partner corporations or subcontractors as can be seen in the table of key facts and figures in Annex 3 of this thesis,²²¹ so EU may feel an economic backlash from this dispute. Thus, export subsidies have multiple facets. An awareness of this type of possible backlash might discourage nations from unnecessary involvement in matters concerning export subsidies, unless the government gets nudged by domestic industry, like in the Boeing

²¹⁷ Sykes, Fall 2010, p. 474

²¹⁸ Sykes, Fall 2010, p. 475

²¹⁹ Sykes, Fall 2010, p. 476

²²⁰ Sykes, Fall 2010, p. 476

²²¹ EU-US Agreement on Large Civil Aircraft 1992: key facts and figures p.3 and Annex 3

case, to act. Furthermore, most member states are interested in subsidy issues only if the specific case affects them.²²²

Several transparency issues still exist within the context of the ASCM; as was proven by an analysis of the ASCM from a transparency perspective.²²³ After the ASCM was introduced, the new SCM Committee created a questionnaire for subsidy notifications and established procedures for reviewing these notifications. Article 25 of the ASCM requires that Members to notify all specific subsidies (at all levels of government and covering all goods sectors, including agriculture) to the SCM Committee. It quickly became apparent that WTO Members, including several of the biggest developed Members, were alarmingly deficient in meeting the notification obligations i.e. they were not aware of the SCM transparency requirements of notifying the WTO of subsidy programs granted, nor the demand of countervailing notifications regarding the usage of unilateral measures. Further the research surfaced a lack of knowledge of the identification of subsidies, most eye strikingly a lack of understanding of some of the key elements of its essential subsidy disciplines, including the definition of a subsidy and the concept of specificity (WTO, 2003b).²²⁴ It appears that the members should consider how to aggregate information both for internal WTO purposes in the Committee, and for use by government officials, other economic actors and the public of the member states.

It is difficult to examine or interpret subsidies one is not aware of. Most countries choose not to do countervailing notifications under ASCM 25.11, regardless of the fact that Article 25.7 of the ASCM openly states that the notification of a measure doesn't prejudge the measure's legal status under GATT 1994 and the ASCM, its effects under the ASCM or the nature of the measure itself.²²⁵ This makes it impossible for the DSB to exert influence, if some of the subsidies targeted by the unilateral countervailing duties are e.g. indirect subsidies; as an effect these subsidies are anonymous. A recent SCM Committee report revealed that half of the member states did not hand in their required subsidy notifications despite the due date on June 30, 2011.²²⁶

With the increased need of different relief and stimulus packages applied as a toolkit by the governments of WTO member states, to help the severe economic crisis, many have started to ask for changes in the ASCM. Especially a need to establish clear, consistent and fair rules for all types of export financing has arisen, also with regard to the interpretation of a *de facto* export contingency. Additionally further clarifications were requested by the EU²²⁷ in cases where the link between the subsidy and the recipient of the product is concealed, i.e. indirect subsidies.

²²² P.Steger, 2010, p. 766

²²³ Wolfe, 2010, p. 575

²²⁴ Wolfe, 2010, p. 563

²²⁵ Wolfe, 2010, p. 564 et seq.

²²⁶ Subsidies, 2012 para. 8

²²⁷ P.Steger, 2010, p. 785 et seq.

7.2 Analysis

The requirements for a “*subsidy*” in Article 1 of ASCM has to be met, as was established in chapter 3.2 before it can be further investigated, if the measures at issue are inconsistent with their obligations as a Member State under Article 3.1(a) of the ASCM. If the prerequisites are met, the subsidy must additionally fill the requirement *de jure* or *de facto* of Article 3.1(a) before it can be classified as an *indirect export subsidy*. The ASCM contains a large amount of ambiguities which complicates the formation of a fully comprehensive picture vis-à-vis subsidies.²²⁸ This seems intentional, to provide a greater flexibility for political manoeuvres in regards to possible interpretations on such a sensitive issue as subsidies. The existence of ambiguity helps to circumvent delicate issues in order to ease the conclusion of negotiations.²²⁹ If too much focus had been on details the ASCM might never have come to be. This viewpoint stems from the partial impasse of the Doha round negotiations for improvements in the ASCM.

One of the targets of the Doha round of negotiations was to clarify and improve the ASCM²³⁰, which resulted in the establishment of a Negotiating Group on Rules. In November 2007 the Group introduced proposals to the ASCM text focused on clarification of interpretation of issues related to different aspect of a benefit e.g. the indirect pass through benefits, specificity and export credit practices. Additionally it included the determination of the role of the Illustrative List of export subsidies in Annex I and a clarification of issues regarding prohibited export subsidies by adding a subpara c) to Article 3.1, referring to the current Article I of Annex VIII about the upstream subsidies/export subsidies connection. The proposals mainly reflected the Panels and AB rulings on these issues.²³¹ The proposals have not met with any success, after all this time the ASCM remains unmodified.

Since the 2008 report, which added no new proposal for revised text concerning *export subsidies*, there has been insufficient basis to present a revised legal text. The issues have been lack of convergence, controversy of the issues, insufficient discussion to allow the identification of legal language reflecting convergence and several new proposals.²³² As a consequence a legal vacuum remains. The need for clear measuring points is clear for the rules to function accurately, not merely ambiguities that have no defined scope. Guidance for interpretation and existing benchmarks are found in WTO jurisprudence.

As mentioned previously in this thesis the fundamental benchmark, set by Canada–Aircraft, is that the existence of a benefit is to be determined by comparison with the market-place. The US-FSC further provided another important benchmark *in re* prohibited *export subsidies* set by ASCM Article 3.1(a) in the form of indirect “*export*” tax incentives in light of footnote 59. Hence, tax advantages granted should be compared to taxes paid under normal circumstances with respect to taxpayers in comparable

²²⁸ Benitah, p. 58 et seq. gives as an example Article XVI:3 GATT 1994, Brazil-Aircraft, 1999 para. 7.42 et seq.

²²⁹ Benitah, p. 60

²³⁰ Doha, 2001, p. 28

²³¹ Draft consolidated chair texts of the AD and ASCM, 2007,p.41 et seq.

²³² Communication from the Chairman, 2011 p.37 para.2 et seq.

situations within the meaning of Article 1(1) of the ASCM.²³³ Regarding research and development, the relevant market benchmark for financial contributions to conduct R&D programmes, based on the terms of the commercial transaction between entities was set in US-Large Civil Aircraft.

Further support to understand some key terms and concepts in regards to *indirect export subsidies* are set by the rulings of Panels and the AB e.g. the definition of “*subsidy*”. The AB of US-Large Civil Aircraft might, by indicating that measures that fall within the scope of the “*chapeau*”, Article 1(1) of the ASCM could be extensive beyond the list of its subparas,²³⁴ opened a loophole which needs to be addressed in the future. The weakness of the ASCM has been the lack of proper definitions, though the *subsidy* definition in Article 1 has been thought to be exhaustive to its subparas, and thereby definitive.²³⁵ Now a possibility exists that there may be several ways that indirect subsidies might fall under the “*chapeau*” of Article 1.1.

Jurisprudence presented in this study gives the following examples how indirect subsidizing may occur, *de jure* or *de facto*:

- as a upstream/input subsidy granted to a product used in the manufacture of another product, as in US-Chilled and frozen pork Article XVI of the GATT 1994
- as a “*passed through*” input subsidy as in US-Softwood Lumber IV
- as a government failure to impose a tax as in US-FSC Article 1.1(a)(1)(ii) ASCM
- as a government providing goods or services other than general infrastructure in context of Article 1.1(a)(1)(iii) like in US-Large Civil Aircraft
- as payments to a funding mechanism, or via a private body when a strong element of State authority is present as in US-Export Restraints Article 1.1(a)(1)(iv). This can be granted in any of the other forms presented above.
- Illustrative List shortcut in Annex I as in Brazil-Aircraft
- Mutually Agreeable Solution shortcut which Australia-Automotive leather I and Australia-Automotive leather II

Based on chapter 3.4 of this study no particular “*specificity*” requirements are needed since *export subsidies* as such are already specific, as found by Korea–Vessels.

On the topic of *export contingency* the following observations were made based on the sources for this thesis. A superficial glance at the disputes during WTO era, since several members have invoked solely Article 3 or 3.1 instead of 3.1a) for measures in extent of forbidden export subsidies, might give the impression that any measure under the “*chapeau*” of the Article 3 is forbidden. The jurisprudence shows that this is not the case though, a tie to an anticipated export performance is necessary. In all the cases examined the common factor has been: to receive the monetary benefit in whatever form it is granted the goods have to be exported. This tie may occur *de jure*, as in Canada-Autos by the law constructed in such a way that to receive tax or tariff exemptions export is

²³³ See chapters 3,4,3,5 and 6.1 above

²³⁴ See chapter 3.2 above

²³⁵ P.Steger, 2010, p. 795

needed. Or *de facto* as in US-FSC when tax exemption is received because of export. The presence of a tie might even be based upon if sales targets can be met in the domestic market i.e. is export required to meet the targets as in Australia-Automotive Leather II. The EC-Large Civil Aircraft also showed that the intention with the grant of a subsidy plays a minor role at most. A subsidy must be objectively proven to have encouraged producers to export instead of selling domestically.

According to the WTO secretariat non-tariff measures i.e. policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, have increased in importance. One of several challenges that is especially hard to tackle for the WTO, due to the tension between legitimate domestic goals and protectionist effects, is the beyond-the-border measures that address public policy concerns. Furthermore the constant evolution and change in the usage of different rules has led to the regulatory measures becoming more widespread. Thus an upward trend in the incidence of non-tariff measures is likely to continue.²³⁶

The world has changed and the global economy with it in a far more extensive way than expected when the Uruguay round ASCM was created. The manufacturers of end products and components are often located in different countries, thus economic remedies have a potential to cause a global downstream effect i.e. have an unexpected harmful effect on the member state that is invoking them. The financial crisis has also accelerated this change by the increased amount of government aid to stimulate a wide range of social and economic areas. The positive economic effects just might outweigh the negative effects corresponding to the economic calculations made by economists Kyle and Bagwell.²³⁷ Several bilateral Agreements have been negotiated lately between Member states governments, restraining exports “*voluntarily*” or agreeing to other means of sharing markets which are outside GATT’s auspices as they are *lex specialis* to circumvent the prohibition in article 3.1.a).²³⁸

Furthermore WTO is soft law, a member state can choose to risk the possibility of the economic sanctions and behave inconsistent to the ASCM rules. Therefore the purpose behind forbidding export subsidizing, despite a government addressing public policy concerns by granting subsidies which they do not necessarily recognise as forbidden, seems illogical. This is especially true vis-à-vis indirect subsidies. When governments try to hide subsidies behind ambiguities in a law text from other member states like in US-Chilled and frozen pork from Canada and the more recent Korea-Vessels, it enforces the viewpoint of the irrationality behind forbidding indirect export subsidizing. This raises a question if the prohibition of “*export subsidies*” in the article 3.1a) in relation to indirect subsidies has a valid legal purpose. Indirectly the WTO system and case law supports this perspective. The mutually agreeable solution in Article 3.7 of the DSU is the preferred way to solve disputes and in most disputes this has indeed been reached. This circumvents the legal text in the Article 3.2 of the ASCM.

²³⁶ What will the World Trade Report 2012 be about, 2012

²³⁷ Bagwell, 2006

²³⁸ WTO homepage, Understanding the WTO: The Agreements

Maybe now in the middle of the economic crisis the right direction would be to ease up on the rules rather than tightening them, so that the potential increase of remedies stemming from breaches of article 3.1a) of the ASCM could be avoided.

After all, the legal value of voluntary rules which its own creators do not understand or repeatedly try to circumvent is questionable. It should be noted though that the members do remove any prohibited measures according to DSB's recommendation, as seen in the US-FSC case. The rules of the ASCM seem to be more about politics than law. In a way the codified prohibition of *export subsidizing* inside WTO does raise a question whether the absolute prohibition of *export subsidies* really is worth it?

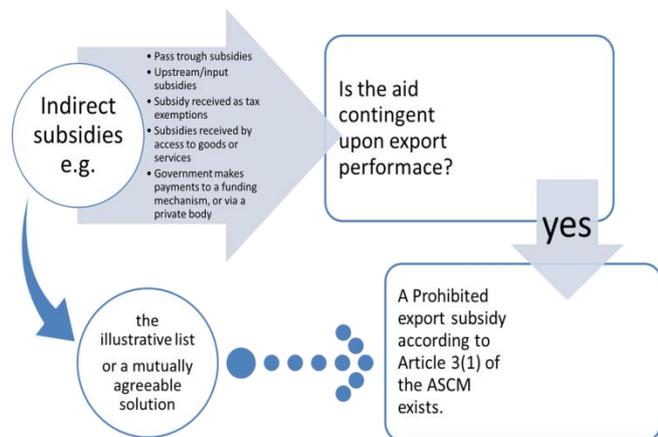
The research made by Kyle's and Bagwell's came to the conclusion that tightening the subsidy discipline might affect the Trade negatively.²³⁹ This would be contradictory to the WTO's principle to promote free trade.

7.3 Conclusion

The original research question of this paper was: *How do domestic internal actions of a state qualify for indirect prohibited export subsidies?*

Even though WTO lacks the sanctioning power of hard law, it does influence even individuals and companies indirectly, by the member states incorporation of the WTO Agreements into their national law, thus becoming hard law. Therefore it is of key importance to understand that the ASCM has no general banning of subsidization. Only subsidies that meet the definitions of the ASCM Articles 1 and 2 are subject to discipline as described in Chapters 3.2 -4. For subsidies to qualify as *prohibited subsidy* additional elements must be in place according to ASCM Article 3.1(a). As has been established in Chapters 3-5 of this study, the expression prohibited "*export subsidy*" is commonly used as a term for subsidies affecting exports and truly only belongs in the context of ASCM Article 3.1(a) when the subsidy is somehow tied to an export performance. This tie may appear as *de jure* or *de facto* indirect explicit conditions related to export performance. A *de facto* tie may also be an implicitly contingent, based on all facts combined.

Summed up for a governmental domestic measure to be qualified as an indirect prohibited export subsidy, it must meet the combination of the following elements; the subsidy exist according to Article 1.1(a)(1) or Article 1.1(a)(2) and a benefit has been conferred according to Article 1 para 1.1(b). Additionally the subsidy is categorized as prohibited by Article 3, thus becoming classified as "*specific*" by Article 2.3 or if the



Picture 8

²³⁹ Bagwell, 2006, p. 893

subsidy violates an item of the Illustrative List in Annex I. Another interesting turn is that any subsidies can emerge from a mutually satisfactory solution.²⁴⁰

After combining all the elements presented, it seems relatively clear why several member states, not only EU and U.S, lack an understanding of what exactly fits into the context of the term of Article 3.1.a) prohibited “*export subsidy*”. The subsidizing being granted indirectly certainly does not make this recognition easier. This thesis has found seven separate paths that seem to lead to a prohibited *indirect export subsidy*, which are visualized in Picture 8. Other paths may exist as this research does not claim to be exhaustive. With some imagination this might be a Pandora’s Box waiting to be opened.

As to the purpose of this study to possibly find some guidance for improvements to the ASCM by this research, obviously there is a need for change. To borrow a famous quote from the Greek philosopher Aristotle:

"Even when laws have been written down, they ought not always to remain unaltered."

Unfortunately the recognition of the fact is far from accomplishing the feat. This is especially true in a democratic supranational organization like the WTO which consists of so many different states, all with different economic, politic and legal background.²⁴¹

In the light of what has been presented earlier in this thesis the first intuitive possible solution is radical, thus not likely to gain much success, is to simplify the ASCM by the following change:

- Abolishing the prohibition of ASCM Article 3.1.a) and GATT 1994 Article XVI para.4, i.e. export subsidies would have the same status as actionable subsidies in Part III of the ASCM.

However, some doctrine believes that a try to modify the prohibitions on *export subsidies* contained in ASCM Article 3.1(a) is pointless, since they are perceived as trade distorting by tradition. This opinion is supported by the findings in the 2011 Report from the SCM Committee.²⁴² Some creative thinking is needed to develop and establish clear, consistent and fair rules for all types of export financing.

As established by the *empiri* which initiated this paper, over half of the indirect measures causing disputes were tax related. A *priori* solution could be to remove the categorization between indirect and direct taxation in WTO Law to avoid unnecessary disputes of which way tax exemptions should be granted. These technical details have the same underlying purpose, a fiscal relief is granted when goods are exported. This action might remove the need for member states to artificially attempt to adjust their fiscal system to match benefits other member states enjoy i.e. it would appear more clear, consistent and fair

²⁴⁰ See chapter 5.4

²⁴¹ WTO, Doha work programme DEC, 2005, para. 6 and Communication from the Chairman, 2011 p.37 para 2 et seq.

²⁴² Communication from the Chairman, 2011 p.37 para. 2 et seq. and P.Steger, 2010, p. 794 et seq.

thereby being in line with the wishes of the Member States. Hence, maybe by small steps, the Doha round goal for the ASCM might be achieved.

An interesting revelation from this study is that in the big picture the WTO rules are relatively successful, mainly because of their flexibility. The key reason is that we deal with soft Law which is in WTO context codified guidelines ratified by the Member states. Nations have indeed reached consensus in areas like the creation of the ASCM and they have adjusted their hard Law according to the DSB's recommendations after disputes. An interesting side effect of the ASCM may be that it could influence the bilateral Agreements by providing a minimum starting point, in a similar way as a dispositive law i.e. if no bilateral exists, the Member states can always fall back on the ASCM basics.

During my research, using the tools available to me, I have not been able to find any other research that summarizes the different *indirect export subsidizing* methods in this way. This thesis will hopefully contribute towards a more in-depth understanding of the area of stringency in application of WTO law in regards to *indirect export subsidies*.

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Annex 1

Article 3	Of 33 case(s) 20 are about export subsidies DS46, DS70, DS103, DS104, DS106, DS126, DS127, DS128, DS129, DS130, DS131, DS139, DS222, DS236, DS267, DS283, DS307, DS387, DS388, DS390
Article 3.1	Of 10 case(s) 9 are about export subsidies DS266, DS273, DS283, DS301, DS316, DS317, DS353, DS357, DS365
Article 3.1(a)	9 cases: DS70, DS108, DS126, DS139, DS142, DS236, DS265, DS347, DS357

Table 1

	Case(s) id	Cases total
direct	DS46, DS70, DS222, DS265, DS267, DS273, DS307, DS316, DS317, DS347, DS353, DS357, DS365, DS387, DS388,	15
indirect	DS108, DS126, DS127, DS128, DS129, DS130, DS131, DS139, DS236, DS273, DS307, DS316, DS317, DS347, DS353, DS142	15
Panel established	DS46, DS70, DS103, DS108, DS126, DS142, DS222, DS236, DS265, DS266, DS267, DS273, DS283, DS301, DS316, DS317, DS347, DS353, DS357, DS365	20
Confirmed 3.1 a)	DS46, DS70, DS108, DS126, DS139, DS142, DS222, DS267, DS273, DS353	10

Table 2

Annex 2

From (Komission, 2012, pp. 2-3)background fact sheet updated 12 March 2012

Essential facts about the "Boeing case"

1. NASA has provided Boeing with more than US\$2.6 billion in subsidies through eight NASA-funded federal research programmes through direct payments and free access to facilities, equipment and employees;
2. The AB confirmed that the above programmes provided subsidies in the form of a direct transfer of funds or the provision of goods and services by NASA to Boeing for which no fee is payable and for which Boeing acquired the commercial IP rights;
3. The AB confirmed moreover that the US Department of Defence (DOD) under its Research Development, Test and Evaluation programmes has transferred to Boeing, at no cost, dual use technology worth up to US\$1.2 billion for direct use in Boeing's production of Large Civil Aircraft as well as free access to DOD's facilities;
4. The AB clarified that the relations between NASA and DOD on the one side, and Boeing on the other side was akin to that of a joint venture, with the essential feature that the fruits of the joint labour largely went to one partner, Boeing, which had provided none of the funding;
5. Boeing continued to be eligible for US\$2.2 billion in Foreign Sales Corporation export subsidies, despite previous WTO rulings that these are prohibited subsidies under WTO law;
6. The City of Wichita (Kansas) granted almost US\$ 500 million in the form of tax abatements on Industrial Revenue Bonds between 1989 and 2006;
7. Washington State tax breaks to be granted for the period 2006-24 amount to a subsidy value of close to US\$3.1 billion;
8. NASA and DOD research and development subsidies enabled Boeing to develop key technologies, without which it would not have been possible to launch the 787 "Dreamliner" in 2004;
9. The above research subsidies gave Boeing a competitive advantage causing Airbus to lose sales campaigns, thus losing sales of the A330 and A350 models (i.e. in the 200-300 seat market) and threatening to lose its share of certain export markets. Even where it was able to make sales, it had to make them at reduced prices because of the presence of the subsidized 787 on the market;
10. The AB has also confirmed that the Washington Tax subsidies and Foreign Sales Corporation subsidies, as well as the Wichita subsidies, enabled Boeing to beat Airbus to winning orders in the "single aisle" 100-200 seat market (Boeing 737 vs A320).

Annex 3

From EU – US Agreement on Large Civil Aircraft 1992: key facts and figures p.3

Boeing 7E7 – European suppliers	
Cobham (U.K.)	Pumps & valves
Dassault Systemes (France)	Software & tools
Finmeccanica (Italy)	Airplane elements
GKN (UK)	Materials technology development
Groupe Latecoere (France)	Structural development work
Rolls-Royce (UK)	Engines