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A Comparative Analysis between EU State Aid and WTO Subsidies

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1. List of Abbreviation

AD	<i>Anti-Dumping</i>
CVD	<i>Countervailing Duties</i>
DSB	<i>Dispute Settlement Body</i>
EU	<i>European Union</i>
FDI	<i>Foreign Direct Investment</i>
GATT	<i>General Agreement on Tariffs and Trade</i>
MEIP	<i>Market Economy Investor Principle</i>
OECP	<i>Organization for Economic Co-operation and Development</i>
SCM	<i>Agreement on Subsidies and Countervailing Measure</i>
SME	<i>Small and Medium Sized Enterprises</i>
TFEU	<i>Treaty on the Functional of the European Union</i>
WTO	<i>World Trade Organization</i>

2. Preface

One of the most complex and difficult issues arising within the World trading legal system is the subject of subsidies. In many countries subsidies are an essential tool of governance. They can be an essential profit for societies in performing important and valid measures to benefit their citizens. Still, some subsidies have important damaging effects and can destroy the market system. It should not be surprising that the subject of subsidies creates many tensions and conflicts in international economic regulation and their measures. These conflicts expand into major judicial cases, such as in the World Trade Organization dispute settlement system as well as in the European Court of Justice and European Commission.

It is important to understand the relevance of WTO rules to the State Aid regime in addition to its reform and improvement. The EU is bound by significant restrictions under the WTO regime. However, it seems that EU avoids multilateral disciplines. Nevertheless, the establishment of the European Union was one of the main purposes of EU countries in challenging foreign subsidies before the WTO and of countervailing duty measures.

This study compares European State Aid control and World Trade Organization disciplines on subsidies and discusses their strengths and weaknesses. The comparison often mentions the need for balancing, which raises important questions about the manner in which the balance is controlled, and by whom. Many of the international rules regarding subsidies require comparisons to criteria such as the market model. This is mainly true where the government follows an economic activity and where the market therefore is the only appropriate criteria for determining whether the measure grants an advantage.

3. Introduction

The World Trade Organization was established in January 1995 as result of the Uruguay Round of the General Agreement on Tariffs and Trades (GATT). The main purpose of the WTO is to allow “open, fair and undistorted competition” regarding goods, services, and intellectual property, to the extent possible.¹ The WTO also provides a forum for the settlement of disputes. The WTO settlement behaviour is directed to restrict governments’ distortionary actions against normal trade. Decisions of the WTO are binding on the governments that are parties in the dispute. EU and WTO law regarding State Aid and subsidies have similar elements, but they are significantly different from each other in some areas. Conflicts between EU State Aid law and WTO rules are possible.

The European Union is unique among the members of the WTO in applying a tough internal subsidies regime. In general, this regime is more restricted on the EU Member States than the WTO disciplines on subsidies. Because of their distortive effects on trade and competition, both organizations try to reduce State Aid and subsidies. However, they vary in their approach concerning subsidies. EU law prohibits many State Aid measures and only considers those measures compatible with EU law that do not affect the trade between Member States² or measures they are especially justified.

Both the EU and WTO legal systems review aid measures that favour certain undertakings which causes unfair competition between EU Member States and adverse effects to WTO Members. This review contains an assessment carried out by the European Commission under Article 107 and 108 TFEU. It also contains an assessment by anti – subsidies authorities of WTO and the Dispute Settlement Body under the WTO Agreement on Subsidies and Countervailing Measures. This assessment under different legal systems means that there is a risk of conflicting decisions. It should be considered that objectives of the rules, interpretations, and applications within the different legal systems will not lead to the same result.

WTO law only bans export subsidies but allows countervailing measures against a huge number of subsidies if they affect the interest of other WTO Members badly. WTO

¹ Understanding the WTO, Fifth Edition, (Geneva: World Trade Organization Information and External Relations Division, 2015), pp. 10, 12, and 23.

² Article 107(1), TFEU.

rules regarding subsidies are not restricted as EU State Aid rules, it allows countervailing measures which may also have negative effects on international trade. This difference may be clarified by the different aims and functions of the two regimes. While the EU try to save a undistorted competition and establish an internal market³, WTO law is aimed at the liberalizations of trade with reduction of tariffs and other barriers to trade as well as abolition of discriminatory treatment.⁴

WTO law is an integral part of EU law and hence binding on the Member States of the EU.⁵ State Aid in the European context means the Member States must ensure that the aid scheme complies with both EU State Aid and the WTO law on subsidies. If not, the beneficiary undertakings may be placed at risk being subject to the recovery of illegal State Aid under the EU regime or to countervailing measures under the WTO regime.⁶

The general contexts and objectives of the WTO and EU are different and may have an impact on the comparison of a specific set of rules. The differences between WTO and EU discipline would be so many and fundamental as to render the interest in a comparative analysis limited to providing useful insights into both disciplines.⁷

The big difference between the two systems depends on the different weight given to textual and useful interpretation respectively. This has an impact on how the process of interpretation itself is conducted.⁸ As Professor Ehlermann states: “While the Appellate Body clearly privileges literal interpretation, the ECJ is a protagonist of teleological interpretation.”⁹

EUs support measures are covered by WTO rules and EU co-operators may not adopt the any measures which would violate these agreements. In addition, other countries may react to EU support measures by imposing countervailing duties on European products.

³ Article 26(2), TFEU.

⁴ WTO Agreement, Preamble.

⁵ Article 216(2), TFEU.

⁶ Sanford E. Gaines, Birgitte Egelund Olsen, Karsten Engsig Sorensen. ” Liberalising Trade in the EU and the WTO”. (Cambridge University Press, 2012), p 289.

⁷ J Flett, AC Jessep, and K Talaber-Ritz, “The Relationship between WTO subsidies law and EC State Aid Law” in EC State aid law- Le Droit des Aides d `Etat dans la CE, Liber Amicorum Francisco Santaolalla Gadea (Kluwer Law International, 2008) 441,442.

⁸ Luca Rubini, The Definitions of subsidies and State aid, WTO and EC Law in comparative respective. (Oxford, 2009) 15.

⁹CD Ehlermann, Six Years on the Bench of the World Trade Court_ Some Personal Experiences as Member of the Appellate Body of the World Trade Organization in (2002) Journal of World Trade 605,616.

State Aid rules in EU apply when the aid has an effect between the Member States and on the internal market while WTO rules apply to subsidies that have an impact on the international market. This market includes trade between both EU Member States and other WTO Members. Member States willing to give aid to their domestic industry must take both legal systems into account at all stages, drafting, implementing and applying aid measures. The Member States should always ask to comply with both legal regimes to be sure about compliance with relevant legal framework.

The purpose of this article is the comparison of subsidies in the WTO and State Aid in the EU. First, a short overview of the definition of subsidy and State Aid is introduced and explores the major similarities and differences between EU State Aid and WTO Subsidy. It can be difficult since there is no legal concept of subsidy in the WTO rules. The concept of subsidy cannot be expressed in general but depends essentially on its context, be it legal, political, economic, etc.¹⁰

As the second question, I would like to evaluate EU State Aid and the WTO subsidy's obligations and assess their functions to understand the framework of two regimes.

The concluding part will highlight the similarities and differences between WTO disciplines on subsidies and EU State Aid control and try to find the interference between them. The interface and comparison between EU and WTO law will be included the aims of these two organizations and their manner to dealing with problems.

4. Methodology and Sources

To achieve the above goals, I am employing the functional approach. Comparative law methodology shows that one will inevitably come across functionalism. This method has been adopted from the social sciences in the first half of the 20th century. Today, it is probably still the most prevalent method used in comparative law studies.

A general problem of functionalism is that laws often do not have one single function, but serve unintended functions, several functions or no function at all. More importantly, the premise that legal systems face similar issues is problematic given the cultural diversity of our society.

¹⁰ Luca Rubini, *The Definitions of subsidies and State aid, WTO and EC Law in comparative perspective.* (Oxford, 2009), p 17.

Comparative research is a research methodology in the different sciences that aims to make comparison across different issues. For the subject of this comparison in general, and for the study of the EU and WTO, the question is whether these legal systems are in fact culturally distinct. The EU and WTO are built on the same foundation: the economic theory that mutual welfare benefits accrue to both parties in cross-border exchanges based on comparative advantage. Most of the appointed director-general of the WTO and before that, the GATT, have been Europeans who earlier held important offices in the European system.¹¹

However, the fact that the EU and the WTO have common roots in economic theory should not deflect attention from fundamental differences in their essential framework and relationship with constituent national governments that define their legal and political cultures. EU has evolved into much broader internal market regime than the WTO, which holds its focus on international trade issues. Furthermore, there are systemic differences in the two trading systems, which make it appropriate to focus less on the details of how the law has developed in each system.

In sum, the comparative analysis in this study is built on the same basis as any comparative law study: an examination of differences between two legal systems with respect to very similar, and thus comparable, functions. I will attempt to attain a balance between a full appreciation of the fundamental similarities in objectives and core principles in the EU State Aid control and WTO disciplines on subsidies, and a critical focus on points of differentiation and legal conflict between them.

Due to the connectivity of methodology and sources, these primary sources will be used in this thesis:

- Agreement on subsidies and countervailing measure.
- General agreement on tariffs and trades.
- Treaty on the functional of the European Union.

And for secondary sources:

- Council Regulation.
- The Draft Community Framework for State Aid for Research and Development and Innovation.
- WTO Agreement, Preamble.

¹¹ Sanford E. Gaines, Birgitte Egelund Olsen, Karsten Engsig Sorensen. " Liberalising Trade in the EU and the WTO". (Cambridge University Press, 2012), p 6.

- WTO, Negotiating Group on Rules, Treatment of Government Support for Export Credits and Guarantees under the Agreement on Subsidies and Countervailing Measures.

5. Overview of the EU's Rules on State Aid

5.1. State Aid Law and Policy

EU State Aid law is part of the EU competition policy aimed at safeguarding undistorted and effective competition in the internal market.¹² The starting point of European Union State Aid policy is that aid given by the individual EU Member States to industrial and commercial undertakings is prohibited as incompatible with the Internal Market. This prohibition is not absolute and there are several areas where State Aid is seen as necessary and fair.

The basic legal framework ruling State Aid control is gathered in Article 107 and 108 of the treaty on the functioning of the European Union (TFEU). The European Union is unique to including the State Aid in its competition law provision and we cannot find any other jurisdiction or trade area with similar provisions. Moreover, the European Commission is trying to reform its State Aid rules. The Commission's aim is to present the State Aid regime more impressive and more equitable, the European Commission wants to achieve a State Aid that will develop innovation, economic growth, and job creation.

The closest provisions to article 107 and 108 TFEU are the Anti-subsidy provisions in the World Trade Organization (WTO), but those are more limited in scope and in enforcement regimes.¹³ The reason why the EU developed itself with such a unique State Aids control regime has to do with the unique politics of the European integration project, and in particular, with the political imperative on ensuring that

¹² Article 3.1 TFEU.

¹³ See eg speech of Vice President Almunia of 11 January 2013, "Doing more with Less-State aid reform in times of austerity; Supporting growth amid fiscal constraints, SPEECH/13/14; and C-D Ehlermann," State aid control in the European Union: success or failure? (1994) 18 Fordham International Law Journal, 1212.

national economic rivalry did not stifle the creation of the internal market that was and remained a central element of that project.¹⁴

The main reasoning for including State Aid control as part of the Treaty of Rome was to avoid State protection from the other Member States, which could conclusively result in a subsidy race. This can be an obstacle to creating an internal market.

Unlike most of the competitions provisions, the EU State Aid rules are regulating the manner of governments instead of companies. Because of this, these provisions are likely to interfere with national sovereignty and national interest than other competition provisions. An argument between governments and EU Commission regarding the State Aid gives the State Aid very special political dimension. Thereupon, third parties have limited procedural rights in State Aid proceeding and they are unable to take part effectively in the debate between the government and Commission.

One of the most important tools to enlarge the benefits of State Aid is a refining of an economic approach to State Aid. More economic approach to State Aid has been implemented through the so-called “balancing test”, which weighs the positive effects of the aid against its negative aid.¹⁵

5.2. The Reason for Granting State Aid

The economic activity and role of governments have been increasing in the twentieth century. The core State Aid rules have been in place since the 1957 Treaty of Rome. The content of the policy has changed over time; the current EU State Aid regime is designed to result in less, but better- targeted aid to raise the European economy. Government investment in many Western European countries went from 10% in gross domestic product in the 1870s to over 40% in the 1970s.¹⁶ The extension of pension schemes, universal health coverage and access to education has been the primary driver for the increased economic role of the state.¹⁷ In order to achieve market stability, the number of services, which became a subject to the State Aid rules increased.

¹⁴ See W Mederer, N Pesaresi and M Van Hoof(eds) EU Competition Law, Vol. € State aid (Claeys &Casteels, 2008) pp26-8.)

¹⁵ Staff Working paper: Common principle for an economic assessment of the compatibility of State aid under Article 87.3(15May2009) for more details; and see further paras 3.29-3.30.

¹⁶ J Hindriks and G Myles, Intermediate Public Economics (MIT Press, 2006), Chapter3.

¹⁷ Keyln Bacon, European Union Law of State aid, (second edition 2013, oxford), p7.

State Aid does remain a politically important instrument for governments to interfere in their economies. Governments often grant State Aid in order to benefit their own enterprises at the expense, among others, of rivals located in other Member states.¹⁸ On the other hand, State Aid may increase economic welfare in two main ways; by improving efficiency and proficiency and by improving equity and fairness. The efficiency objective is commonly referred to as making a pie larger, while the equity objective is commonly referred to as sharing the pie fairly. The discussion of equity issues in the Commissions policy papers is relatively short and high-level.

There is always the risk that powerful and determined stakeholders may influence the political process to achieve a result which is even less efficient for society.

5.3. The Aims of EU State Aid Control

One of the first rationale reason to imposing EU oversight on State Aid is to prevent countries from intentionally using State Aid to benefit their own investments against their rivals located in other Member State. Current economic thinking is less critical towards subsidy races because not all State Aids results in these races and not all races are wasteful since a subsidy race may be a market-oriented mechanism to specify the most efficient location of a production facility.

The common view of State Aid is that it used to distort competition. State Aid can distort the competitive process by crystallizing inefficient industry structures;¹⁹ it may increase private investment; it may diminish impressively competition by increasing market power or by reducing the incentive to compete; it may distort production and location decisions across the Member States, and it may develop excessively risky or otherwise inefficient behaviour.

Now, State Aid control covers only the small part of public spending that involves subsidies to specific economic activities. The Commission instituted a consultation in 2005 designed to reform the State Aid regime.²⁰ In 2012, the European Commission launched a State Aid modernization process, aimed at reducing and directing public spending to areas where it enhances long-term growth and fosters job creation. In recent years, the Commission has been reconsidering its State Aid rules to prepare for this

¹⁸ Keyln Bacon, European Union Law of State aid, (second edition 2013, oxford), p7.

¹⁹ Keyln Bacon, European Union Law of State aid, (second edition 2013, oxford), p10.

²⁰ State Aid Action Plan, Less and Better Targeted State Aid: a RoadMap for State Aid Reform 2005-2009, COM (2005) 107 final.

potential developed role of State Aid control. The main purpose of Commissions reforming is an efficient process for recognizing good aid from bad aid and a more relevant economic way to which State Aid balances the benefits of government intervention in the economy with the distortions of market motivations. Reform of State Aid is still ongoing, with further initiatives planned.

5.4. The Definition of State Aid

State Aid is any advantages granted by the public authorities through state resources on a selective basis to any organizations that could potentially distort competition and trade in the European Union. The definition of State Aid is very broad because “an advantage” can take many forms.

Article 107(1) does not define State Aid. Article 107(1) provides: “Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States, be incompatible with the internal market.”

Definition of State Aid in article 107(1) is incompatible with the internal market, except that aid is permitted by other Treaty provisions. The State Aid is not allowed in the EU but some State Aid is beneficial to the economy and other policy objectives. State Aid can support an activity including research and development, environmental protection. We can find the most of these provisions, in Article 107(2)(3) TFEU and 106(2) TFEU.

The Europeans Court has not yet provided a consistent interpretation of the conditions for State Aid under Article 107(1). The court’s definition of State Aid is often based on the wording of Article 107(1),²¹ but in practice, the court has not adhered to that formulation. The ECJ has made it clear that the concept of aid covers not only positive benefits, such as subsidies, but also measures that reduce the charges an

²¹ Case C-172/03 Heiser (2005) ECR I-1627, Para 27; Case T-8/06 FAB Fernsehen v Commission (6 October 2009). Para 48.

undertaking would normally bear²², such as a supply of goods or services at a privileged rate²³, a diminution in social security contributions²⁴, or tax exemptions.²⁵

Due to the results of the court's interpretation of Article 107(1), all the following criteria must satisfy:

1. There must be aid in the sense of an economic advantage;²⁶
2. The advantages must be granted directly or indirectly through state resources²⁷ and must be imputable to the state;²⁸
3. The measure must favour certain undertakings or the production of certain goods (selectivity).
4. The measure must be liable to distort competition and affect trade between the Member States.²⁹

5.4.1. Economic Advantage

In certain cases, payments made by the State will not constitute aid. For example, investments satisfying the market economy investor principle (MEIP) are not treated as aid. The MEIP is a useful tool in state aid control. However, no text can be exhaustive, and the existing Commission texts which explain the principle do not cover every eventuality. The essence of the MEIP is that when a public authority invests in an enterprise on terms and in conditions which would be acceptable to a private investor operating under normal market economy conditions, the investment is not a state aid. Due to the Altmark case³⁰, compensation paid to undertakings in return for their performing services of general economic interest will not be assumed aid where a few number of conditions are satisfied. The Altmark ruling specified that public service compensation would not constitute State Aid, and hence would not need to be notified if the conditions laid down were met.

²² Case C-237/04 Enirisorse SpA v Sotacarbo SpA (2006) ECR I-2843.

²³ Case C-241/94 France, N 83.

²⁴ Case C- 75/97 Belgium v Commission (1999) ECR I- 3671.

²⁵ Case C- 6/97 Italy v Commission (1999) ECR I-7115.

²⁶ Case C-280/00 Altmark (2003) ECR I-7747, para 83 &84; Case C-34-38/01 Enirisorse v Ministero delleFinanze (2003) ECR I-14243, para 29&30.

²⁷ Case C-379/98 Preussen Elektra (2001) ECR I-2099, para58.

²⁸ Case T-358/94 Air France v Commission (1996) ECR II-2109, para 55.

²⁹Case C-372/97 Italy v Commission (2004) ECR I-3679, para 44.

³⁰ Case C-280/00 Altmark (2003).

Difficulties have arisen where the state takes a shareholding in a private company. In *Intermills*³¹ the ECJ made it clear that no distinction could be drawn between aid granted in the form of loans and aid granted in the form of a holding acquired in the capital of an undertaking. Both could be caught by Article 107(1).³² When capital is invested by a public investor there must be some interest in profitability in the long term, otherwise, the investment will be an aid for the purposes of Article 107(1).³³

5.4.2. Resources and Imputability

A second condition for the application of Article 107(1) is that the aid should be granted by a Member State or through State resources. This feature includes regional as well as central government.³⁴ It is not enough that the measure establishing aid was taken by a public undertaking. It should be shown that the state exercised control over the undertaking and was involved in the adoption of the measures.³⁵ Due to the fact, if all advantages granted by a public or private body, have designed and established by state then it is compatible with Article 107(1).³⁶

5.4.3. Selectivity

To constitute aid, a State measure must favour certain undertakings or the production of certain goods. This requirement is known as the selectivity³⁷ condition and is one of the defining features of State Aid. An aid to individual undertaking is obviously selective.

But in the case of multiple undertakings, the basic problem is that not every measure that can be described as an advantage for one or more group of undertakings over others is regarded as selective as defined in Article 107(1). For assessing the situation, first, the relevant reference system must be identified. Secondly, it must be established whether the measure is *Prima Facie* selective, considering that reference

³¹ Case 323/82 *Intermilles SA v Commission* (1984) ECR 3809.

³² Paul Craig & Grainne De Buca, *EU Law Text, Cases, and Materials*. (Oxford, Sixth Edition), p 1134.

³³ Case C-303-88 *Italy v Commission* (1991) ECR I-1433; Case C-42/93 *Spain v Commission* (1994) ECR I-4175.

³⁴ Cases T-227,229,265,266 and 270/1 *Territorio Historico de Alava v Commission* (2009) ECR II-3029.

³⁵ Case C-482/99 *France v Commission* (2002) ECR I-4397.

³⁶ Case 290/83 *Re Grants to Poor Farmers: Commission v France* (1985) ECR 439.

³⁷ Case C-200/97 *Ecotrade* (1998) ECR I-7907, para 40.

system. A measure is *Prima Facie* selective if it produces advantages exclusively for certain undertakings or certain sectors of activity.³⁸ In less obvious cases (no single undertaking) the court applies a test of whether the measure favours some undertaking. The analysis should begin by identifying the relevant reference framework, or in other words the point of reference for the comparison.³⁹ This does not mean that the reference system is the aid measures itself. It is necessary to refer to a broader criterion applying to most of the undertakings. That criterion should be relatively easy to identify in case of an exemption for a certain category of undertakings, derogation, etc.

The reference system must relate to undertakings in at least the same Member State. A selective aid which causes an advantage for undertakings in one Member State, cannot be assumed as selective if they do not be in a competition position with undertakings in the other Member States.

The reference in Article 107(1) to favouring the production of certain goods makes clear that granting aid to sectors is to be regarded as selective. The court has emphasized that State Aid may exist despite the high number of eligible undertakings and the variety and size of the sectors to which those undertakings belong.⁴⁰

A measure may also constitute selective aid where it indirectly benefits a particular sector. In case of *Commission v Italy* the court applied a Commission decision about an Italian measure granting greater decrease in employee's sickness insurance contributions for female employees than male employees. The measure was found to be State Aid on the basis that it favoured industries employing large numbers of female workers, such as textile, clothing, footwear and leather goods sector.⁴¹

As discussed before, where the relevant reference structure is itself a particular region, measures allowing an advantage in only that region will not be selective. But where the geographic reference framework is the whole of the Member State, aid to a specific region within that State may fall within the scope of Article 107(1).⁴²

Burden and Standard of Proof: In principle, the burden of proof is on the Commission to establish that the measure in question creates differences between

³⁸ Case T-55/99 *GETM v Commission* (2000) ECR II-3207 para 39.

³⁹ Case C-88/03 *Portugal v Commission* (2006) ECR I-7115, para 56.

⁴⁰ C-75/97 *Maribel bislter*, para 32; Case C-126/01 *GEMO* (2003) ECR I-13769, para 39.

⁴¹ Case 203/82 *Commission v Italy* (1983) ECR 2525.

⁴² Case *Germany v Commission* (1987) ECR 4013.

undertakings that are in a comparable factual and legal situation, and is, therefore, selective.⁴³ However, the Court has ruled that where a Member State asserts that a differential measure is justified by the nature of the system, it is for the Member State to obtain the justification claimed. It is not easy to claim that a measure is justified by the nature of the system.⁴⁴

Aid must have an actual or potential effect on trade between the Member States. Except in the case of low-value (*de Minimis*) aid, this jurisdictional test is easily satisfied.

5.4.4. Distortion of Competition and Effect on Trade

A fourth condition for the application of Article 107(1) is that the aid distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods. In many cases, this will be unproblematic. The grant of a subsidy will place the recipient in a more beneficial position. It is no defence for the state to argue that an aid is justified because its effect is to lower the costs of an industrial sector which have, in relative terms, higher costs than other such sectors.⁴⁵

The final element in Article 107(1) is that there should be an effect on inter-state trade. If aid creates the powerful financial position for an undertaking as compared to other undertakings within the EU, then the inter-Union trade will be affected. The fact that the aid is given to an undertaking that only provides local transport services does not preclude an effect on inter-state trade, since the aid may render it more difficult for transport undertakings from the other Member States to enter the market.⁴⁶ It is not obligatory for the Commission to prove that trade will be affected. It is sufficient to show that trade might be affected.⁴⁷

In the case of non-notified aid, if the Commission were required to demonstrate the actual effect of the aid on competition and trade, it would favour those Member States which granted aid in breach of the obligation to notify⁴⁸. If a non-notified aid was likely to distort competition and affect trade at the time of its entry into force, those

⁴³ Case C-279/08 P Commission v Netherlands (judgment of 8 September 2011), para 62.

⁴⁴ Case C-83/98 P France v Ladbroke Racing and Commission (2000) ECR I-3271, AG Cosmas Opinion Para 26.

⁴⁵ Paul Craig & Grainne De Buca, EU Law Text, Cases, and Materials. (Oxford, Sixth Edition), p 1138.

⁴⁶ Case C-280/00 AltmarkTrans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH (2003) ECR I-7747, para 77-82.

⁴⁷ Case 23/98 Alzetta Mauro v Commission (2000) ECR II-2319.

⁴⁸ Case C-301/87 France v Commission (Boussac) (1990) ECR I-

conditions are satisfied even if the measure transpires to have had a little competitive effect. The reasoning is that a Member State that has failed to notify an aid scheme should not be placed in a better position than a State which has complied with its obligation to notify.⁴⁹

The classic test for a distortion of competition is whether the aid reinforces the position of an undertaking in relation to its competitors.⁵⁰ In fact, it should not be important to establish the existence of actual competing undertakings at all; that is clear from the fact that a measure may be regarded as aid even if it extends to a whole sector.⁵¹ If aid is granted in a sector characterized by intense competition, it will usually distort or at least risk of distorting competition.⁵²

A State authority cannot be criticized for not increasing the benefit of the measure to undertakings not established in its territory, and such undertakings are in a wholly different position to undertakings established within the territory.⁵³ Thus in a decision about a proposed change to the Swedish system of deductions from taxable income for fisherman, Sweden's argument that the aim of the change was to bring its tax regime into line with neighbouring States (Denmark and Norway) did not prevent the measure from constituting aid.⁵⁴ Even if the circumstances of the aid show that there is a distortion of competition, the Commission is required to refer its decision to the facts relied upon to can support its conclusion on its condition.

The condition that the aid must be liable to affect inter-State trade is an important requirement since it shows the dividing line between the jurisdiction of the EU authorities and the independent action of the Member States.⁵⁵ It is, therefore, necessary to show that the aid reinforces the position of an undertaking compared with other undertakings competing in intra-EU trade. It is not required for the aid beneficiary to be involved in intra-trade itself.⁵⁶ Even where the beneficiary undertaking does not export its products and operates only in local level, the aid still affects inter-State trade by increasing domestic products power against foreign.

⁴⁹ Case C-351/98 Spain v Commission (2002) ECR I-8031, Para 66-67.

⁵⁰ Case 730/79 Philip Morris v Commission (1980) ECR 2671, Para 11.

⁵¹ AG Darmon in Cases C-72-73/91 Sloman Neptun (1993) ECR I-887, opinion Para 61 & 2.122.

⁵² Case T-214/95 Vlaamse Gewest v Commission (1998) ECR II-717, para 46.

⁵³ Case C-351/998 Spain v Commission (2002) ECR I-8031, para 57.

⁵⁴ Decision 2006/269/EC Tax deductions for professional fisherman (2006) OJ L99/21, para 32.

⁵⁵ Case T-93/02 Confederation nationale du Credit Mutuel (2005) ECR II- 143, para 82.

⁵⁶ Case C-393/04 and C-41/05 Air Liquide Industries Belgium (2006) ECR I-5293, para 35.

5.5. De Minimis Aid

The court has consistently highlighted that even a very small aid, granted to small undertakings, may distort competition and affect trade between the Member States; where the benefit to an undertaking is limited, competition is distorted to a lesser extent but is still distorted.⁵⁷

Even if Article 107(1) itself does not exclude *de minimis* aids, the Commission has taken the view that not all aid has a tangible impact on trade and competition between member States, small amounts of aid to small and medium-sized enterprises (SME).⁵⁸ Aid of no more than EUR 200 000 granted over a period of three years are not regarded as State Aid within the meaning of Article 107(1) TFEU. In order to prevent any abuse, the regulation applies only to transparent *de minimis* aid. Aid is regarded as transparent when the amount can be calculated precisely in advance without needing to carry out a risk assessment.

6. Overview of the WTO's disciplines on Subsidies

6.1. Evolution of the Disciplines

The General Agreement on Tariffs and Trade (GATT) rules on subsidies are found in Article XVI GATT, which has been amended over the years. First, Article XVI imposed on WTO Members an obligation to notify subsidies, including any form of income or price support, that directly or indirectly increase exports or reduce imports of a product in their territory.

Article VI mentions a Member should seek to avoid the use of export subsidies on primary products. If a Member granted such subsidies that worked to increase its export of that primary product, then it had to show that the export subsidy did not destroy the fair of the world export trade. Export subsidies to non-primary products ceased 1

⁵⁷ Case T-214/95 *Vlaamse Gewest v Commission* (1998) ECR II-717, para 46.

⁵⁸ Comment in decision in Case N 599/1999 *Standardised record books for cattle and sheep farmers* (14 December 1999) that the measure budgeted at £150,00 in total, representing about €1 per recipient, would have a purely hypothetical effect on trade between Member States.

january1958 where such subsidies bring the lower price to the product than its domestic price.

The GATT did not include any express definition of subsidy. The WTO disciplines on subsidies are, therefore, primarily covered in the Agreement on Subsidies and Countervailing Measures (SCM). Article VI GATT regarding antidumping duties and countervailing measures is also relevant.

6.2. The Agreement on Subsidies and Countervailing Measures(SCM)

The adoption of the SCM was an outcome of the Uruguay Round. Like all other agreements of the Uruguay Round, the SCM had to be accepted by all the Members as part of the WTO's single package. The SCM is a multilateral agreement and mandatory for all WTO Members. Generally, only subsidies granted to producers of non-primary products or industrial products subjected to the SCM Agreements and subsidies to agricultural products fall within the scope of the Agreement on Agriculture (AoA). The SCM include two forms of rules. The first one refers to the imposition by a WTO Member of countervailing duties on imports from a Member granting a subsidy, where that subsidy damages the former's domestic industry. The second one refers to the multilateral disciplines, the rules that a WTO Member must respect or else find itself in violation of the Agreement and there is always a risk to be asked before the WTO judicial instances (Panel, on appeal, Appellate Body).⁵⁹

Accordingly, contrary to the EU system, there is no ex-ante control of subsidies in the WTO. A Member should apply self-discipline, and other Members can either impose countervailing duties to retaliate their effects on their domestic market or challenge the subsidies granted under the second form.⁶⁰

6.3. Definition of Subsidy

The SCM Agreement covers the first definition of subsidy in GATT/WTO history. A large majority of the experts considered that it covered only subsidies granted

⁵⁹ Claus-Dieter Ehlermann and Martin Goyette, *EU State Aid versus WTO Disciplines on Subsidies*-EStAL(2006), p 696.

⁶⁰ Claus-Dieter Ehlermann and Martin Goyette, *EU State Aid versus WTO Disciplines on Subsidies*-EStAL(2006), p 696.

by governments or by semi-governmental bodies. A subsidy is defined as a “financial contribution”, price or income support by a government or a public body, which confers a benefit on a recipient. It was agreed that the word subsidies covered not only actual payments but also measures having an equivalent effect.

The regulation of subsidies in the WTO is included in two main instruments, the SCM Agreement and the Agreement on Agriculture (AoA). The analysis of the forms of governmental action covered a provision which is particularly notable, the “financial contribution” in the general definition of subsidy of Article 1.1(a)(1) of the SCM Agreement.

6.4. The Agreement on Agriculture

Subsidies which affect trade in agriculture are one of the most contentious subjects addressed by the multilateral trading system. In general, two types of measures need to be discussed: measures which aim at a support of domestic producers and measures which explicitly apply to exports. The WTO’s Agreement on Agriculture (AoA) address both types of measures. The AoA does not prohibit domestic support measures and export subsidies. Instead, Members schedule reduction commitments which are binding for each Member (Article 3.3 AoA). Furthermore, the AoA’s regime on domestic support relies on a system of coloured boxes picture. Support measures which are part of a production limiting programme (blue boxes) are exempt from the inclusion in the calculation of the Aggregate Measurement of Support (AMS) (Article 6(5) AoA). Similarly, subsidies which are mentioned in Annex 2 are also not part of the obligation to reduce domestic support measures. All other measures are subject to the reduction of domestic support.

Export subsidies are covered both by the AoA and the SCM, but the AoA is *lex specialis* and will therefore be applied first. Unlike the SCM, the AoA does not totally outlaw export subsidies. Article 3(3) and Article 8 AoA require that Members do not provide export subsidies unless they are in conformity with the commitments as specified in the schedules of the Members.⁶¹ Export subsidies are defined as subsidies contingent upon export performance (Article 1(e) AoA). Article 9.1 AoA include several export subsidies which are subject to the reduction commitments under the

⁶¹ Rike Krämer and Markkus Krajewski, *State Aid in International Trade Law*, p 420.

AoA. These contain direct subsidies contingent on export performance, sale or disposal for export by governments at a price lower than the comparable price charged in the domestic market or payments on the export of an agricultural product (Article 9(1) AoA).

6.5. Financial Contribution and Cost to Government

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

- i. Direct transfer of funds and potential direct transfers of funds or liabilities (loan guarantees)
- ii. Government income that is otherwise due is foregone or not collected. (e.g. tax credits and other fiscal incentives)
- iii. Provision of goods or services other than general infrastructure or government purchase of goods.
- iv. a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments.⁶²

The concept of financial contribution ensures that not all government measures that confer benefits are deemed to be subsidies.⁶³ Because of the function of limitation, according to the Panel, those forms (listed in items (i) to (iii)) should be considered exhaustive. There are two necessary elements of a subsidy under SCM Agreement; the presence of a financial contribution and a benefit. The Appellate Body in Brazil-Aircraft sanctioned the Panel's commingling the concept: "In its interpretation of Article 1.1(a)(i), the Panel imported the notion of a benefit into the definition of a "financial contribution". We see the issues and the respective definitions of a "financial contribution" and a "benefit" as two separate legal elements in Article 1.1 of the SCM Agreement, which together determine whether a subsidy exists.⁶⁴ The Panel concluded that the focus of the financial contribution assessment must, therefore, be on the

⁶²SCM Agreement, Article 1(1.1) (a).

⁶³ Claus-Dieter Ehlermann and Martin Goyette, *EU State Aid versus WTO Disciplines on Subsidies- EStAL(2006)*, p 697.

⁶⁴ Report of the Appellate Body Brazil- Export Financing Programm for Aircraft, WT/DS46/AB/R, 2 August 1999, (Brazil- Aircraft) , paragraph 157.

government's action rather than its possible effects on those especially affected, even if those effects or reactions can be expected.

The Panel found that the SCM Agreement regulated only certain forms of governmental action that distort or may distort international trade.⁶⁵ In other words, the function of the financial contribution requirement is to ensure that not all government measures that confer benefits can be deemed to be subsidies. After the Article 1.1(a)(1) makes clear that a financial contribution by a government or public body is an essential component of a subsidy, the Appellate Body has recognized that paragraph (i) through (iv) of Article 1.1(a)(1) set forth the situations where there is a financial contribution by a government or public body.⁶⁶ Consequently, not all government who are capable of measuring conferring benefits would necessarily fall within Article 1.1(a), otherwise, there would be no need for the financial contribution because all government measures conferring benefits, per se, would be subsidies.⁶⁷

According to the Panel, all forms of financial contribution include a clear transfer of economic resources in the form of a transfer of something of value, either money, goods or services, from the government or an intermediary to a private entity. The last paragraph of Article 1(1.1) (a) (iv) SCM Agreement seeks to prevent a Member States from doing indirectly what it cannot do directly.

In US-Export Restraints, the US were substantially claiming that the key factor in the interpretation of the terms “entrust” and “direct” in Article 1.1(a)(iv) was the causal relationship between the action by the government and the conduct of the private body. An export restraint would thus fulfil the required “direction” when the producer of the restrained goods has no other choice but to sell in the domestic market.⁶⁸

In the US- DRAMS dispute, the Appellate Body took a significant step further by rejecting the view that the concepts of entrustment and direction be limited to the notions of delegation or command.

It has been said that the two forms of indirect action under the fourth subparagraph are aimed at capturing equivalent government actions.⁶⁹ This assimilation is put into doubt by the recent interpretation of the term “entrust” in the other form of

⁶⁵ Panel, Canada- Aircraft, para 9. 119.

⁶⁶ Appellate Body, US- DRAMS, para 107 & 108.

⁶⁷ Appellate Body, US- DRAMS, para 114, US- Softwood Lumber IV, para 52, n35.

⁶⁸ Luca Rubini, *The Definitions of subsidies and State aid, WTO and EC Law in comparative perspective.* (Oxford, 2009), p 112.

⁶⁹ Panel, US_Export Restraints, para 8.32.

indirect action which, according to the Appellate Body, would not necessarily refer to an act of delegation. If this is correct, the financial contribution through a funding mechanism would arguably be characterized by a more direct and intense course of action than the entrustment of a private body to carry out a financial contribution. The government makes a payment to a funding mechanism which is there exclusively to finance somebody, and hence any payment received from the government should almost automatically be used for such mission.⁷⁰

The words “practices normally carried out by governments” are the true core of this provision and more generally of the whole subparagraph(iv). It seems that normal governmental practice should be given a specific meaning, referring to the forms of action that involve the exercise of the prerogatives of taxation and expenditure. This is the view that passed across time from the GATT to the WTO. In 2001, US- Export Restraints Panel said: “We find very significant the Group of Experts interpretation that the 1960 Panel’s reference to practice in no real sense different from those normally followed by governments was a general reference to the delegation to private parties of the particular government functions of taxation and expenditure of revenue, and not a reference to government market interventions in the general sense, or the effects thereof.”⁷¹

In conclusion, the concept of financial contribution substantially follows the GATT notion of subsidy. It generally refers to well-defined and commonly agreed forms of governmental action involving a clear transfer of economic resources, which, directly or indirectly, call for the exercise of the powers of taxation and expenditure, forms of financial assistance. Despite the uncertainty raised by recent Appellate Body’s findings on the standards of imputability in the case of indirect action, a proper construction of the concepts of entrustment and direction, and of the two last sentences in subparagraph(iv), would preclude that more complex course of regulatory action could be covered.⁷²

The recognition in the SCM Agreement that a financial contribution is granted when a government “entrusts” or “directs” a private body to provide a financial

⁷⁰ Luca Rubini, *The Definitions of subsidies and State aid, WTO and EC Law in comparative perspective*. (Oxford, 2009), p 116.

⁷¹ Panel, *US-Export Restraints*, para 8.72.

⁷² Luca Rubini, *The Definitions of subsidies and State aid, WTO and EC Law in comparative perspective*. (Oxford, 2009), p 122.

contribution under Article 1.1(a)(1) (i)-(iii) suggests that the definition of a subsidy under the Agreement is broader than that of “State Aid” in EU Law. EU Law requires that, for a measure to constitute State Aid, it must correspond to a government expenditure. This is referred to as the requirement of a “charge on the public account”.

⁷³ In *Sloman Neptun* case⁷⁴, the European Court of Justice examined a measure enabling certain shipping undertakings flying the German flag to subject non-EU national’s seafarers to working and pay conditions less favourable than those applicable to German nationals. The court refused to consider such a measure as State Aid and affirmed that only advantages that are granted directly or indirectly through States resources are to be regarded as State Aid within the meaning of Article 87 TEC (Now 107 TFEU).

In more recent case, the ECJ found that the measures in question, while conferring an economic advantage on renewable energy producers, did not involve any direct or indirect transfer of State resources to undertakings which produce that type of electricity,⁷⁵ and remarked that: “the case-law of the Court of Justice shows that only advantages granted directly or indirectly through State resources are to be considered aid within the meaning of article 107 TFEU”. In the *PreussenElektra* case, the court followed the well-reasoned opinion of Advocate General Jacobs and reaffirmed its position.⁷⁶ The court concluded that national legislation requiring private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum process higher than the real economic value of that type of electricity did not constitute State Aid within the meaning of Article 107(1) because there was no direct or indirect use of State resources.

In sum, State Aid will only exist, under the current Court jurisprudence, where the measure entails a direct or indirect transfer of state resources to a certain undertaking.⁷⁷ In such cases, measures taken by private actors can be imputed to the State. By contrast, no “cost to government” requirement exists under WTO Law, with the result that various government-mandated measures that do not impose a “cost” on the granting

⁷³ Do Different Treaty Purposes Matter for Treaty Interpretation? A Comparison of WTO and EC Law, London, Cameron May, (2005), p 97-126.

⁷⁴ Cases C-72/91 and C-73/91-Firma Sloman Neptun Schiffahrts AG v. Seebetriebsrat Bodo Ziesemer der Sloman Neptun, (1993) ECR-I887, para 18.

⁷⁵ Case C-379/98, *PreussenElektra AG v. Schlesweg AG*, (2001) ECR-I2099, para 59.

⁷⁶ Case C-379/98.

⁷⁷ *Bronckers/Quick*, What is a countervailable subsidy under EEC Trade Law?, *Journal of World Trade*, 23(6), (1989), page 5.

government are nonetheless regarded as subsidies,⁷⁸ meaning that several subsidies that would not constitute State Aid under EU rules will nevertheless constitute subsidies under WTO Law. This result is obvious from the text of Article 1.1(a)(1)(iv) given that government instructions to a private body, for instance, a private bank, to grant a financial contribution will satisfy the definition of subsidy.

Thus, the requirement in EU Law that a measure corresponds to a charge on the public account signifies that EU State Aid Law is more lenient than the WTO's disciplines on subsidies.⁷⁹

6.6. Benefit

WTO and EU Law have a similar requirement. In both systems, a Subsidy or State Aid will be created, if it confers an advantage on the recipient. Whether an advantage is conferred is defined in relation to the marketplace.

In Canada-Aircraft, the Appellate Body mentioned that, because there can be no benefit unless the financial contribution makes the recipient “better off” than it otherwise would have been, the notion of benefit implies a comparison. The marketplace provides an appropriate basis for comparison in determining whether a “benefit” has been “conferred” because the trade-distorting potential of a “financial contribution” can be identified by determining whether the recipient has received a “financial contribution” on terms more favourable than those available to the recipient in the market.⁸⁰

The definition of subsidy is discussed by the Panel in EC-DRAMs. The Panel noted that the existence of a benefit is a constitutive element of the definition of a subsidy. The Panel mentioned that if the public or publicly directed financial contribution is provided under the same condition as a private market player would have provided, then there would be no reason to impose any disciplines, simply because the financial contribution was provided by the government.⁸¹

⁷⁸ Appellate Body, Canada-Measures Affecting the Export of Civilian Aircraft, WT/DS70/AB/R, 2 August 1999, para 160.

⁷⁹ Claus-Dieter Ehlermann and Martin Goyette, EU State Aid versus WTO Disciplines on Subsidies- EStAL(2006), p 699.

⁸⁰ Appellate Body Report, Canada – Aircraft, para 157.

⁸¹ Report of the Panel, EC – DRAMs, para 7.175- 7.178.

It is also to be mentioned that benefit does not always need to be established, for instance, the SCM Agreement contains an illustrative list of export subsidies and as we know export subsidies is forbidden; benefit, therefore, needs not be established separately.

In the light of the Article 14 SCM, it is not always the market that determines a benchmark. In Lumber IV, the US had argued that the price of lumber in Canada did not represent the valid commercial benchmark. The US authorities have used a so-called cross-border benchmark, i.e. they used as a benchmark the price of lumber of comparable species in neighbouring US States. The Appellate Body found that although domestic market conditions provided the starting point for the analysis, certain conditions prevailing on the market might justify the use of other benchmarks.⁸²

EU State Law includes a concept similar to that of “benefit”. It is necessary that there is an aid favouring certain undertakings or the production of certain goods, in other words, that it confers an advantage on the recipient.⁸³ While sometimes formulated differently, the operation is the determination of a benefit under WTO law. The test is whether the benefit would not have been received in the normal course of business, or under normal market conditions.⁸⁴ Thus, also under EU State Aid Law, the relevant benchmark is the market.

6.7. Specificity

Specificity is not a requirement for a subsidy under WTO law. But subsidies are only subject to the provision of parts II (prohibited subsidies), III (actionable subsidies), and V (CVDs) of the SCM Agreement if it is specific within the jurisdiction of the granting authority. Prohibited subsidies are assumed specific, meaning that even if they are available to all enterprises, the disciplines of part II and V will apply.⁸⁵ The Panel, in Korea-Vessels, held that a subsidy that is specific by Article 2.3 SCM is automatically specific for both part II (prohibited export subsidy) and part III (actionable subsidy) claims.⁸⁶

⁸² Appellate Body Report, US-Lumber IV, para 80-122.

⁸³ Case C-353/95, Tierce Ladbtoke v. Commission, (1997), ECR I- 7007.

⁸⁴ Case C-39/94, Syndicat Francais de IExpress international (SFEI) and others v. La Poste and others, (1996) ECR I- 03547, para 60-62.

⁸⁵ Article 2.3 SCM.

⁸⁶ Korea – Vessels, Panel para 7.514.

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

- i.** Where access to a subsidy is explicitly limited to certain enterprises, by the granting authority, or the legislation pursuant to which it operates.⁸⁷
- ii.** The presence of objective criteria: specificity does not exist where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions. The criteria or conditions must be clearly spelled out in law, regulation, or another official document, to be capable of verification.⁸⁸
- iii.** A subsidy may be specific even in the absence of clear limitation to certain enterprises or the presence and adherence to objective criteria or conditions. If we can prove that a subsidy is specific, then other factors will be considered; for example, the use of a subsidy by a limited number of certain enterprises or predominate use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises and the way in which discretion has been exercised by the granting authority to grant a subsidy.⁸⁹
- iv.** Article 2.2 SCM addresses the special rules for regional aid; a subsidy which is limited to specified enterprises located within a geographical region within the jurisdiction of the granting authority shall be specific. This means that a subsidy granted to all enterprises in a certain region is non-specific.⁹⁰

There is relatively little WTO jurisprudence on the issue of specificity. The US – Cotton Panel found that an industry or group of industries could be defined by reference to the type of products they produce. In the Panel’s view, a subsidy would not count as specific if it is sufficiently broadly available throughout an economy as not to benefit a limited group of producers of certain products.⁹¹ Accordingly, it noted that subsidies would be considered as specific when they are limited to a restricted number of agricultural products and not generally available in all agricultural production.

For the panel, Article 2 SCM addresses the limitation to or predominant use of a subsidy by a limited number of certain eligible enterprises. Finally, the Panel held that

⁸⁷ Article 2.1(a) SCM.

⁸⁸ Article 2.1(b) SCM.

⁸⁹ Article 2.1(c) SCM.

⁹⁰ Dunkel draft (Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, GATT document MTN.TNC/W/FA.20 December 1991, p1.3, Article 2.2.

⁹¹ Report of the Panel, Unites States – Subsidies on Upland Cotton, WT/DS267/R 8 September 2004, para 7.1142.

specificity is examined at the enterprises or industry, not product level, what matters is this fact that the subsidy is limited to specific industries or groups of industries.⁹²

The concept of selectivity in EU State Aid Law does not differ fundamentally from the concept of specificity under WTO Law. Article 107(1) TFEU requires an assessment of whether a State measure is such as to favour certain undertakings or the production of certain goods in comparison with other undertakings. As previously mentioned, the concept of selectivity is rather broad and embraces all measures that are not of general application. The ECJ held that neither a large number of eligible undertakings nor the diversity and size of the sector to which those undertakings belong, provide sufficient ground to conclude that a measure is a general measure of economic policy.⁹³

Thus, unlike under WTO Law, aid that is limited to SMEs is selective. The fact that some sector's benefit more than others does not necessarily make a measure selective,⁹⁴ but aid granted under measures of general application may become selective where the administering authority is granted a wide discretion in applying it and in determining the manner of the aid granted.⁹⁵

However, one important difference between WTO and EU Law is that of regional selectivity. Subsidies applying only to part of a Member's territory are non-specific in the sense of the SCM Agreement if these subsidies are available to all enterprises in the region. Under EU Law, these subsidies could well be specific.⁹⁶

Furthermore, there are some specific measures, adopted by regional authorities, in the field of taxation. In the Azores case, the court rejected arguments by the Commission that claimed a reduction in the national tax rate, decided by regional authorities which applied only to the territory subject to their jurisdiction was necessarily selective.⁹⁷ In such a case, it is the area in which the intra-State body responsible for the measure exercises its powers and not the country as a whole. The court held that in such a case, it is appropriate to examine whether the measures was

⁹² US – Lumber IV, Panel Report, para 7.121.

⁹³ Case C 143/99, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v. Finanzlandesdirektion für Kärnten*, (2001), ECR I-8365, para 35-41.

⁹⁴ Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ 1998 C384/3, point 14.2. Case 203/82, *Commission v. Italy*, (1983) ECR I-225.

⁹⁵ Case C-241/94, *French Republic v. Commission of the European Communities*, (1996), ECR I-4551, para 23&24.

⁹⁶ Claus-Dieter Ehlermann and Martin Goyette, *EU State Aid versus WTO Disciplines on Subsidies- EStAL(2006)*, p 704.

⁹⁷ Case C-88/03, *Portugal v. Commission*, (2006), Para 57.

adopted by the exercise of powers sufficiently autonomous vis-à-vis the central power.⁹⁸ Another situation is where a local authority adopts a tax rate lower than the national rate and which is applicable only to undertakings present in the territory within its competence. The court notified a number of factors relevant to determine whether a decision adopted in this context can be regarded as having been adopted in the exercise of sufficiently autonomous powers: **First**: the decision must have been taken by a local authority which has a political and administrative status separate from the central government. **Second**: it must have been adopted without the central government being able to directly interfere. **Finally**: the financial consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government.⁹⁹

It is not clear how the same situation would be addressed by WTO Panels and the Appellate Body under Article 2.2 second sentence, a horizontal tax rate decided by a regional government would not be specific, even if that tax rate is lower than the national rate.

In conclusion, it seems that the EU and WTO in this concept are generally similar in their basic doctrine but, the concept of selectivity under EU Law and the concept of specificity under WTO Law differ in some aspect. It seems that the EU Law concept has a broader reach in certain cases (e.g. regional specificity or aid limited to SMEs).

6.8. Other Criteria of the Definition of State Aid in EU Law

As it says before, a measure of support in EU Law only considered State Aid if it affects trade between the Member States, and distorts the competition in the common market. *Prima facie*, these requirements are additional to those of the WTO, such they may not being recognized as State Aid but nonetheless constituting subsidies under the SCM Agreement. The Commission and European Courts interpreted the requirement broadly at **first**, for instance, there is no need that the beneficiary of the aid participates directly in intra-community trade.¹⁰⁰ **Second**, financial support which is either *de minimis*,

⁹⁸ Case C-88/03, Portugal v. Commission, (2006), Para 62.

⁹⁹⁹⁹ Claus-Dieter Ehlermann and Martin Goyette, EU State Aid versus WTO Disciplines on Subsidies- EStAL(2006), p 704.

¹⁰⁰ Case C66/02, Italian Republic v. Commission of the European Communities, (2005), ECR I-10901, para 117.

and does not affect trade between the Member States or does not distort competition in the common market would ever be challenged before the WTO.

6.9. State Aid That is Compatible with the Common Market

The presumption in Article 107(1) that State Aid is incompatible with the common market is not absolute. Article 107(2)(3) TFEU orders and allows the Commission to declare that certain State Aid measures are compatible with the common market. The Commission has developed a body of Guidelines, Communications and Block Exemptions to guide the exercise of the discretion under Article 107(3), as well as provide some predictability to the Member States and affected undertakings.

This truth that State Aid is so authorized, creates a real risk of conflict with WTO Law. It is just because, since the disappearance of the concept of non-actionable subsidies, the SCM Agreement recognizes no exception of its disciplines based on the objectives of a measure. Measures which the Commissions finds are compatible with the common market may fall under the SCM Agreement's provision.

The risk of conflict with the WTO disciplines is real because of following reasons;

- i.** Aid authorized based on Article 107(3): given that they concern large investment projects, such aid, where provided to undertakings exporting to the world market, are likely to cause adverse trade effects.¹⁰¹
- ii.** Aid authorized based on Article 107(3)(b), i.e. aid to promote the execution of an important project of European interest, such as aid for Airbus.
- iii.** Aid authorized under Article 107(3)(c), such as rescue and restructuring aid, for example aid seems to offer the greatest danger of a creation by the EU's international counterparts as aid to firms in financial difficulties will often take the form of operating aid which a priori has the potential of causing adverse trade effects.¹⁰²

7. Types of Subsidies under WTO Law

The SCM Agreement recognizes two different categories of subsidies; prohibited subsidies and actionable subsidies. Such subsidies can be either countervailed or subject

¹⁰¹ Communication on Multisectoral Framework on regional aid for large investment projects, OJ 2002 C 70/8.

¹⁰² Commission Communication on the Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty, OJ 2004, C244/2.

to dispute settlement. From the beginning and until 1999, a third type added; non-actionable subsidies.¹⁰³ This was, in fact, a means of shielding certain subsidies regarded as non-distortive or action like certain R&D, regional assistance, and environmental subsidies. Non-specific subsidies were also included in the category of non-actionable subsidies.

There are two types of prohibited subsidies: export subsidies and import substitution subsidies. In both cases, the conditions attached to the granting of the subsidy lead to prohibition. By contrast, a subsidy is actionable when it causes adverse effects on another Member's interests.

7.1. Prohibited Subsidies

The main question in the context of WTO dispute settlement is whether the subsidies are indeed export subsidies. Footnote 4 to the SCM Agreement provides that: "This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision."

The Appellate Body has interpreted the meaning of export contingency in *Canada-Aircraft*,¹⁰⁴ that says; the legal standard represented by the word "contingency" is the same for both de jure and de facto contingency and as we see in footnote 4, three elements need to be established for export contingency: (1) the granting of a subsidy, (2) that it is ... tied to (3) actual or anticipated exportation or export earnings. In the Appellate Body's view, the analysis of the first element focuses on the granting authority, not the recipient's knowledge.¹⁰⁵ The Appellate Body understood that "tied to" confirms the linkage of "contingency" with "conditionality" in Article 3.1(a) SCM Agreement, so that the fact must "demonstrate" that the granting of subsidy is tied to or contingent upon actual or anticipated exports. The third element refers to an

¹⁰³ Part IV of the SCM Agreement, Article 31 SCM provided that part IV would only apply for a period of five years unless extended by the WTO Members. Since no extension was agreed, the provisions of part IV lapsed on 1 January 2000.

¹⁰⁴ Appellate Body Report in *Canada-Aircraft*, para 162-180.

¹⁰⁵ Appellate Body Report in *Canada-Aircraft*, para 170.

expectation. The Appellate Body reasoned a subsidy may be granted in the knowledge, or with the anticipation, that exports will result, is not sufficient.

7.2. The Illustrative List of Export Subsidies

In some cases, the SCM Agreement helps complaining WTO Members to establish that a measure is prohibited export subsidy. There is an illustrative list of export subsidies in Annex A, that has 12 entries. This list is not exhaustive. The list contains examples of prohibited export subsidies, but it does not prevent the existence of other such subsidies under the terms of Article 3.1.¹⁰⁶

Meanwhile, under the terms of Article 3.1, measures referred to in the list as not constituting export subsidies are not prohibited under either Article 3.1 or any other provision of the SCM. Furthermore, measures that fall under the scope of the illustrative list are deemed to be prohibited export subsidies, i.e. the list allows a Member to directly go to the list to show that a measure is a prohibited subsidy, without having to first demonstrate that the measure falls within the scope of Article 3.1(a) SCM.¹⁰⁷ Thus, the list provides a shortcut for an aggrieved Member to establish that another Member grants a prohibited export subsidy.¹⁰⁸

Most of the items on the list are of no particular interest. However, item (k) on list creates some controversy. Item (k) says: “The grant of export credits at rates below those that governments actually have to pay for the funds so employed or the payment by governments of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.”

Item (k) is composed of two paragraphs. The first establishes the general rule and the second paragraph provides for what has been termed a “safe harbour”: export credit practices which would otherwise be prohibited under the first paragraph will nevertheless not be prohibited if they are in conformity with the interest rate provisions of an international undertaking on official export credits to which at least twelve original Members to SCM Agreement are parties as of 1 January 1979. In practice, the Organization for Economic Co-operation and Development (OECD) Arrangement on

¹⁰⁶ Report of the Panel, Brazil-Export Financing Programme for Aircraft, Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW, 9May 2000, para 6.30.

¹⁰⁷ Report of the Panel, Brazil-Aircraft (21.5), para 6.31.

¹⁰⁸ Report of the Panel, Brazil-Aircraft (21.5), para 6.42.

Guidelines for Officially Supported Export Credits is the only such international undertaking.¹⁰⁹

The OECD Arrangement provides the framework for the orderly use of officially supported export credits and essentially avoids a race to the bottom among OECD countries trying to offer the best possible export credit terms. Moreover, the reference to the OECD Arrangement is an evolving one: by the very terms of paragraph 2 of item (k), the reference is to the version of the Arrangement currently in force. This means the Arrangement can be modified by the OECD Members without the approval of the rest of the WTO membership.¹¹⁰

In other word, a sub-group of the WTO (composed of mostly developed countries) can unilaterally change the terms of the SCM Agreement. This interpretation has bothered some of the WTO`s non-OECD members, such as Brazil. Brazil has fought against the interpretation and in a recent proposal in the context of Doha negotiations, Brazil made a proposal that would cure this perceived injustice.¹¹¹

Due to this fact, the Panel and Appellate Body in Brazil-Aircraft dedicated a lot of attention to the interpretation of the first paragraph of item (k). Brazil argued that the last clause in the first paragraph could be interpreted a contrary and payments not conferring a material advantage not only are not prohibited export subsidies but, are in fact permitted by the SCM Agreement. Also, Brazil argued that “material advantage” had to be read in relation to what other Members provide their exporters.¹¹²

Brazil`s argument was rejected by two of the three Panels.¹¹³ The panel argued that Brazil`s reading of item (k) was at odds with the general way the SCM Agreement determines benefit.¹¹⁴

Thus, the Panels and the Appellate Body refused a reading that makes compliance dependent on another Member`s practices. Regarding to the second paragraph of item (k), the main issue came in the Canada-Aircraft (21.5) case. The Panel in that case

¹⁰⁹ Report of the Panel, Canada-Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU, WT/DS70/RW, 9 May 2000, para 5.78.

¹¹⁰ Report of the Panel, Canada-Aircraft, para 5.132, 5.68.

¹¹¹ WTO, Negotiating Group on Rules, Treatment of Government Support for Export Credits and Guarantees under the Agreement on Subsidies and Countervailing Measures, TN/RL/GEN/66, 11 October 2005, para 4 ff.

¹¹² Report of the Panel in Brazil-Aircraft, para 7.15, Appellate Body Report, para 165.

¹¹³ Report of the Panel, Brazil-Aircraft, Para 7.18, Report of the Appellate Body, Brazil-Export Financing Programme for Aircraft, /DS46/AB/R, 2 August 1999, para 187.

¹¹⁴ Report of the Panel, Brazil-Aircraft, para 7.24-26.

examined in detail the various components of the safe harbour. First, it examined what constitutes an export credit practice for the purpose of the second paragraph of item (k). For the Panel, the export credit practices that could potentially qualify for the safe harbour of item (k) were a broad category of measures. The Panel then assessed the Arrangement's "interest rate provisions" with which an "export credit practice" ought to conform in order to benefit from the safe harbour and found that they were the OECD Arrangement's provision which specifically, address interest rate support in the form of direct credits, refinancing and rate support at fixed interest rates with repayment of two years or more.¹¹⁵ The Panel examined, whether, as argued by Canada, the Arrangement's matching derogation was covered by the safe haven.¹¹⁶ Canada's reading of the scope of the safe haven was simply at odds with the overarching principles and purposes of the WTO Agreement and SCM Agreement:¹¹⁷ "we believe that an interpretation of item (k) that would create a very broad exemption from prohibition in respect of export credits would not be consistent with the purpose of that prohibition in the context of the SCM Agreement."

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

7.3. Actionable Subsidies

The second type of subsidies is actionable subsidies. Actionable subsidies are defined by their effects not their nature: a subsidy is actionable when it causes adverse effects to another Member's interests.¹¹⁸ Whether a subsidy meets the conditions set out under part III of the SCM Agreement, dealing with actionable subsidies, is determined by a dispute settlement panel.

Adverse effects are explained:

- i.** Where another Member's industry is injured because of the subsidies.
- ii.** Where benefits accruing directly or indirectly to another Member under the GATT are nullified or impaired.

¹¹⁵ Report of the Panel, Brazil-Aircraft (21.5 II), para 5.96.

¹¹⁶ Report of the Panel, Canada-Aircraft (21.5), para 5.137.

¹¹⁷ Report of the Panel, Canada-Aircraft (21.5), para 5.139.

¹¹⁸ Article 5 SCM.

iii. Where the subsidy causes serious prejudice to the interest of another Members.¹¹⁹

7.3.1. Injury

Injury is defined in similar terms as the injury that must be established before CVDs can be imposed, as prescribed under Article 15 SCM.¹²⁰ Thus, it refers to material injury to a domestic industry or material retardation of the establishment of such an industry. The determination of injury is difficult. There is a need to examine of the volume of subsidies imports, their effects on prices of the domestic product and impact of the imports on domestic producers.

7.3.2. Nullification or Impairment of Benefits

Nullification and impairment have the same concept that is in the Article XXIII of GATT 1994. Article XXIII recognizes two types of nullification or impairment: “Violation nullification or impairment”, like the quasi-rebuttable presumption of nullification or impairment flowing from a Member not respecting its obligation under the Agreement, and “non-violation nullification or impairment”, like impairing or nullifying the benefits of another Member received from the provisions of the Agreement without violating a provision of the Agreement.¹²¹

7.3.3. Serious Prejudice

Serious prejudice is defined as: displacement or impedance of the imports of another Member’s imports into the market of the subsidizing Member or in a third country market; or significant price undercutting, price suppression, price depression on another Member’s products by the subsidies products in the same market or lost sales in the same market; or an increase in the world market share of the subsidizing Member in a particular subsidized primary product compared to the average share it had in the

¹¹⁹ Claus-Dieter Ehlermann and Martin Goyette, *EU State Aid versus WTO Disciplines on Subsidies-* EStAL(2006), p 710.

¹²⁰ Article 5(a) SCM, note 11.

¹²¹ Anderson Husisian, *The Sbsidies Agreement*, in Stewart, *The world Trade Organization: The Multilateral Framework for the 21 st Century and U.S. Implementing Legislation*, Washington D.C., American Bar Association, Section of International Lawand Practice, (1996), P 314.

previous three years and this increase follows a consistent trend over a period when subsidies have been granted.¹²²

7.4. Non-Actionable Subsidies

The most difficult category is the green basket of non-actionable subsidies (Article 8 SCM). This category was included because of European pressure. The EU tried to transpose its State Aid exception system to the WTO level with the notion of non-actionable subsidies, in order to create legal security for the EU Member States.¹²³

State Aid granted legally in the EU should be following WTO disciplines and not be subject to countervailing duties. The US, in contrast, was opposed the green basket. In their view this category would make it easier for Member States to avoid the SCM Agreement by hiding their measures as non-actionable subsidies.¹²⁴ In addition, developing countries were concerned that the provision favours developed countries interests.¹²⁵

Unlike the SCM, the green category in the EU, Article 107(2) TFEU, is applicable. Therefore, State Aid granted legally in the EU may sometimes not comply with WTO law or trigger countervailing duties.

7.5. Remedies

The SCM Agreement also contains rules on trade remedies. Remedies include measures applicable to prohibited, actionable or non-actionable subsidies. Remedies can be adopted either at the international level through the dispute before the Dispute Settlement Body (DSB) or can be pursued at the national level through countervailing duties. The purpose of both systems is the correction of the market distortion caused by subsidy. Countervailing duties evaluate the effect of the subsidy on the national market and withdrawal of the subsidy and reduce the effect on third markets are Dispute Settlements Body' tasks.

¹²² Article 6.1 of the SCM.

¹²³ Didier, 1999, p 256.

¹²⁴ Luengo Hernandez de Madrid ,2007, p 87.

¹²⁵ Minutes of the regular meeting of the Committee on Subsidies and Countervailing Measures held on 1-2 November 1999, G/SCM/M24.

7.6. The Different Procedures Before the DSB

The possibilities of claims before the DSB depends on the different categories of subsidies. One difference is the procedure time. The procedure time for prohibited subsidies is shorter than actionable subsidies.¹²⁶

The procedure for prohibited subsidies is established in Article 4 SCM. If the Panel distinguishes that the measure in question is a prohibited subsidy, it recommends the withdrawal of the subsidy. The Panel report will be adopted by the DSB unless it is appealed against the WTO's Appellate Body and it will have to decide on the matter.¹²⁷ If a Member does not accept the Panel or Appellate Body's recommendations, the DSB can authorize the adoption of appropriate countermeasures (Article 4.10 SCM).

Article 7 SCM defines the procedure for actionable subsidies. When the Panel ascertains the Member has two possibilities to react against actionable subsidies. First, the Member can take appropriate steps to remove the adverse effects. second, the Member can withdraw the subsidy. If the Member does not react appropriately, the DSB can allow the complaining Member to take countermeasures, unless the DSB decides by consensus to reject the request.

7.7. Countervailing Duties and Other Types of Unilateral Measures

Another instrument against distortive subsidies provided for in the SCM Agreement are countervailing duties on another Member's products. Unlike the withdrawal of a subsidy, countervailing duties only neutralize the effect of the subsidy on the Member's market. Rules governing the countervailing duties (CVDs) by a WTO Member against another member's products establishes in part V of the SCM Agreement. A Member may bring a challenge before the WTO's judicial instances, like under track II, if another Member has imposed CVDs on its exports in contravention to these substantive and procedural requirements.

Countervailing duties are an unfair trade remedy just like anti-dumping duties. They are adopted to rectify what is an unfair market practices. Both are applied in a similar manner but the main distinction is that CVDs counteract a government's actions

¹²⁶ Article 4 & 7 SCM Agreement.

¹²⁷ Rike Krämer and Markkus Krajewski, *State Aid in International Trade Law*, p 418.

while anti-dumping(AD) measures counteract the private entity's action (selling at less than it sells on its home market or at an abnormally low price in order to take market share). It should be mentioned that both actionable and prohibited subsidies can be countervailed.

A Member must respect procedural requirements, that the SCM Agreement establishes, before duties can be imposed. Countervailing duties may only be imposed after the following; the existence of a prohibited or actionable subsidy, injury to the domestic industry and causation between two, have been established.

Today, all types of subsidies can be countervailed, even those that had previously fallen in the non-actionable category, for instance regional aid, environmental subsidies and R&D subsidies.

The EU has countervailed not only export subsidies, but also other types of subsidies, such as regional assistance¹²⁸ or domestic support subsidies.¹²⁹ In fact, The EU has also countervailed services.¹³⁰ In conclusion, unlike the EU Law, the withdrawal of the subsidy is not the only possible remedy. Instead, countermeasures, that is, measures authorized by the DSB, or countervailing duties, that is, measures provided for in the SCM, are options within the SCM framework.¹³¹

8. Matching Subsidies

There are, besides the countervailing duty instrument, other types of unilateral actions that can be used by a Member in response to foreign subsidies. The clearest instrument that comes to mind are "matching subsidies". Matching is a technique, which is allowed under the OECD Agreement on guidelines for officially supported export credits, referred to in item (k) of the illustrative list. On the contrary, several panels have found that the matching derogation of the OECD Arrangement is not covered by the "safe haven" provisions of the second paragraph of item (k). In order to be compatible with WTO, a matching subsidy needs to be SCM Agreement-consistent on its own

¹²⁸ Commission Regulation (EC) NO 1810/1999 of 17 August 1999 imposing a provisional countervailing duty on imports of polyethylene terephthalate (PET) FILM originating in India, OJ 1999 L 219/14.

¹²⁹ Council Regulation (EC) NO 1891/97 of 26 September 1997 imposing a definitive countervailing duty on imports of farmed Atlantic Salmon Originating in Norway, supra note 107.

¹³⁰ Bronckers/Goyette, supra note 3, p 155.

¹³¹ Rike Krämer and Markkus Krajewski, State Aid in International Trade Law, p 419.

right. Therefore, a matching subsidy may be prohibited or actionable under track II or countervailable under track I if the relevant conditions are fulfilled.¹³²

8.1. Retaliatory Subsidies

Retaliatory subsidies are another type of unilateral action, they are defined as subsidies that are granted in order to pressure another Member into withdrawing its own subsidies. The EU has imposed such subsidies in its temporary defence mechanism against Korean subsidies in the shipbuilding sector.¹³³ Under this mechanism, Member States could grant operating aid to European shipbuilding undertakings that were in competition with a Korean shipyard. Korea challenged the mechanism before a WTO Panel. The Panel held that the mechanism was incompatible with the EU's obligations under the SCM Agreement.¹³⁴ The Panel mentioned, however, where the EU would give subsidies merely to offset the injury suffered by its shipbuilders. In addition, the Panel held that the EU was not permitted to apply this type of unilateral pressure, but should have limited itself on its WTO procedure against Korea.

Consequently, both regimes involve the matching of foreign subsidies, although in different ways and for different motives. In Korea-commercial Vessels case, the EU is too careful in granting subsidies to pressure another Member to leaves its own subsidies. However, it seems acceptable to match foreign subsidies, as long as the aid granted in the context of the matching exercise is itself consistent with the SCM Agreement's disciplines.¹³⁵

8.2. Applying of the WTO Disciplines on Subsidies Since 1995

It should be stated that imposing CVDs is faster than going through the WTO dispute settlement process. Also, CVDs will suffice in most cases to meet the domestic industry's concerns. In addition, the CVDs instrument offers better chances of success.

¹³² Claus-Dieter Ehlermann and Martin Goyette, *EU State Aid versus WTO Disciplines on Subsidies-EStAL*(2006), p 713.

¹³³ Council Regulation (EC) NO 1177/2002 of 27 June 2002, concerning a temporary defensive mechanism to shipbuilding, OJ 2002 L 172/1.

¹³⁴ Report of the Panel, WT/DS301/R, 2005.

¹³⁵ Claus-Dieter Ehlermann and Martin Goyette, *EU State Aid versus WTO Disciplines on Subsidies-EStAL*(2006), p 712.

Taking the unilateral route is also easier as a Member can impose measures and then await a possible challenge on the part of the Member whose exports have been countervailed. Time and burden of proof will play in the favour of the Member imposing the CVDs too.

However, it should be mentioned that there are some cases which the imposition of CVDs will not suffice. This will be the case where the national industry is not concerned about the effect of subsidies on its home market, but when the effects of subsidies happened on third country or on the market of the WTO Member granting the subsidies, refer to WTO dispute settlement will become an essential. It is just because of the experience of WTO dispute settlement to date.

It is also interesting to compare the application of countervailing duty measures to that of the anti-dumping instrument. In both EU and US, anti-dumping duties are used much more often than countervailing duties.¹³⁶

Furthermore, the CVDs and the multilateral rules may assess the remedies as well. The multilateral rules only present a prospective remedy, i.e. they do not affect subsidies that have been granted in the past. The remedy for prohibited subsidy is the withdrawal of the subsidy;¹³⁷ for actionable subsidies, it is the withdrawal of the subsidy or the removal of its adverse effects.¹³⁸ Thus, there is no repayment of subsidies violating the SCM Agreement provisions. On the contrary, countervailing measure will grant remedy against past subsidies.

Most of the WTO subsidy dispute settlement cases to date have concerned export subsidies. Only a few number of cases complaints against actionable subsidies: Indonesia Autos,¹³⁹ US-Cotton¹⁴⁰ and Korea-Vessel.¹⁴¹ Apart from US-FSC, the EU has never, since 1995, taken multilateral action against foreign agricultural subsidies.

Contrasted with this, under GATT, EU Member States measures were challenged a total of 9 times before a Panel, most of them concerning subsidies to agricultural products.¹⁴² EU subsidies were recently challenged twice under the multilateral rules, in

¹³⁶ Mayer Brown Rowe & Maw LLP, Evaluation of EC Trade Defence Instruments, Report prepared for the European Commission, 2005. Annex7, p 25.

¹³⁷ Article 4.7 SCM Agreement.

¹³⁸ Article 7.8 SCM Agreement.

¹³⁹ Report of the Panel. Indonesia-Certain Measures Affecting the Automobile Industry, WT/DS55/R, WT/DS64/R, 1998, Indonesia-Autos.

¹⁴⁰ Report of the Panel, US-Cotton, WT/DS267/R 8 September 2004.

¹⁴¹ Report of the Panel, Korea-Vessels, WT/DS273/R 7 March 2005.

¹⁴² Report of the Panel, German Exchange Rate Scheme for Deutsche Airbus, SCM/142, 4 March 1992.

the EC-Sugar¹⁴³ and EC-Commercial Vessels cases. The EU has similarly been one of the major targets of countervailing duties.

8.3. Practical concept of the WTO Rules

As we have mentioned, the definition of subsidies under the WTO rules and State Aid of EU law is mostly similar. However, some subsidies, those granted under government direction or entrustment but not representing a cost to the government, may be allowed under EU law while there are subject to the WTO disciplines. Therefore, there is always a risk that recipients of that subsidy find them countervailed or challenged before a WTO Panel.

Moreover, The EU rules allow the commission to permit State Aids which may fall out of the SCM Agreement's provision on prohibited or actionable subsidies. For instance, State Aid for major investments in assisted regions, for important projects of European interest and rescue and restructuring aid.

Only for the procedural reasons mentioned above, the EU State Aid law is stricter than the corresponding WTO subsidy discipline. To avoid distortions of competition within the internal market, the EU attempts to impose tough State Aid policy. It is not strange that over the last years, this policy has become more demanding.

Nevertheless, third world countries and other Members of WTO also grant subsidies not only the EU Member States. No other WTO Members has an internal regime of subsidy control. It is appropriate to ask the question whether the EU should have softer and flexible State Aid rules when the State Aid of one of its Member States is seeking to match subsidies granted by another WTO Member.

8.4. Matching Aid Granted by Another Member State

From the EU perspective, both the European court of justice and the European commission has been recognized that a Member State should not act on its own to counter the effects of unlawful aid from another Member State. In Steinike case, the ECJ held that: Any breach by a Member State of an obligation under the treaty in connection (sic) with the prohibition laid down in Article 92 (now 107 TFEU) cannot be justified by the fact that other Member States are also Failing to fulfil this obligation.

¹⁴³ Report of the Panel, European Communities-Export Subsidies on Sugar, WT/DS283/R, 15 October 2004.

The effects of more than one distortion of competition on trade between Member States do not cancel one another out but accumulate and the damaging consequences on the common market are increased.¹⁴⁴

The commission ruled same decision in another case and suggested that matching could be allowed to counter foreign subsidies.¹⁴⁵ In this case, the Commission refused to authorize aid proposed by the Netherlands, the purpose of which was to match aid allegedly granted by Spain. The Commission noted that matching aid could only be allowed for aid initially granted by a third country and that in any case, the Netherlands aid scheme initially approved by the Commission has expired.

8.5. Matching Aid Granted by a Third Country

As we have seen before, there is some evidence that the EU allow Member States to match aid granted by third countries. The only express provision allowing matching is found in the Commission's Community framework for State Aid for Research and Development.¹⁴⁶ It is significant that the Commission has presented maintaining this matching clause even though the SCM Agreement no longer recognizes non-actionable subsidies.¹⁴⁷

The Commission noted that: "on the implications of the WTO Agreement on subsidies and countervailing measures for State Aid control in the European Union and the possible distortive effects of applying the Community framework to motor vehicle manufacturers in the Community in cases where they face unfair competition from third countries, the Commission stresses that the new WTO Agreement is a major step forward. As regards research and development aid, difficulties may arise as the WTO rules allow higher aid intensities than those applicable within the Community. Nevertheless, if it were demonstrated that the international competitors of Community motor manufacturers were benefiting from more generous treatment, the Commission would consider applying the matching clause written into the new Agreement."¹⁴⁸

¹⁴⁴ Case 78/76, *Steinike & Weinlog v. Federal Republic of Germany*, 1997, ECR, page 595, para 24.

¹⁴⁵ Commission Decision 2005/122/EC, 2004, OJ 2005 L 39, para 17.

¹⁴⁶ Community Framework for state aid for research and development, 96/C45/06, OJ 1996 C 45.

¹⁴⁷ The Draft Community Framework for State Aid for Research and Development and Innovation, 14 September 2006.

¹⁴⁸ Commission Decision 96/313/EC of 20 December 1995 amending Spanish aid scheme for the motor vehicle industry, OJ 1996 L119.

In other words, matching aid was authorized in the temporary defence mechanism against Korean subsidies to shipbuilding. Since, the Commission does not give any explanation, we believe it was referring to Article 9.4 SCM which permitted the imposition of countermeasures against non-actionable subsidies under certain conditions. We should remember that the SCM Agreement applies only to trade in goods and not to the provision of services.

8.6. The Matching of R&D Aid

R&D is the only part in the Commission State Aid rules that envision the granting of matching aid. The R&D&I Framework provides for the possibility of granting higher aid intensities to match the aid amount received for similar projects by competitors located outside of the EU.

Distortions of international trade and competition due to subsidies granted outside the EU are addressed by the current Framework's "matching clause"¹⁴⁹. Pursuant to that clause, aid for R&D projects may exceed the usual permitted support if competitors located outside the EU receive more aid for similar activities. In this regard, it can first of all be noticed that the current wording of the matching clause does not impose any specific conditions or practical limitations. Indeed, to successfully invoke the clause, the Member State concerned needs only "if at all possible" to "provide the Commission with sufficient information to enable it to assess the situation", failing which the Commission "may also base its decision on circumstantial evidence"¹⁵⁰.

R&D subsidies are no longer non-actionable and in theory, the matching of R&D subsidies could be dangerous. In practice, R&D aid will very rarely constitute export subsidies. Regarding to the Illustrative list, a WTO Member challenging EU's R&D under article 3 SCM would have to independently establish export contingency. After that, such subsidies may be actionable. R&D subsidies are harmful if amounts are sizeable and if R&D gets closer to the product development stage. Any move towards relaxation of the current standard of proof could thus result in the approval of otherwise incompatible aid, and possibly induce long-term negative effects. In turn, this might

¹⁴⁹ Section 5.1.7 of the R&D&I Framework.

¹⁵⁰ http://ec.europa.eu/competition/state_aid/legislation/rdi_issues_paper.pdf, p 22.

affect territorial cohesion within the EU, as richer regions would be in a better position to outbid poorer ones with matching aid.

Finally, it should be noticed in this context that the matching clause may well conflict with WTO law and be incompatible with the EU's obligations under Article 32.1 of the Agreement on Subsidies and Countervailing Measures, in particular since the expiry of its Article 8.2 that defined certain types of assistance for R&D activities as non-actionable subsidies.¹⁵¹ For this reason, the possible maintenance of the clause should in principle be subject to a proper verification of its compatibility with WTO law.

8.7. The Matching of Investment Incentives and Operating Aid

Another type of subsidies the EU might be concerned about is that of assistance to large investment projects (FDI). Assistance to large investment projects is usually granted so that companies either establish themselves in the EU or save their operations in the EU. But the EU may encourage its undertakings to establish themselves in a third country to better compete on the market of that country.

Any permission regards outward investment aid, causes no problem under WTO rules. Such aid would neither constitute a prohibited export subsidy nor an import substitution subsidy. Such aid may be actionable and the injury does not produce by the EU even by a third country because the products have produced in third countries not in the EU.

Conversely, granting financial aid to attract FDI to the EU is more problematic than granting outward looking FDI support.

Notwithstanding, both situations are similar, in practice, such aid would challenge by other WTO Members. The main attention may be that the subsidy amounts are larger than in the previous case of favouring outward investment. Therefore, FDI aid may lead to the imposition by another WTO Member of countervailing duties.

The matching of operating aid indicates the most problematic matching case. That is because there is always a risk that the matching of operation aid might establish a

¹⁵¹ E.g. Flett et al., "The Relationship between WTO subsidies and EU State aid law", in "EC State aid law", Chap. 21, p. 442-467

prohibited de facto export subsidy and especially where it is granted to an industry that is heavily export-oriented.¹⁵²

Furthermore, operating aid is actionable and causes injury. Operating aid would be attacked through dispute settlement in the WTO.

9. Conclusion

EU State Aid law and WTO subsidy law aim to regulate states interventions which could affect the structure of the market and impress the cross-border allocation of resources. However, these two sets of laws do not follow the same objectives. A conclusion from the analysis of the goals is that the WTO rules on subsidies have been introduced in order to abolish subsidies as non-tariff barriers, which is an application of the principle of non-discrimination in WTO Law. While, EU State Aid rules follow the broader objective of contributing to the achievement of the internal market.

EU Law generally prohibits a number of State Aid measures and only considers those measures as compatible with EU Law which do not affect the trade between Member states (Article 107(1) TFEU) or which are specifically justified. WTO Law generally prohibits export subsidies but allows countervailing measures against a large range of subsidies if they adversely affect the interest of other WTO Members. Therefore, WTO Law may seem less strict; it allows countervailing measures which may also have negative effects on international trade. This difference may be explained by the different functions of the two regimes. The EU system tries to keep the internal market with undistorted competition (Article 26(2) TFEU) while, WTO Law is aimed at the liberalization of trade through the reduction of tariffs and other barriers to trade, and the elimination of discriminatory treatment (WTO Agreement, Preamble). The different functions of the two systems need to be kept in mind when drawing a comparison between the different concepts and rules of WTO and EU Law.

The main features and elements of the law of subsidies in international trade disclosed some important differences between WTO and EU law. Firstly, the concept of subsidy is larger than the concept of State Aid. In EU law, State Aid requires a charge on the public account, a notion which was refused by the WTO jurisprudence. Secondly, the legal consequences also differ. EU Law, however, does not contain a notion of legal

¹⁵² Claus-Dieter Ehlermann and Martin Goyette, *EU State Aid versus WTO Disciplines on Subsidies- EStAL*(2006), p 716.

State Aid which may nevertheless be subject to countervailing duties. This may cause conflicting rules, if the measure is justifiable under EU Law but not according to WTO Law, while they may become an addressee of countervailing duties. Thirdly, the concept of State Aid under EU Law is stricter than the concept of subsidy under WTO Law, because of the requirement of a charge on the public account. Certain measures in the two systems will be subject to the SCM Agreement's disciplines but not to the EU State Aid control. This seems more logical as the EU has by far more determined goals, such as the internal market, economic, monetary and even political union. As we have noted, the situation seems to be more normal regarding the concept of specificity, where EU and WTO rules are similar, but EU Law appears to be stricter than the rules of the WTO.

However, the most significant difference between the two systems relates not to the definition of State Aid and subsidy, but what happens once a measure meets to such a definition. Under WTO Law, measures meeting the definition of subsidy and produce adverse trade effects are actionable and countervailable. WTO Law does not prepare any exemption from its disciplines based on the objectives of a measure, even export and import-substitution subsidies are prohibited. Harmful and problematic subsidies in the WTO are only subject to notification requirement, to challenges by governments under track II and to countervailing duties under track I. Nevertheless, the practical consequences of the WTO disciplines are unpredictable. For instance, support granted under the bona fide assumption without any adverse trade effects which is not a de facto export or import substitution subsidy may ultimately be sanctioned by the WTO judicial instances or countervailing duties by other WTO Members.

On the contrary, EU Law provides an assessment of planned State Aid by the Commission. Potential State Aid may be subject to extensive investigation prior to implementation. Even private parties can enforce the notification requirement. Yet the EU State Aid rules provide the flexibility with respect to the authorization of notified State Aid. The European Commission has the authority to permit measures that establish State Aid based on their objectives.

Consequently, there is a risk that EU State Aid measures allows any action based on Article 107(2) or (3) against the SCM Agreement's disciplines rules. Therefore, the Commission may want to combine an adverse effect on international trade requirement into its assessment. This in order to understand whether a measure should be compatible

with the common market to decrease the risk of conflict between the EU internal subsidy regime and the WTO subsidy discipline.

If the European Commission would allow the Member States to match third countries subsidies more than they can do today, the risk of conflict would obviously increase. This risk is not the same for all types of subsidies, certain subsidies are more sensitive in than others that they may cause a clash with the SCM Agreement.

However, the risk of distortion of competition among Member States is the main reason for distaste against relaxing the existing State Aid disciplines in the European Union. Allowing the matching of third country subsidies would not only create subsidy wars but it could also be opposed to other fundamental aims of the EU, such as the need to strengthen economic and social solidarity between the Member States and their citizens. Consequently, this risk may undermine the foundation of the European Union.

Therefore, the EU currently wants to fight more than in the past against third countries subsidies by using the international agreements instruments. The most comprehensive and detailed of those agreements is the SCM Agreement. Nevertheless, the EU has not used the SCM Agreement often because of the SCM Agreement is traditional inclination to solve EU's internal problems by granting subsidies or by allowing Member States to grant State Aids.

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